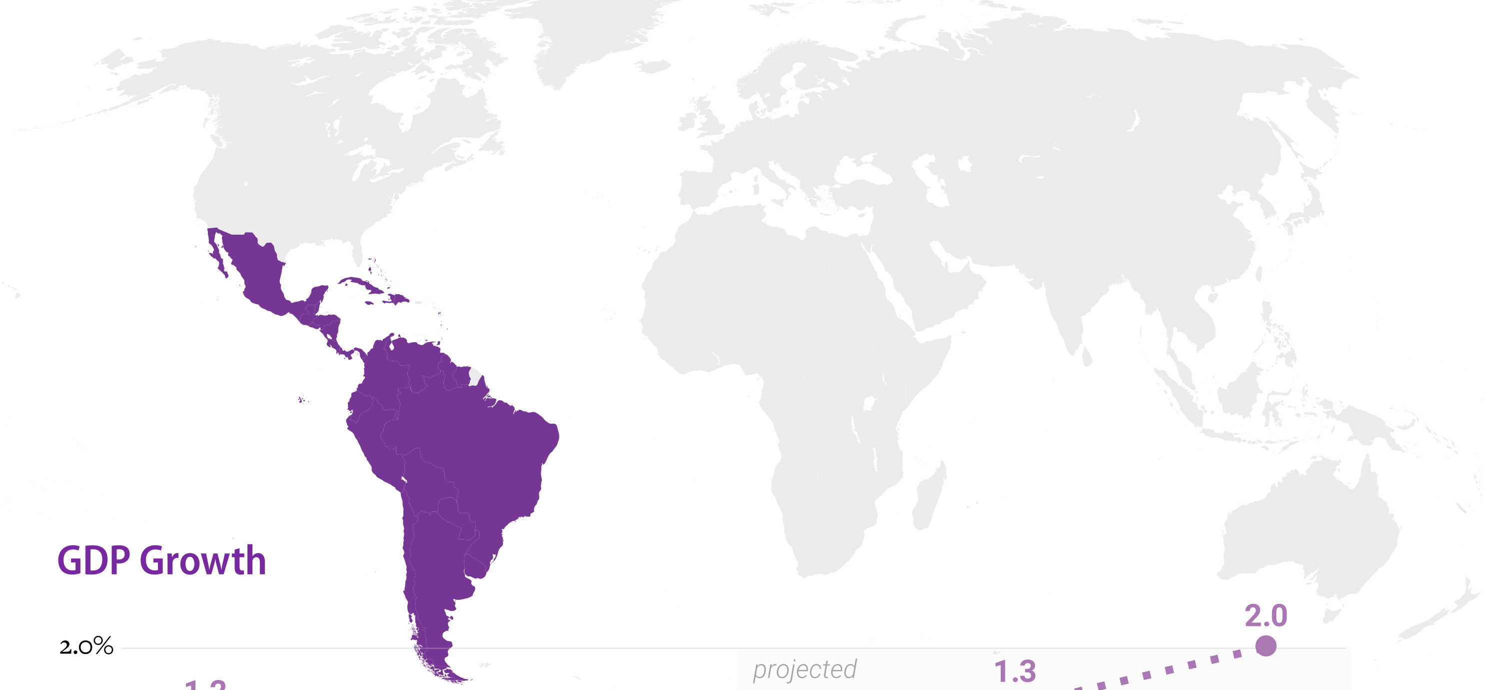
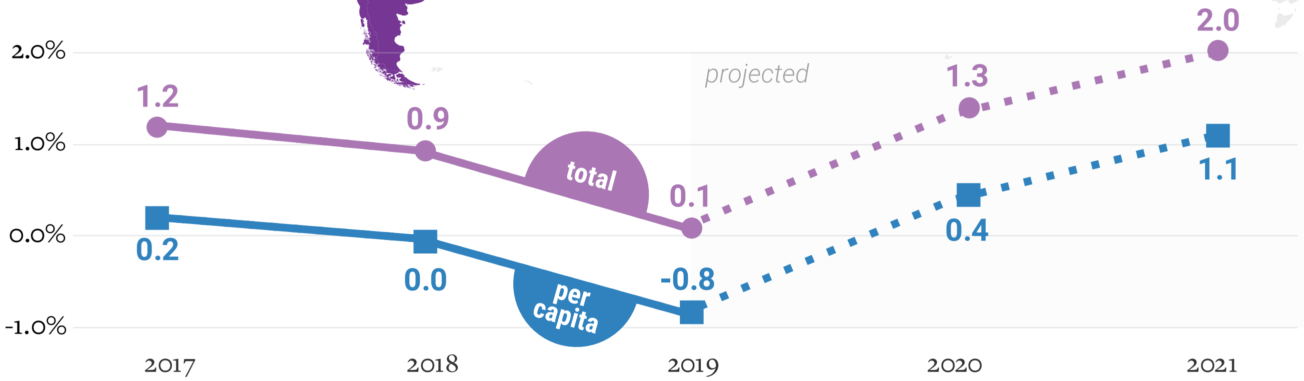
World Economic Situation and Prospects

United Nations
New York, 2020

Latin America and the Caribbean

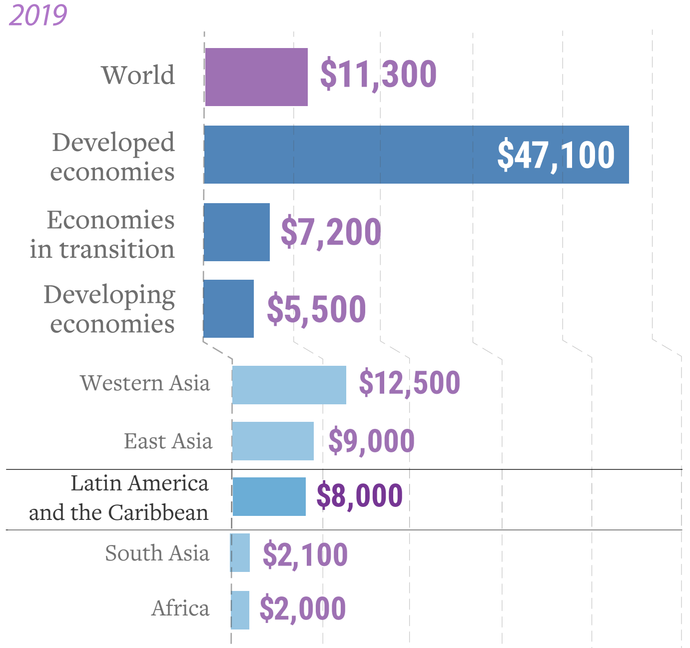


GDP Growth



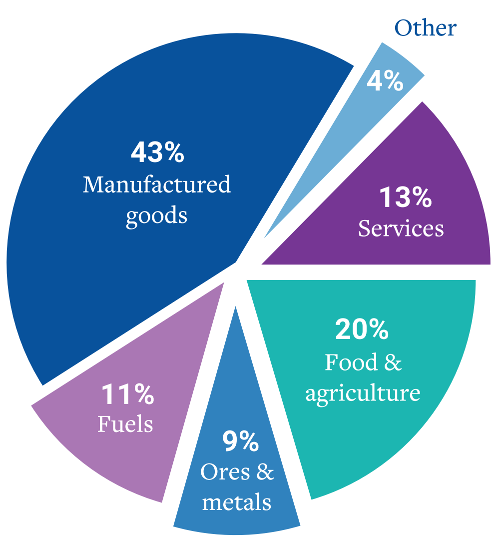
GDP per capita

2019



Export Structure

2018



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Latin America and the Caribbean: the region is mired in a prolonged economic slump

- The regional growth outlook remains weak amid difficult external conditions and heightened policy uncertainty.
- Fiscal pressures create challenges for short-term macroeconomic management and also dampen long-term growth prospects.
- Economic stagnation and large inequalities undermine progress towards achieving the Sustainable Development Goals.

The region is mired in a prolonged economic slump

Latin America and the Caribbean[7] is undergoing a prolonged economic slump that is undermining progress towards the Sustainable Development Goals. Amid challenging external conditions, heightened policy uncertainty and country-specific headwinds, the region's GDP grew by only 0.1 per cent in 2019, down from 0.9 per cent the previous year. The slowdown was broad-based across subregions, and growth in the region's largest economies (Argentina, Brazil and Mexico) was much weaker than expected. A slow and uneven recovery is projected over the next two years, with regional growth averaging 1.3 per cent in 2020 and 2.0 per cent in 2021. Domestic demand will likely be supported by more accommodative monetary policy and moderate inflationary pressures. Consumer and business sentiment are expected to improve gradually in many countries, including Brazil and Mexico. The risks to the outlook are skewed to the downside, however. On the external front, the region is vulnerable to a further slowdown in global trade and lower commodity prices. In addition, abrupt changes in investor sentiment could trigger renewed financial volatility and large capital outflows. On the domestic front, policy uncertainty, political turmoil and social unrest threaten to weigh on growth in several economies. In many cases, these challenges are compounded by a lack of fiscal policy space as Governments continue to grapple with sizeable public deficits and elevated debt burdens.

The broad-based slowdown has raised fears of another lost decade

Buffeted by mounting internal and external headwinds, economic conditions across the region have deteriorated significantly over the past year. GDP growth in 2019 was slower than expected in 24 out of 27 countries, and in 14 countries, including Argentina, Brazil and Mexico, per capita GDP nearly stagnated or declined. Since the end of the commodity boom in 2013/14, the region has failed to achieve meaningful economic growth. Average per capita GDP today is nearly 4 per cent below the 2014 level.[8] At the same time, progress in reducing inequality appears to have slowed. Standard measures of income inequality, such as the Gini or Theil index, have shown little improvement since 2014 (UNECLAC, 2019b). With few exceptions, levels of inequality across the region remain very high, and vast segments of society lack economic opportunity.

Failure to deliver inclusive growth has fuelled popular discontent

Amid lower average incomes and persistently high inequality, poverty levels have trended upward in recent years. According to UNECLAC estimates, 63 million people in the region were living below the extreme poverty line in 2018, up from 46 million in 2014 (ibid.). The total number of poor is likely to have increased further in 2019, as the

7 The country classification is based on the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC). The region of Latin America and the Caribbean comprises three subregions: South America; Mexico and Central America (which includes Caribbean countries that are considered part of Latin America, namely, Cuba, the Dominican Republic and Haiti); and the Caribbean.

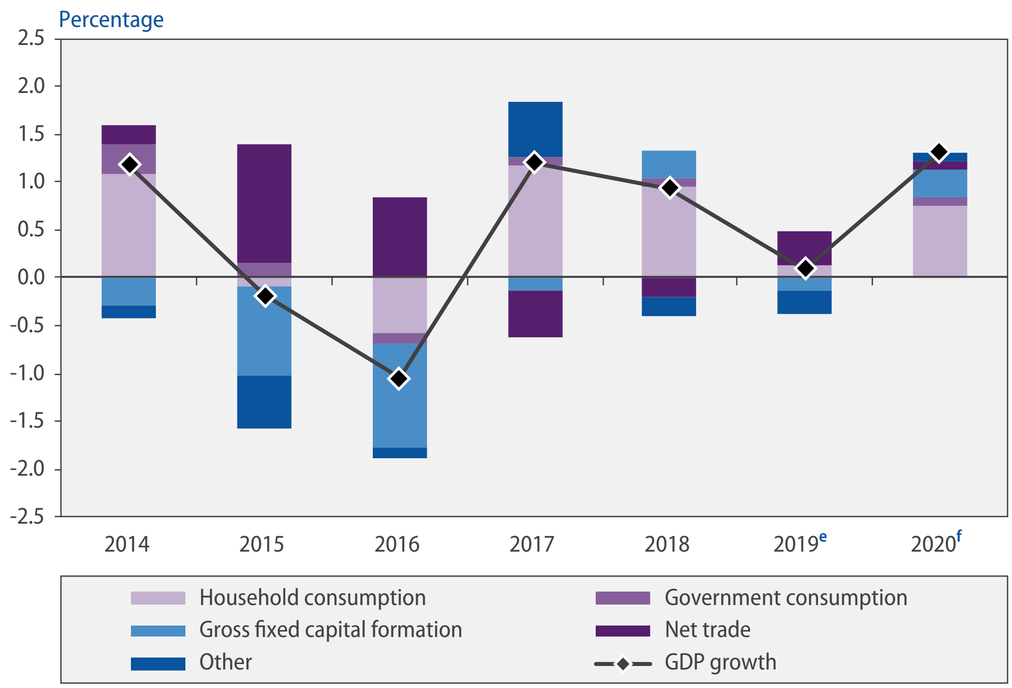
8 When the Bolivarian Republic of Venezuela (which is estimated to have suffered a cumulative output decline of about 60 per cent over the past five years) is excluded from the sample, the decline in per capita GDP in Latin America and the Caribbean since 2014 is estimated at 1.6 per cent.

region's average per capita income fell by about 0.8 per cent. The failure to deliver inclusive economic growth, coupled with an erosion of trust in political institutions, has fuelled growing popular discontent in parts of the region. Over the past year, public unrest and violent protests have erupted or intensified in many countries, including Argentina, the Plurinational State of Bolivia, Chile, Ecuador, Haiti, Honduras, Nicaragua, Peru and the Bolivarian Republic of Venezuela.

Domestic demand is expected to pick up slightly after stagnating in 2019

Amid increased social tensions, heightened domestic policy uncertainty and challenging international conditions, all components of aggregate demand weakened in 2019 (see figure III.16). Despite generally subdued inflation, growth in private consumption almost came to a halt, held back by rising unemployment and slower wage gains. With consumer confidence expected to gradually pick up, private consumption will likely start to recover in 2020, again becoming the main driver of regional growth. Public expenditure across the region will remain weak, as many Governments are still facing fiscal consolidation pressures. Aggregate investment contracted in 2019, even as monetary policy was loosened in many countries. While Brazil saw a moderate recovery in fixed capital formation amid record-low interest rates, there were sharp declines in investment demand in Mexico and (especially) Argentina in the wake of high policy uncertainty. The investment climate

Figure III.16
Composition of GDP growth in Latin America and the Caribbean



Source: UN DESA.
Note: e = estimate; f = forecast.

in Latin America and the Caribbean will likely remain challenging in 2020, though low interest rates and gradually improving business confidence in some large economies should support a mild recovery.

Net trade contributes positively to growth as imports weaken

Regional trade has been negatively affected by increased global uncertainty, slower import demand among key trading partners, and weak intraregional dynamics. Amid lower prices for many of the region's exports, export values are estimated to have declined slightly in 2019. Export volumes held up relatively well, showing a small increase over the previous year thanks to robust growth in Mexico, Central America and the Caribbean. As trade tensions between the United States and China escalated, Mexico benefited from a diversion of trade flows, particularly in the vehicles, auto parts, electronics and machinery sectors. By contrast, South American exports declined notably amid sluggish global demand for the subregion's main commodities, including oil and copper. On the import side, most countries have seen significant declines over the past year as domestic demand has slowed, with capital goods and intermediate inputs generally more affected than consumer goods (UNECLAC, 2019a). The contraction in imports was most severe in the Bolivarian Republic of Venezuela and Argentina amid collapsing domestic currencies and limited access to foreign exchange. With imports slowing more than exports, net trade contributed positively to regional growth in 2019. While uncertainties in the international trade environment persist, the baseline scenario projects a gradual upturn in the region's exports and imports during the outlook period.

A robust recovery in South America remains elusive

In South America, annual GDP contracted by an estimated 0.1 per cent in 2019. External headwinds, such as slowing global trade and lower commodity prices, have compounded country-specific problems, including contractions in mining and agricultural output in Brazil, Chile and Paraguay; sociopolitical tensions and unrest in the Plurinational State of Bolivia, Chile, Ecuador and Peru; and the deepening economic crisis in Argentina, which has adversely affected the neighbouring countries of Brazil, Paraguay and Uruguay. Some of the negative factors that have been weighing on growth over the past year are likely to persist in 2020. Moreover, the subregion faces major structural obstacles, including overdependence on commodities, large informal sectors and low labour productivity growth. Against this backdrop, a return to robust growth will likely remain elusive in the near term. Economic activity is projected to pick up only slowly, with average growth forecast at 1.1 per cent in 2020 and 2.0 per cent in 2021. A failure to achieve robust and inclusive growth threatens to further exacerbate social tensions.

Brazil will recover slowly, while Argentina remains in recession

This modest recovery will likely be supported by gradually improving conditions in Brazil, where the recent approval of a broad pension reform is expected to help restore economic confidence. While additional policy measures are needed to unlock investment, lower interest rates and improving sentiment should lift domestic demand. In Argentina, the economy is projected to remain in recession in 2020 after the IMF-supported macroeconomic adjustment programme has failed to halt the downward spiral. High policy uncertainty, severe fiscal austerity measures and escalating inflation have resulted in a sharp contraction in consumer spending and investment. The short-term outlook is subject to major risks and uncertainties, as the country depends heavily on IMF funding to satisfy its large financing needs, and the policy direction of the new Government remains unclear. The situation is even bleaker in the Bolivarian Republic of Venezuela, where no end to the deep political, economic and social crisis is in sight. Economic prospects for the Plurinational State of Bolivia and Chile have become increasingly uncertain. In Chile, deep social discontent led to nationwide protests against inequality in 2019. While the short-term growth outlook will be adversely affected, the implementation of a "social agenda" by the Government—possibly together with additional structural reforms—would deliver more inclusive and sustainable growth in the medium term. In the Plurinational State of Bolivia, a highly volatile political situation and subdued commodity prices are expected to weigh on growth in 2020. In the remaining countries of the subregion, including Colombia, Ecuador, Paraguay, Peru and Uruguay, economic activity will likely pick up on the back of recovering domestic demand.

Policy uncertainty and austerity weigh on growth in Mexico

The growth outlook for Mexico and Central America has deteriorated significantly over the past year. Growth is now projected to average only 1.6 per cent in 2020 after falling to a 10-year low of 0.5 per cent in 2019. The sharper-than-expected downturn in Mexico has weighed on the subregion's performance. Despite solid export growth, economic activity in Mexico almost came to a standstill in 2019 as policy uncertainty and fiscal austerity dragged down investment. More accommodative monetary policy is expected to support a mild recovery in 2020, but the domestic and external risks remain significant.

Slow growth in Central America exacerbates development challenges

The growth outlook remains subdued in many parts of Central America, especially in view of the subregion's daunting development challenges. Worryingly, average incomes will decline further in Nicaragua and Haiti in 2020—and these are already the two countries with the lowest GDP per capita in Latin America and the Caribbean. The prospects for the northern countries of Central America—El Salvador, Guatemala and Honduras—are slightly more favourable. However, in 2020 and 2021, per capita incomes are expected to increase by only about 1.3 per cent per year, a rate that is clearly insufficient to address pressing structural problems such as large infrastructure deficits and the lack of decent employment opportunities, especially for young people. The Dominican Republic and Panama will likely remain the subregion's fastest-growing economies despite facing external headwinds in the form of weaker global trade and slowing growth in the United States.

Economic growth in the Caribbean is constrained by fiscal consolidation and a sensitivity to climate shocks

Ongoing fiscal consolidation efforts continue to weigh on economic expansion in the Caribbean, where growth slowed to an estimated 1.2 per cent in 2019. Many Caribbean countries are plagued by high levels of debt; in the Bahamas, Barbados, Belize, Jamaica, Suriname, and Trinidad and Tobago, debt-servicing costs alone absorb more than 10 per cent of government revenue (see box III.5). In many cases, the debt burden is associated with the high exposure of these relatively small countries to extreme weather events such as hurricanes. The devastation wrought by Hurricane Dorian on the Abaco and Grand Bahama islands in September 2019 exemplifies such vulnerability; fiscal consolidation measures had the Bahamas on track to record a sharp decline in the deficit last year, but hurricane-related losses pushed the economy into recession, necessitating additional fiscal spending and an estimated increase in government borrowing equivalent to 9 per cent of GDP. Meanwhile, Belize has suffered from severe drought, which has led both to agricultural losses and to energy disruption, as the country relies heavily on hydropower.

Strong acceleration in aggregate GDP growth is projected for the Caribbean in 2020, driven largely by the commencement of oil production in Guyana, where output is expected to reach up to 120,000 barrels per day. Excluding Guyana, only a modest acceleration is anticipated, as many countries in the region will continue to rein in public spending.

Labour market indicators paint a bleak picture

The broad-based downturn in economic activity over the past year has been accompanied by a renewed deterioration in labour market conditions across the region. Having risen significantly between 2015 and 2017, the average rate of unemployment again trended higher in 2019. Argentina and Brazil saw double-digit unemployment rates in the third quarter, and underemployment was even more widespread. As economic activity slowed in Mexico, unemployment also started to rise, albeit from a very low level. Other labour market indicators reinforce this bleak picture. In many economies, the average quality of employment has been declining, as most new jobs are being created in the informal sector (UNECLAC and ILO, 2019). Meanwhile, real wage growth remained sluggish after slowing to a 10-year low in 2018. The region's employment outlook continues to be clouded by serious structural obstacles, including high levels of informality, low productivity, high rates of youth unemployment and significant gender inequalities.

Inflation is generally muted amid low demand-side pressures

Most of the region's economies continue to see low inflation. Demand-side pressures remain generally subdued amid excess capacity and slowing wage growth. Low international commodity prices have also contributed to muted inflation. In Brazil, Chile, Colombia, Guatemala, Mexico, Paraguay and Peru, inflation levels are close to or below central bank targets. These targets have gained credibility over time, with inflation expectations becoming more anchored (Mariscall, Powell and Tavella, 2017). In Ecuador, El Salvador and Panama—the countries that are fully dollarized—price levels have remained largely stable. In 2020, price pressures are projected to edge up in most countries as domestic demand starts to recover, but inflation will generally remain benign. The main exceptions are Argentina and the Bolivarian Republic of Venezuela, where inflation continues to soar. In Argentina, the consumer price inflation rate exceeded 50 per cent in late 2019 after heightened political uncertainty led to a sharp depreciation of the peso. With foreign reserves declining rapidly, the Government introduced capital controls, including obligations for exporters to repatriate foreign-currency earnings and restrictions on foreign-exchange purchases. While these measures are expected to slow upward price pressures, inflation is projected to remain above 20 per cent in the coming years. In the Bolivarian Republic of Venezuela, hyperinflation will likely persist in the absence of wide-ranging structural reforms to rebuild public finances, stabilize the currency and resolve the debt crisis.

The region relies on monetary policy to buffer the slowdown

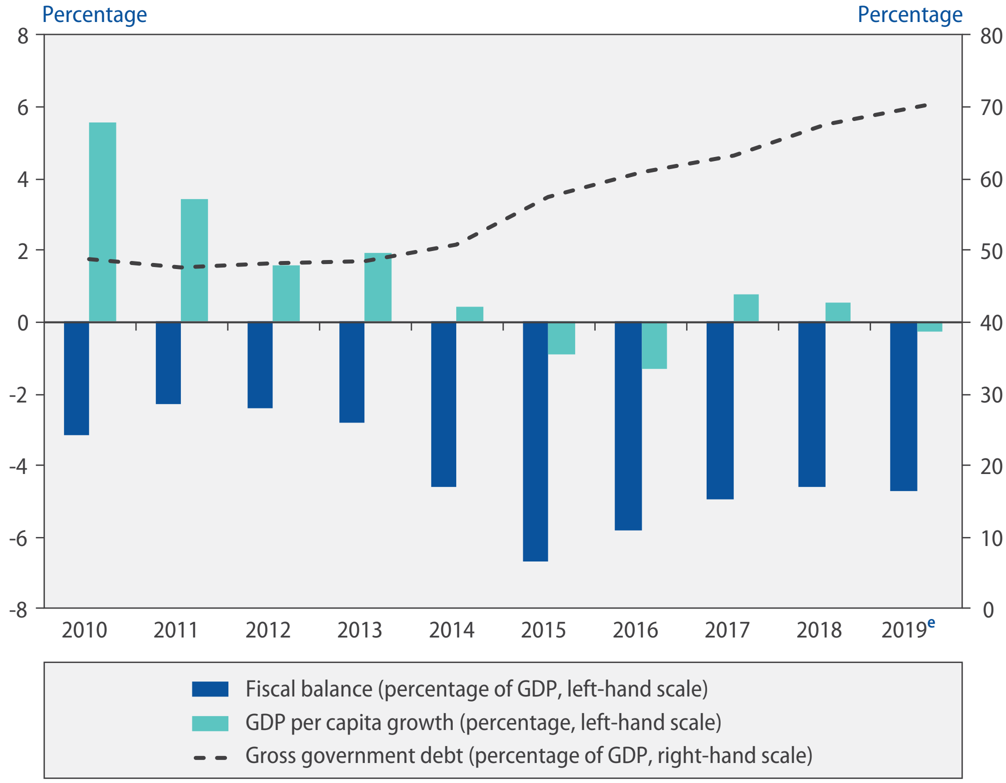
As fiscal space remains limited, countries in Latin America and the Caribbean are relying on monetary policy to buffer the growth slowdown. Amid low inflationary pressures and recent policy rate cuts by the United States Federal Reserve, many central banks have been making use of available monetary space to support aggregate demand. In Brazil, the central bank cut the benchmark interest rate to an all-time low of 5 per cent in October 2019. Policy rates were also reduced in Chile, Costa Rica, the Dominican Republic, Mexico, Paraguay and Peru. The weak demand conditions that prevail in most of the region's economies would normally warrant further monetary easing. However, with current policy rates at or near historical lows in countries such as Brazil, Chile, Jamaica and Paraguay, space for further monetary easing is limited. Moreover, in the context of fragile financial market sentiment, additional rate cuts could increase exchange rate volatility. Large depreciations of local currencies would not only fuel inflation but also increase risks related to currency mismatches.

Fiscal pressures remain large as public debt rises

Latin America and the Caribbean continues to face significant fiscal pressures, creating challenges for short-term macroeconomic management and longer-term development objectives. In many countries, fiscal consolidation continued in 2019 and primary balances improved; the largest adjustments were seen in Argentina, Barbados and Ecuador. Despite consolidation efforts, however, overall budget deficits remained sizeable and debt levels continued to rise (see figure III.17). In fact, all countries except Barbados and Jamaica recorded a fiscal deficit in 2019; in the Plurinational State of Bolivia, Brazil, Costa Rica, Suriname, and Trinidad and Tobago, the deficit exceeded 5 per cent of GDP. As a result, gross government debt as a share of GDP increased further in most countries. In the current low-growth environment, fiscal consolidation efforts are largely offset by higher debt-servicing costs, and debt burdens continue to rise. Average interest payments increased from 1.7 to 2.7 per cent of GDP between 2010 and 2019;[9] in Brazil and Jamaica, interest payments accounted for more than 5 per cent of GDP. Moreover, given the difficulties in raising revenues, fiscal consolidation across the region is focused primarily on reductions in primary expenditures, especially public investment. Average capital expenditure is estimated to have declined to

9 In the Caribbean, interest payments as a share of GDP have declined slightly in recent years from a high level. Mexico, Central America and South America have seen further rises.

Figure III.17
Fiscal and growth performance in Latin America and the Caribbean



Sources: UN DESA and IMF, World Economic Outlook database, October 2019.

Notes: All data are averages weighted by real GDP. The sample excludes Cuba and the Bolivarian Republic of Venezuela owing to a lack of data.
e = estimates.

a historical low of 3.1 per cent of GDP in 2019, with negative implications for productive capacity and future growth. Hence, in the current situation, not only is fiscal policy unable to play a countercyclical role, but by delaying much-needed investment, it may also hamper the region's long-term growth prospects.

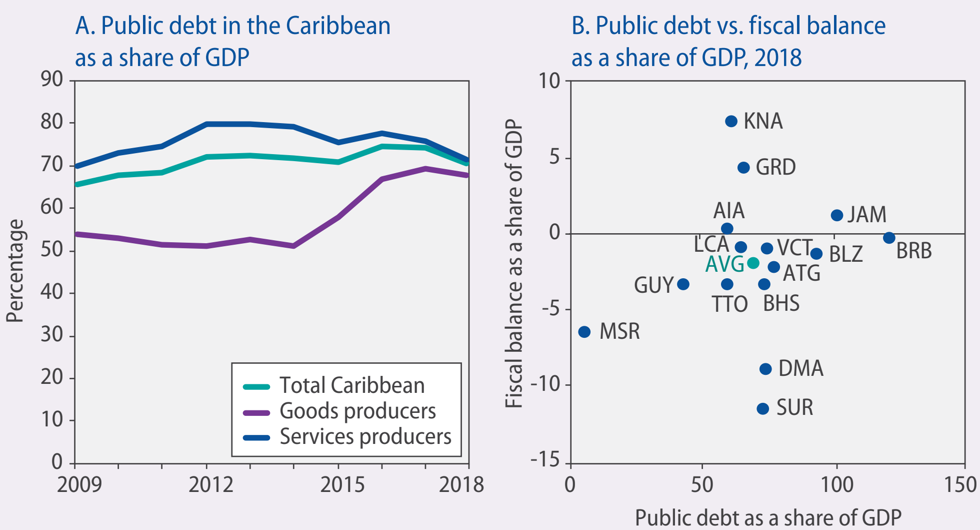
Box III.5

The debt challenge in the Caribbean[a]

For the past decade, Caribbean countries have faced the dual challenge of high debt and low economic growth. Since the global financial crisis of 2008–2009, the regional economy has expanded at an average rate of 1.4 per cent, with GDP growth averaging 1.2 per cent for services producers and 1.9 per cent for goods producers.[b] At the end of 2018, the total debt burden of the Caribbean stood at $56.1 billion, and the average debt-to-GDP ratio was 70.3 per cent; 12 countries registered debt-to-GDP ratios exceeding 60 per cent, with several of them ranking among the most highly indebted countries in the world.

Figure III.5.1

Public debt and fiscal balance figures for the Caribbean region



Source: Eastern Caribbean Central Bank and UNECLAC, based on official figures.

Notes: Data in panel A are simple averages of country level figures. See table J in the Statistical annex for country codes in panel B.
AVG = regional average.

High debt-servicing costs constitute another feature of the debt challenge facing the Caribbean. Total debt-service payments averaged more than 30 per cent of government revenue in 2017. Box figure III.5.1.A illustrates the increase in debt across the region since 2008; the services-producing economies that were hard-hit by the global financial crisis have experienced higher debt levels, and on the heels of the decline in commodity prices, goods producers have seen an increase in debt since 2014. Despite fiscal consolidation efforts—some undertaken in the context of IMF-supported stabilization programmes—most Caribbean countries continue to run fiscal deficits. Box figure III.5.1.B indicates that such deficits averaged 2.0 per cent of GDP in 2018. This implies that many Caribbean economies have limited fiscal space for investing in the modernization of key infrastructures and social and economic development programmes needed to achieve the Sustainable Development Goals.

The debt buildup has been due not only to negative external economic shocks, but also to the impact of climate change and natural disasters. In 2017 alone, the total costs associated with hurricane damage were estimated at $93 billion. The Caribbean has experienced more costly and more frequent disasters than any other region with small island developing States. In the face of these circumstances, fiscal consolidation efforts to reduce the debt burden in Caribbean member States have been undercut by the need to foster stronger growth, preventing debt from declining to sustainable levels.

UNECLAC has proposed a bifurcated strategy to address the challenges faced by the highly indebted countries in the Caribbean. Analysis of the debt situation has revealed broad heterogeneity in the level and composition of public debt in the region. Economies such as Antigua and Barbuda, Barbados, Jamaica and Saint Lucia have high levels of domestic debt, while others owe most of their debt to

(*continued*)

a For the purposes of this publication, the Caribbean refers only to the English- and Dutch-speaking Caribbean countries and excludes Cuba, the Dominican Republic and Haiti.

b The services producers are Anguilla, Antigua and Barbuda, the Bahamas, Barbados, Dominica, Grenada, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines; the goods producers are Belize, Guyana, Suriname, and Trinidad and Tobago.

Box III.5 (*continued*)

either multilateral or bilateral creditors. Jamaica, Belize and Saint Lucia also owe a significant proportion of their debt to private external creditors. This diversity in Caribbean debt makes a one-size-fits-all solution impractical.

The two-pronged UNECLAC strategy is focused on both debt reduction and growth enhancement. To stimulate growth, UNECLAC supports the establishment of a Caribbean resilience facility or resilience fund, which could be housed within a single credible regional financial institution or a combination of regional development banks. Such a facility would be capitalized by donors wishing to help finance climate projects and other forms of resilience-building activities within the Caribbean. Co-financing of resilience projects through grant funding from the Green Climate Fund (GCF) would allow lower borrowing costs and support growth, thereby reducing the debt burden.

To address the severe debt constraints, UNECLAC suggests that donors interested in supporting Caribbean resilience contribute to the Caribbean resilience facility by purchasing some portion of the Caribbean external debt at a discount. The initiative does not rule out voluntary discounts from creditors such as Paris Club members who may wish to invest in resilience. The implication of the discounted debt is that Caribbean member States will carry smaller debt-service burdens. As part of the agreement, these member States will be required to invest in climate-resilience projects, which could also be co-financed with GCF resources.

These two elements of the UNECLAC strategy aim to provide some fiscal space for member States. This initiative is necessary since conventional fiscal adjustment has so far proven insufficient to relieve the high debt burdens of Caribbean countries.

Source: This contribution is attributed to the Economic Development Division, United Nations Economic Commission for Latin America and the Caribbean (UNECLAC) Chile, and the Economic Development and Integration Unit of the UNECLAC subregional headquarters for the Caribbean.