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Summary of the economic survey of Latin America and the Caribbean, 2003

Summary

The economies of Latin America and the Caribbean as a whole grew by 1.7 per cent in 2003. This contrasts favourably with the 0.6 per cent reduction in gross domestic product (GDP) registered in 2002. The recovery was not strong enough to make up for the stagnation of recent years, however, and per capita GDP is still 1.2 per cent lower than in 1997. Gross capital formation showed practically no growth in the year and its current level is 12.5 per cent lower than five years ago. The upturn in economic activity generated a slight increase in the employment rate. Unemployment remained high, however, at 10.7 per cent and poverty spread to encompass almost 44 per cent of the population of the region. The more buoyant economic performance of Latin America and the Caribbean was associated with the international economic situation, which brightened with the recovery in the United States and Japan, and the growth of China.

The prices of commodities exported by the region increased by 15.4 per cent, while the variation in the total export price index, which includes manufactures, is lower (2.8 per cent). Despite a 1.5 per cent rise in import prices, this reactivation was sufficient to halt the 3.3 per cent deterioration in the terms of trade experienced between 1998 and 2002. The combination of volumes and prices has made exports the most dynamic factor of demand. A record trade surplus (US$ 41.8 billion) was recorded in 2003. The buoyancy of exports was fairly widespread — on the order of 5.9 per cent for Central America and the Caribbean, 7.8 per cent for the Andean Community and Chile and 18.9 per cent for the Common Market of the South (MERCOSUR). On the other hand, growth in Mexico's non-oil exports was flat (0.6 per cent), while exports from the region as a whole grew by 8.3 per cent. The trade surplus contributed to an almost unprecedented result in the region's current account: a US$ 5.6 billion surplus.

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Capital flows did not behave negatively, as they had in 2002. Autonomous capital movements were practically neutral with US$ 4.4 billion net in inflows comparing favourably with outflows of US$ 14.4 billion recorded last year. In 2003, the countries of the region were able to access funds at an average cost of 9.6 per cent, which meant 300 basis points less than 12 months earlier. Nevertheless, foreign investment continued to decline. Latin America and the Caribbean received nearly US$ 18.8 billion in compensatory funds, with a third of that sum coming from the International Monetary Fund.

This international environment provided a more favourable framework for the design of national economic policies. Fiscal and monetary instruments failed once again to produce the hoped-for counter-cyclical effects, however. The region's fiscal policy has been directed towards increasing the primary surpluses of Governments but economic growth has been slow. The region's primary balance rose by almost one percentage point, from a deficit of 0.3 per cent of GDP to a surplus of 0.6 per cent.

In terms of the direction of monetary policy, the central banks sought to control inflationary pressures. To achieve this, they initially raised rates and restricted liquidity. Once inflation started to subside, they induced a decline in interest rates, taking a more active stance in an effort to reverse the cycle.

Most countries have established and consolidated more flexible exchange-rate regimes and have been phasing out restrictions on foreign-exchange operations. By the end of the year, the average exchange rate index for the region showed a slight depreciation (1.9 per cent) compared with the end of 2002.

The design and application of various fiscal and monetary instruments resulted, among other things, in a decline in inflation. In 2003, prices rose by 8.5 per cent, four percentage points less than last year.

Bearing in mind the external situation and domestic economic trends, the prospects for 2004 are for a continuation of the upswing that began this year. Economic activity is expected to climb to an average rate of 4 per cent for the region, which is well above the average for the last five years. The region is estimated to have achieved a year-on-year growth rate of around 3 per cent in the fourth quarter and its more robust performance in the second half of 2003 will pave the way for the expansion of its economy in 2004.

Regional panorama

1. The economy of Latin America and the Caribbean grew by 1.7 per cent in 2003. In contrast, the region's per capita gross domestic product (GDP) remained flat at 1.2 per cent below the 1997 level. The lowest point of the cycle came in the first quarter of 2002, after which the economy began to make a mild recovery. The regional economy is expected to grow by 4 per cent, leaving behind the lost six-year period that went before and gradually entering into an expansionary phase. For the first time since 1997, there is no Latin American economy for which negative growth is projected.

2. This brighter outlook is in part a reflection of the more favourable international environment. The reduction in sovereign risk ratings from their peak levels of September-October 2002, the improvement in raw material prices, the expansion of tourism and the beginnings of an upswing in non-oil exports to the United States of America are the main positive impulses coming from the international economy. The stronger domestic positions achieved by the countries of the region are also significant, however. After six years of turbulence, most of the countries are emerging with fiscal and monetary policies well in hand and with more competitive exchange rates; even the economies that were overtaken by severe crises have already started to pick up.

3. The six years of negative per capita growth caused social damage that will take time to reverse. There were 20 million more poor Latin Americans in 2003 than there were in 1997. Unemployment increased by two percentage points during this period to stand at 10.7 per cent.

4. It appears that the projected growth phase will be stronger in those countries that have managed to reconcile improved economic governance with better political governance and weaker in those where the domestic political situation exhibits greater vulnerability. On the external front, the recovery of the world economy suffers from disequilibria that will have to be addressed primarily by the more developed economies.

5. The economies of Latin America and the Caribbean, taken as a whole, grew by 1.7 per cent in 2003. This contrasts favourably with the 0.6 per cent reduction in GDP recorded for 2002. The recovery has not been strong enough to offset the economic stagnation experienced in the region in recent years, however: from 1998 to date, the region grew by a low 1.4 per cent per year and per capita GDP is still 1.2 per cent lower than in 1997. The reactivation of investment and saving will be of key importance in achieving higher growth rates. Gross fixed capital formation remained stagnant in 2003 and by the end of the year was 12.5 per cent lower than the rate recorded five years earlier. National saving, which financed all of the year's investment, was also insufficient. All in all, the countries in the region had a lower savings rate than other emerging economies in the world.

6. The positive economic outlook led to a slight increase in the employment rate. However, at 10.7 per cent, unemployment remained high and it is estimated that during the course of the year some 600,000 persons joined the ranks of the urban unemployed, raising their number to 18 million. Given this weak growth profile and the sluggish labour market, it is hardly surprising that poverty and indigence in the region both increased further in 2003. The existence of 227 million persons (44 per

cent of the population) living below the poverty line suggests the scope and complexity of the problem to be tackled.

7. The region's stronger performance has been linked to the situation in the international economy. The recovery in the United States, where the annual growth rate is expected to stand at 3.1 per cent, made it possible for the Latin American and Caribbean region to increase its exports to that market. Japan also introduced a new demand factor in the international arena, since, at 2.7 per cent, its growth for 2003 is a vast improvement over the 2002 figure (-0.4 per cent) and the years of lethargy that preceded it. The Asian economies, led by China and its rapid expansion (9.1 per cent), boosted purchases and prices of various commodities exported by the Latin American and Caribbean region, such as copper, tin, iron and soybeans. The recovery and normalization of intraregional trade flows have also helped to fuel greater economic activity.

8. The combined effect of these factors was a 15.4 per cent increase in the prices of commodities exported by Latin America and the Caribbean. Leaving aside oil, whose price jumped by 21 per cent, the effect is still positive, although it is then reduced to 7.2 per cent. If the price index for total exports (including manufactures) is used, then the variation is lower (2.8 per cent). This upswing in export prices, although partially offset by a 1.5 per cent rise in import prices, was sufficient to halt the deterioration in the terms of trade seen between 1998 and 2002 (3.3 per cent). The improvement can be observed in oil-producing and non-oil-producing countries alike, with the exception of Central America. The combination of increased volumes and higher prices has made exports the most dynamic demand factor and has turned 2003 into a record year in terms of the region's trade surplus (US$ 41.8 billion). The buoyancy of exports was quite widespread as well, as growth rates for the year are on the order of 5.9 per cent for Central America and the Caribbean, 7.8 per cent for the Andean Community and Chile, 18.9 per cent for MERCOSUR and 8.3 per cent for the regional average. In contrast to this performance, Mexico's non-oil exports have been sluggish (0.6 per cent).

9. The hefty trade surplus contributed to a surplus of US$ 5.6 billion on the balance-of-payments current account. This is the first time a surplus has been posted in half a century. However, the negative level of external saving is a result that requires cautious consideration when interpreting the growth process. In emerging economies, it is important that external savings accompany an appropriate level of national saving in order to sustain capital formation. In 2003, however, the region has not only lacked a complementary flow of savings from the rest of the world but has also registered a decline in national saving in absolute values.

10. Apart from the growth impulses transmitted through the channel of trade, capital flows were also positive, in contrast to the situation in 2002. Autonomous capital movements, although modest — net inflows stood at just US$ 4.4 billion — compare favourably with the US$ 14.4 billion outflow registered the year before. Financial flows were negative, but direct investment more than offset that outflow. Foreign direct investment has been on the decline, and the level posted for 2003 (US$ 30.1 billion) is 23 per cent lower than the figure for 2002. This outcome points to a lower level of interest in local assets and suggests that the privatization process has run its course in many countries.

11. After a year of adverse markets for Latin American government debt in 2002, in 2003, the countries of the region were able to access funds at an average cost of

9.6 per cent, which is 300 basis points less than 12 months earlier. At the beginning of December 2003, the interest rates being paid by the region were similar to the rates paid during the first half of 1997, prior to the outbreak of the Asian crisis. Mexico's and Chile's risk premiums were at record lows, and Brazil's declined by 1,800 basis points between the last quarter of 2002 and December 2003. In addition, the Latin American and Caribbean region received compensatory funds amounting to almost US$ 18.8 billion. A third of this sum was provided by the International Monetary Fund (IMF), since 12 countries in the region are implementing agreements they signed with that organization. The balance of the funds corresponds to debt service arrears. In all, the countries have built up reserves of almost US$ 29.4 billion.

12. Despite the significant level of financing, the net transfer of resources continued to be negative (US$ 33.3 billion), equivalent to 7.9 per cent of exports. This fact reflects, among other elements, the increasingly negative results being recorded on the income account, specifically in terms of profit remittances, dividends and interest payments on the debt and on the foreign investments that have accumulated over the years. Another structural feature that has been taking shape in Latin America and the Caribbean is the inflow of remittances from nationals residing abroad. Current transfers, consisting mainly of remittances from family members abroad, amounted to US$ 33.5 billion in 2003 and are acquiring key importance in various countries of the region, in particular Mexico and various Central American economies.

13. The international situation described above has provided a more positive setting than in 2002 for the design of national economic policy. Once again, however, fiscal and monetary instruments have failed to generate the hoped-for countercyclical effects. In terms of public finances, the countries' high levels of indebtedness, which in various cases are above 50 per cent of GDP, acted as a major constraint and forced fiscal policy to move in the same direction as the business cycle. The effort to strengthen long-term fiscal solvency has dominated the design of income and expenditure policy, and fiscal policy in the region has thus been oriented towards increasing the primary government surplus, despite the fact that economic growth rates have been low. The primary balance of the region improved by almost one percentage point, moving from a deficit of 0.3 per cent of GDP to a surplus of 0.6 per cent. In view of this situation, the countries took steps to bring about an adjustment in expenditure, in addition to introducing other more intensive measures. More specifically, many Governments embarked upon social security reforms (especially in the public sector), new decentralization schemes, fiscal rules based on macroeconomic considerations and tax reforms. As the Economic Commission for Latin America and the Caribbean (ECLAC) has indicated on numerous occasions, macroeconomic management calls for efficient tools for moderating the cycle. The countries will not recover the ability to make use of fiscal instruments overnight, however, as a number of structural issues that strongly influence solvency must first be resolved. Hence the importance of the public-sector reform agenda being pursued by the countries.

14. As for the direction of monetary policy, the countries' central banks have focused on controlling inflationary pressures. Various countries have set inflation targets and are using interest rates as a tool for meeting those target levels. In others, the authorities have chosen to use monetary aggregates to provide them with benchmarks for this purpose. Whatever instruments are chosen, the prevailing goal has been to reduce inflation rates, which had climbed to double-digit levels in 2002.

This is particularly evident in countries such as Brazil, Colombia and Mexico, whose inflation indexes for the early months of the year were endangering their chances of meeting their policy goals. In order to deal with this situation, the authorities initially raised rates and restricted liquidity. Once inflation subsided, they paved the way for a reduction in interest rates and adopted a more active stance in an effort to reverse the business cycle. This greater degree of freedom in monetary management was possible, among other reasons, because of the improved fiscal outturn. Argentina, Brazil and Mexico finished the year with real lending rates that are much lower than the rates charged on loans at the beginning of 2003.

15. Most of the countries consolidated their use of more flexible exchange-rate regimes and have been phasing out restrictions on foreign-exchange operations. In fact, in 2003, very few changes were made in the countries' exchange-rate regimes. The only exception was Venezuela, which adopted a fixed exchange rate in February together with strict controls on foreign-exchange operations. Despite this preference for a flexible exchange rate, currency values are closely monitored by the authorities in view of the influence they have on real and financial flows. In addition, various countries in the region have maintained a high degree of dollarization in their economies or have simply adopted the dollar as legal tender.

16. The real effective exchange rate is a key variable for commercial competitiveness. In December 2003, the region's average exchange-rate index showed a slight depreciation (1.9 per cent) in relation to the end of 2002. Currency movements have been very uneven over the past months, however. The currencies of various South American countries (Brazil, Argentina and Chile) have not only undergone significant appreciations in relation to the dollar but have also risen slightly in value (0.7 per cent) against the currencies of their trading partners. By contrast, the Central American and Mexican currencies depreciated by 2.3 per cent against the dollar and 6 per cent against the other currencies. From an overall and longer-term perspective, the main point to be noted is that the exchange rates that are relevant to trade in the region were, in December 2003, 18.1 per cent higher than their 1997-2001 average. Maintaining suitable exchange rates is an essential ingredient in expanding the export base while bringing in higher value-added and more technologically complex production activities.

17. The design and implementation of various fiscal and monetary instruments has helped, inter alia, to reduce inflation. In 2003, prices have increased by 8.5 per cent, four percentage points less than the previous year. The region has thus returned to single-digit levels of inflation, as was the case between 1998 and 2001. This return to low inflation rates takes on added importance in the light of the difficulties experienced in 2001 and 2002, including, in particular, substantial rises in nominal exchange rates. Accordingly, relative prices were altered without fuelling inflation, in clear contrast to the problems encountered by the region in this respect in the past. The management of economic policy and the absence of cost pressures have also contributed to these results.

18. In view of the external environment and economic trends on the domestic front, in 2004, the region should continue the expansion that began in 2003. An increase in economic activity is expected to bring the average rate for the region up to 4 per cent, which is far higher than the average for the past five years. Growth estimates for the fourth quarter of 2003 point to an acceleration of economic activity to a level 3 per cent above the rate for the same period in 2002. Consequently, in

2004, growth will be fuelled by the region’s improved performance in the second half of 2003. An analysis of various external and internal factors suggests that these favourable economic trends will continue during 2004. First of all, the positive factors that brought about the recovery in 2003, particularly in the export sector, will continue to apply. The reactivation of the world economy ought to continue, bringing with it an upturn in prices and in international demand for commodities. In the light of the most recent data, the recovery in the United States is also expected to continue in 2004, thanks to unprecedented fiscal and monetary incentives. Yet the situation is not free of risk. The serious external and fiscal disequilibria affecting the United States economy, combined with the reactivation under way, could make the dollar fall further and, in that event, interest rates would rise. Most analysts agree that these adjustments are necessary and ought to occur in late 2004 or in 2005.

19. There are also internal factors that contribute to this favourable outlook for 2004. Although each country has its own particular features and the factors discussed here have varying effects in each case, some considerations that are valid for the region as a whole can be advanced. First, domestic interest rates should remain low in 2004, especially with domestic prices continuing to trend downwards. Second, exchange rates in Latin American and Caribbean countries will remain high despite the cases of currency appreciation observed in the last few months of 2003. Third, if economic activity continues to pick up, fiscal policy would cease to be contractionary and could even become expansionary in some countries. Lastly, it should be pointed out that the region’s performance will be influenced by the elections due to be held in various countries of the region during 2004.

Annex

Latin America and the Caribbean: total gross domestic product

(Annual growth rates)

Country	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
Argentina	5.9	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.8	-4.4	-	8.6
Bolivia	4.3	4.8	4.7	4.5	4.9	5.0	0.3	2.3	1.6	2.7	2.6
Brazil	4.5	6.2	4.2	2.5	3.1	0.2	0.9	3.9	1.3	1.5	-0.2
Chile	11.1	5.0	9.0	6.9	6.7	3.3	-0.5	4.5	3.5	2.0	3.3
Colombia	4.2	6.0	4.9	1.9	3.3	0.8	-3.8	2.4	1.4	1.7	3.7
Costa Rica	7.1	4.6	3.9	0.8	5.4	8.3	8.0	1.8	1.2	2.8	5.5
Cuba	-	0.5	2.7	9.1	2.7	0.0	5.7	6.3	2.9	1.1	5.6
Ecuador	1.8	3.7	2.1	3.0	5.2	2.2	-5.7	0.9	5.5	3.8	3.0
El Salvador	6.4	6.0	6.2	1.8	4.2	3.8	3.4	2.0	1.7	2.1	2.0
Guatemala	4.0	4.1	5.0	3.0	4.4	5.1	3.9	3.4	2.6	2.2	0.6
Haiti	-8.0	-	9.5	5.6	3.2	2.9	2.9	2.0	-0.6	-0.2	0.6
Honduras	7.1	-1.9	3.7	3.7	4.9	3.3	-1.5	5.6	2.7	2.6	3.5
Mexico	1.8	4.4	-6.1	5.4	6.8	5.1	3.6	6.7	-0.3	0.7	1.3
Nicaragua	-0.4	3.4	6.0	6.6	4.0	3.1	6.9	4.4	3.1	0.7	2.3
Panama	5.3	3.1	1.9	2.7	4.7	4.6	3.5	2.6	0.4	0.8	4.0
Paraguay	4.0	3.0	4.5	1.1	2.4	-0.6	-0.1	-0.6	2.4	-2.5	2.1
Peru	4.8	12.7	8.6	2.5	6.9	-0.6	0.9	2.7	0.2	4.9	4.0
Dominican Republic	3.0	4.7	4.3	7.2	8.2	7.4	8.0	7.3	3.0	4.3	-0.4
Uruguay	3.6	7.1	-2.4	5.2	5.4	4.4	-3.5	-1.9	-3.6	-	2.3
Venezuela	0.1	-3.0	4.8	0.0	6.9	0.6	-5.5	3.8	3.5	-9.0	-9.2
Subtotal	**3.5**	**5.2**	**1.1**	**3.8**	**5.1**	**2.2**	**0.4**	**3.7**	**0.3**	**-0.6**	**1.7**
Antigua and Barbuda	5.0	6.2	-4.8	6.0	5.5	5.0	4.9	2.6	1.6	1.7	3.0
Barbados	1.1	4.4	1.9	2.5	2.6	4.0	3.0	3.1	-2.2	-0.4	2.5
Belize	4.3	1.5	3.7	1.3	4.4	2.0	6.0	10.5	4.7	3.7	4.0
Dominica[a]	1.9	1.9	1.2	2.9	2.2	3.1	1.3	1.3	-3.3	-5.8	0.4
Grenada[a]	-1.1	3.4	3.1	3.0	4.3	7.6	7.5	7.3	-3.8	-1.1	1.0
Guyana	11.4	9.4	3.8	7.4	6.8	-2.2	5.0	-2.3	2.3	1.5	1.0

Country	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
Jamaica	1.7	2.2	-0.2	-1.9	-0.9	0.7	1.0	1.7	0.9	0.9	1.0
Saint Kitts and Nevis[a]	5.2	5.5	3.2	5.8	7.2	1.1	3.5	5.6	2.0	0.9	1.9
Saint Vincent and the Grenadines[a]	2.0	-2.3	7.8	1.2	3.5	5.8	3.6	1.8	0.0	1.3	1.0
Saint Lucia[a]	1.6	1.6	2.1	0.8	-0.3	3.0	2.9	0.2	-4.1	0.2	2.0
Suriname[a]	-4.1	-0.1	0.0	5.3	3.3	2.9	-3.5	-1.2	1.3	1.2	3.5
Trinidad and Tobago	-1.2	4.2	4.2	4.4	4.0	5.3	7.8	9.2	4.3	3.0	5.5
Subtotal Caribbean[a,b]	**0.9**	**3.3**	**1.9**	**2.0**	**2.3**	**3.1**	**4.2**	**4.9**	**1.9**	**1.7**	**3.3**
Latin America[b]	**3.4**	**5.2**	**1.1**	**3.8**	**5.1**	**2.3**	**0.5**	**3.7**	**0.4**	**-0.6**	**1.7**

Source: ECLAC, on the basis of official figures converted into dollars in constant 1995 prices.

[a] The last column refers to the period 1990-1999.

[b] Refers only to those countries which submitted information.