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Latin America and the Caribbean: economic situation and outlook, 2005-2006

Summary

The Latin American and Caribbean economy grew for the third consecutive year in 2005. Gross domestic product (GDP) expanded by an estimated 4.5 per cent, equal to a per capita GDP growth rate of almost 3 per cent. The dynamism of the global economy was behind the most outstanding feature of that period of economic growth, namely an expanding surplus on the balance of payments current account. The combination is without precedent in the region's economic history. The current account surplus for 2005 was equivalent to 1.3 per cent of GDP, exceeding the surpluses recorded for the previous two years. Major differences exist however between subregions.

Latin America and the Caribbean recorded an inflation rate of 6.2 per cent (as against 7.4 per cent in 2004), a continuation of a downward trend in this indicator for the region. Economic growth also led to a decrease in unemployment, although the jobless rate is still high. The expansion of the business cycle is expected to carry over into 2006, with an overall projected economic growth rate of 4.6 per cent.

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I. Main trends

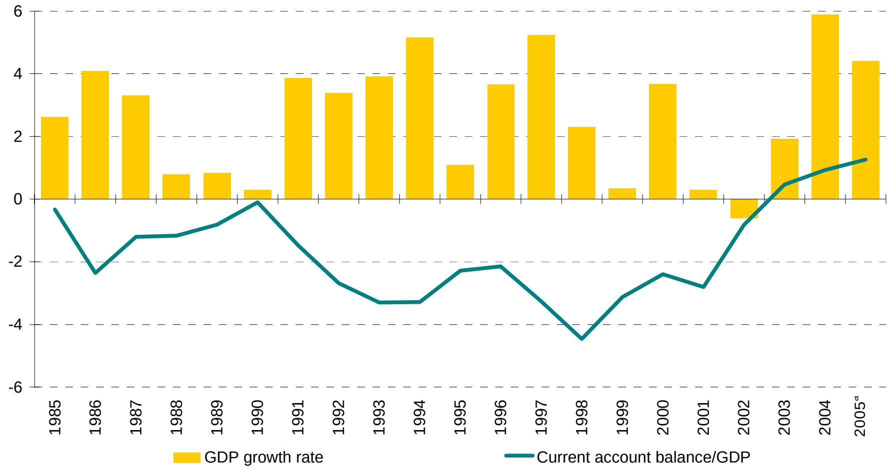
1. The Latin American and Caribbean economy grew for the third consecutive year in 2005. Gross domestic product (GDP) expanded by an estimated 4.4 per cent, equal to a per capita GDP growth rate of almost 3 per cent. The rates were lower than those recorded in 2004, but higher than the averages for the 1990s (3.2 per cent and 1.5 per cent for global GDP and per capita GDP, respectively) and the values recorded for the period 2000-2005 (2.3 per cent for GDP and 0.8 per cent for per capita GDP). Most of the economies in the region grew in 2005, though sharp differences were observed from one subregion to another (see below).

2. The expansion of the business cycle carried over into early 2006, with the economic growth rate likely to remain at around 4.4 per cent for the year overall. If projections prove correct, the average growth rate for 2003-2006 will be just over 4 per cent, while the cumulative increase in per capita GDP will be close to 11 per cent.

3. The performance of Latin American economies has not been isolated, indeed it is part of the widespread growth witnessed throughout the world economy. External demand helped to fuel another substantial rise in the volume of merchandise exports, with the price of commodities exported by Latin America and the Caribbean rising by 20.6 per cent overall, or 14.4 per cent excluding energy products. The increase was lower than the exceptionally high increase recorded in 2004, although several products clearly continued to benefit from very favourable conditions in 2005. Other markets, by contrast, suffered downward price trends.

4. The circumstances described above gave rise to the most outstanding feature of this period of economic growth, namely an expanding surplus on the balance of payments current account, a combination without precedent in the region's economic history. The current account surplus for 2005 was equivalent to 1.3 per cent of GDP, thus exceeding the surpluses recorded for the previous two years (0.9 per cent in 2004 and 0.5 per cent in 2003). Major differences exist, however, between subregions, with South America posting a current account surplus amounting to 3.1 per cent of GDP in 2005 (as against 2.5 per cent in 2004 and 2.1 per cent in 2003), while calculations for Central America and Mexico indicate a deficit of 1.7 per cent of GDP (as against 1.4 per cent in 2004 and 1.6 per cent in 2003), while the Caribbean (excluding Trinidad and Tobago, a net oil exporter) has posted a deficit of over 10 per cent on its current account for the last three years.

Figure 1
Growth in gross domestic product and balance of payments current account
(*Percentage*)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Estimate.

II. Economic policy

5. Economic policy was mainly aimed at capitalizing on good external conditions and the growth of the domestic economies to lessen the region's financial vulnerability. In particular, Latin American and Caribbean Governments took advantage of the current economic circumstances to improve their public accounts.

6. Generally speaking, the fiscal performance for the period 2003-2005 was unusual for the region. First, macroeconomic conditions helped to increase fiscal income, thanks to an upturn in activity levels and better terms of trade. Second, regional Governments avoided slipping into the usual pattern of expansionary spending on the back of better macroeconomic indicators. The two factors combined to allow central Governments to achieve a primary surplus of 1.1 per cent of GDP (measured as a simple average) at the end of 2005, compared with 0.7 per cent in 2004. The overall deficit (including interest on the public debt) dropped from 1.8 per cent to 1.6 per cent of GDP. Based on the budgets drawn up by the countries of the region, primary surpluses should continue to be high in 2006 (1.1 per cent of gross domestic product).

Table 1
Latin America and the Caribbean: central Government fiscal indicators[a]
(*Percentage of GDP at current prices*)

	Primary balance				*Overall balance*				*Public debt*[b] *Central Government*				*Public debt*[b] *Non-financial public sector*			
	2002	*2003*	*2004*[c]	*2005*[d]	*2002*	*2003*	*2004*[c]	*2005*[d]	*2002*	*2003*	*2004*	*2005*	*2002*	*2003*	*2004*	*2005*
Latin America and the Caribbean																
Simple average	-0.5	-0.2	0.7	1.1	-3.3	-3.0	-1.8	-1.6	56.1	54.5	50.3	42.9	61.3	59.1	53.3	45.9
Weighted average	1.3	1.7	2.2	2.3	-3.6	-1.8	-0.7	-0.9	48.2	46.5	42.9	34.6	64.8	58.2	53.7	44.1
MERCOSUR[e,f]	0.4	1.7	2.8	2.2	-3.7	-1.8	0.0	-0.9	86.3	78.4	68.4	49.4	104.7	87.5	76.4	56.2
MERCOSUR and Chile[f]	0.3	1.5	2.9	2.6	-3.2	-1.5	0.4	0.0	72.2	65.3	56.9	41.3	88.2	74.0	64.6	48.1
Andean Community[f]	-1.0	-0.5	0.1	0.4	-4.2	-3.8	-2.8	-2.6	56.2	57.6	53.4	49.0	61.7	63.9	58.3	53.4
Oil-exporting countries[f]	1.6	1.5	1.7	1.6	-2.4	-2.4	-1.5	-1.5	51.1	47.9	44.0	41.6	48.7	48.8	42.9	40.1
Other countries[f]	-2.7	-1.9	-0.9	-0.4	-5.3	-4.8	-3.7	-3.4	57.8	60.8	56.5	51.4	74.7	79.1	73.8	66.6
Mexico	0.9	1.7	1.9	2.6	-1.2	-0.6	-0.3	-0.2	24.0	24.2	23.3	22.6	27.5	27.6	26.1	25.4
Central America[f]	-0.5	-0.7	-0.1	0.4	-3.0	-3.4	-2.6	-2.3	70.2	71.0	64.0	58.7	71.7	72.8	65.8	60.4

Source: ECLAC, on the basis of official figures.
[a] Includes social security.
[b] At 31 December each year, using the exchange rate applicable to external debt. For 2005, the latest available data were used. The public debt shown for the Dominican Republic refers to external debt only.
[c] Preliminary estimate.
[d] Official targets.
[e] Common Market of the South/Mercado Común del Sur.
[f] Simple average.

7. It should be recalled that the central government fiscal balance is not entirely representative in the case of those countries of the region whose public sectors are more decentralized. Taking into account the broader public-sector accounts in Argentina, Brazil, Colombia and Mexico, the primary balance of non-financial public sectors moved, on average, from 3 per cent of GDP in 2003 to 3.6 per cent in 2004, and to an estimated 3.5 per cent in 2005.

8. The improvement in fiscal aggregates has helped to lessen the region's external vulnerability, manifested essentially in its debt indicators. This is the result of a combination of factors, among which governmental decisions and the characteristics of the business cycle figure prominently. The debt of central Governments was thus estimated at 42.9 per cent of GDP in 2005, compared to 54.5 per cent in 2003 and 50.3 per cent in 2004. The decrease in that indicator was attributable mainly to the generation of primary surpluses, debt restructuring and currency appreciation with respect to the United States dollar.

9. Although many of the countries' debt coefficients are still very high, the reduction in their public debt:GDP ratios are helping to make the region less vulnerable to external shocks. Another factor that is leading the region in the same direction is the decline in the ratio between its external debt (less its international reserves) and its exports of goods and services. While exports are rising at a considerable pace, the counterpart to the current account surplus takes the form of a

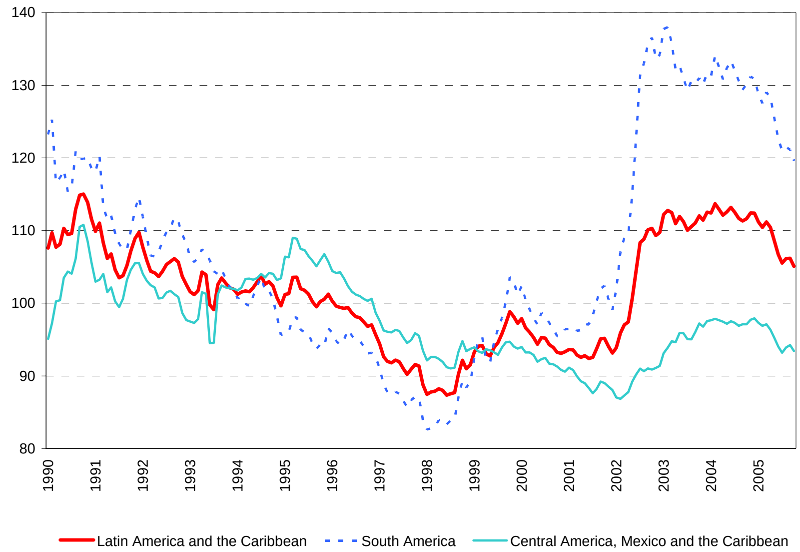
dual process, consisting of a paydown of the external debt and a build-up of reserves, which is allowing the countries of the region to reduce their net liabilities position.

10. The smaller financing requirement resulting from such a fiscal situation added to the build-up of reserves by Governments and their interest in demonstrating their ongoing commitment (without the conditions inherent in a letter of intent) to maintaining fiscal solvency, reduced the incentives to conclude standby arrangements with the International Monetary Fund (IMF). Of the region's six largest countries in terms of GDP (Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia and Mexico), only Colombia had a standby agreement in place at the end of 2005. In that connection, both Argentina and Brazil have prepaid their entire debt to IMF.

11. The region continues, however, to display a number of structural features that are in need of attention. Despite rising revenue in recent years (including 2005), the region still has a weak and inequitable tax structure and shows a significant dispersion of tax burdens across different countries. On the spending side, consideration must be given to the poor quality of adjustments made in recent years, which have undermined the capacities of Governments to address the remaining problems in the region's public sectors, namely the low level of public investment, the need to improve the provision of social services and the need to remedy the serious coverage and solvency problems observed in social security systems.

12. In 2005, the extraregional real effective exchange rate (which excludes trade with other countries in the region) exhibited a year-on-year appreciation of 5 per cent, which was mainly due to the faster real appreciation (6.5 per cent) among the South American currencies, with the currency rising in value in 9 of the subregion's 10 countries. Central America, Mexico and the Caribbean exhibited a lower rate of extraregional effective appreciation (3.3 per cent), as a result of currency appreciation in eight countries. The Dominican Republic recorded a real currency appreciation of 29.8 per cent against the United States dollar.

Figure 2
Latin America and the Caribbean: extraregional real effective exchange rate
(*Average for January 1990-December 1999=100*)



Source: ECLAC, on the basis of official figures, and IMF.

13. As regards the total effective exchange rate, which includes trade with the other countries of the region, 10 Latin American and Caribbean countries saw year-on-year currency appreciation in real effective terms in 2005. Of those 10, 3 South American countries (Brazil, Colombia and Uruguay) registered double-digit currency appreciation, while Jamaica and Guatemala were the only Central American and Caribbean countries to see a substantial drop in their real effective exchange rates (7.4 per cent and 7.1 per cent, respectively).

14. In order to offset the trend of their currencies towards real effective appreciation, the authorities in several countries of the region (including Argentina, Colombia and Peru) intervened repeatedly in currency markets, buying large volumes of foreign currency during the year.

15. Unlike the situation in the 1990s, capital movements were not the determining factor in the cases of currency appreciation in South America in 2005. Capital inflows were recorded in a number of countries, but, according to preliminary data, the subregion registered a net outflow in 2005. Perhaps the most significant factor in 2005 was that currency appreciation in the region was influenced by terms-of-trade upturns in several South American countries, Mexico and some Caribbean countries, as well as by substantial income from emigrant remittances in several Central American countries.

16. Holding down inflation continued to be the main objective of monetary policy in the countries of the region. Given the rise in oil prices and the improved outlook for economic activity, Latin American central banks increasingly focused on inflation. Prices have, in fact, increased at a fairly moderate rate, given the generalized appreciation of local currencies, as discussed in more detail below.

17. Until mid-2004, countries that were on track towards their inflation targets were able to use monetary policy to help fuel their economies by means of successive cuts in interest rates. Thereafter, most of the countries having met those targets, many central banks cautiously raised monetary policy interest rates to avoid deviation from international rates.

18. Since then, reference rates have risen in the region, but are still relatively low in historical terms. Given the modest rise and the price increases in some countries, real interest rates have stayed virtually unchanged or have even come down in the past 30 months. Brazil and Mexico, the region's two largest countries, are two important exceptions.

19. Bank lending is relatively more important in the Latin American and Caribbean countries than in the developed world because capital markets in the region are less developed. In that regard, the upturn seen in bank credit in 2003 bore out expectations of better growth prospects, which have continued thus far. Total and private credit continued to expand at rates of over 10 per cent in 2005, thereby continuing the previous year's trend and regaining levels seen before 2001.

III. Domestic performance

20. Against a backdrop of widespread economic growth, domestic performance was particularly good in the economies of South America and, to a lesser extent, the Caribbean, where the levels of activity have risen faster than those of Central America and Mexico.

Table 2
Latin America and the Caribbean: gross domestic product
(*Annual growth rates expressed as a percentage*)

	2004	*2005*[a]	*2006*[b]
Latin America and the Caribbean	**5.9**	**4.4**	**4.4**
South America	**6.9**	**5.0**	**4.8**
Brazil	4.9	2.3	3.3
Southern Cone	8.4	8.3	6.5
Andean Community	9.5	6.7	5.5
Mexico and Central America	**4.2**	**3.1**	**3.6**
Central America	4.0	4.0	4.2
Mexico	4.2	3.0	3.5
Caribbean	**3.9**	**4.3**	**6.1**

Source: ECLAC, on the basis of official figures.
[a] Estimate.
[b] Projection.

21. The satisfactory regional performance was reflected in most of the countries, all of which, except Guyana, posted positive growth rates. In that context, the highest rates were registered in the Bolivarian Republic of Venezuela (9.3 per cent) and Argentina (9.1 per cent), while the lowest were in Haiti (1.8 per cent), Brazil

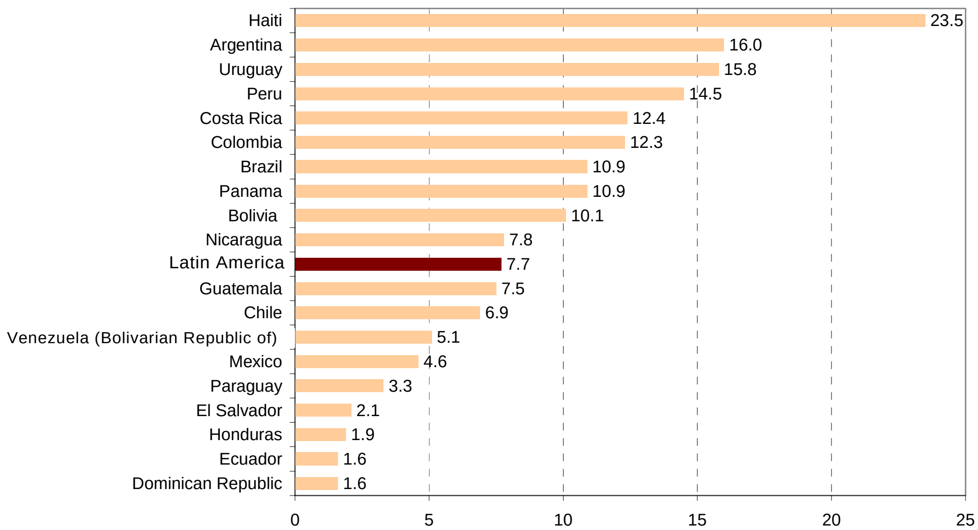
(2.3 per cent), Paraguay (2.7 per cent) and El Salvador (2.8 per cent). The growth rates of Chile, the Dominican Republic, Panama, Peru and Uruguay varied between 5.5 per cent and 7 per cent; those of Bolivia, Colombia, Honduras and Nicaragua were around 4 per cent, and those of Ecuador, Guatemala and Mexico around 3 per cent. The Caribbean countries achieved an expansion of 4.1 per cent, despite the impact of intense hurricanes; the countries that grew most in that subregion were Saint Lucia (8 per cent) and Trinidad and Tobago (7 per cent).

22. Thanks to favourable external conditions, regional economic expansion continued to be fuelled by exports. Even though growth in external demand slightly dropped, export volumes rose by 8 per cent in volume, compared to 12.4 per cent in 2004. In 2005, external sales accounted for 24.9 per cent of regional GDP, a considerable increase compared to 12.5 per cent in 1990.

23. The growth of the world economy once again had a positive impact on regional terms of trade, which improved by 4.8 per cent in 2005, slightly lower than the figure of 5.3 per cent for 2004. The positive overall trend was due to a 10.6 per cent increase in export prices, while import prices rose by 5.5 per cent. Between 2002 and 2005, regional terms of trade accumulated an increase of 13.2 per cent. The expansion was concentrated in countries that export oil, minerals and metals, while net importers of energy products suffered an even sharper decline than in 2004. There was also a sharp difference between subregions, since the South American countries had reaped the benefits of the upturns in terms of trade seen in the previous few years.

24. Fuelled by the upturn in terms of trade, gross national disposable income expanded by 5.6 per cent, calculated at the previous year’s prices. In the region overall, the impact of the terms of trade was larger than in 2004, at 1.34 per cent of GDP. The larger increase in national income with respect to GDP was witnessed in most South American countries (except for Paraguay and Uruguay) and Mexico. Over the same period, gross national disposable income in Central American countries, grew more slowly than GDP, owing to the negative impact of the terms of trade.

Figure 3
Latin America and the Caribbean: estimated growth rate for merchandise exports, 2005
(*Percentage*)



Source: ECLAC, on the basis of official figures.

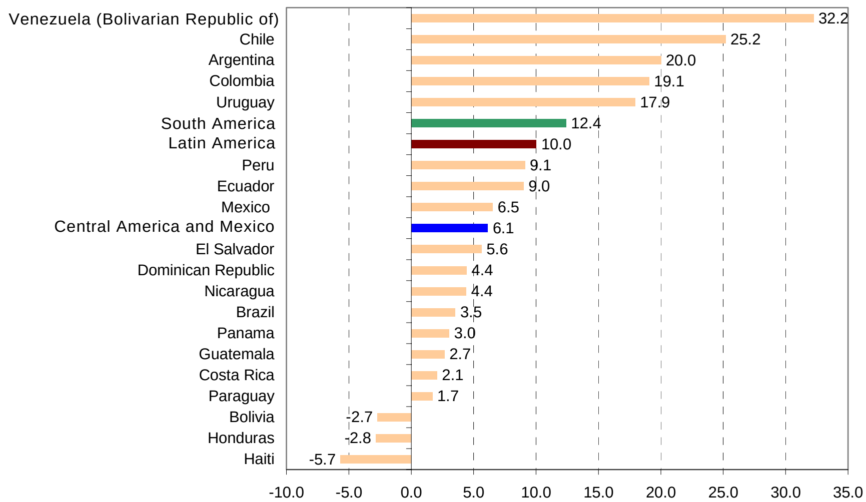
25. In 2005, the upturn in gross national disposable income in most countries helped to strengthen the recovery in domestic demand that began in 2004. As a result of that factor and of changes in exchange rates, most countries posted high growth rates for imports of consumer and capital goods. Although domestic interest rates in most cases began to follow the upward trend of international interest rates, they are still low, facilitating both investment and consumption decisions, while the exchange rate appreciations registered in some countries in 2005 helped to bring down the cost of imports, thus contributing to a higher level of domestic demand. Import volume increased by 12 per cent, making the contribution of net exports to growth in the region negative for the second consecutive year. Consumption rose by 3.3 per cent, driven by more rapid expansion of private consumption

26. With regard to the region's future growth potential, it is interesting to note that investment is climbing sharply in most of the countries (a regional average of 10 per cent). Nonetheless, since the investment rate is starting from very low levels, in 2005 it will still be equivalent to only about 22 per cent of GDP. Although the figure represents an appreciable upturn, it is still not high enough to sustain a sufficiently rapid growth rate to make any significant dent in unemployment or poverty. An examination of investment provides a clear picture of the differing economic trends in the subregions of Latin America and the Caribbean. Whereas gross fixed capital formation rose at an average rate of over 12 per cent in South America in 2005 (20 per cent if Brazil is not included in the calculations), in Central America and Mexico it rose by only 6.1 per cent, and the rate for Central America alone was just 2 per cent. The differing implications of changes in the terms of trade and, once again, uneven trends in competitiveness, have surely played a role in the differences

in investment performance in the region which, in some cases, may constrain future growth capacity.

Figure 4
Latin America and the Caribbean: estimated gross fixed capital formation, 2005

(*Rates of variation based on figures in constant value of 2000 United States dollars*)



Source: ECLAC, on the basis of official figures.

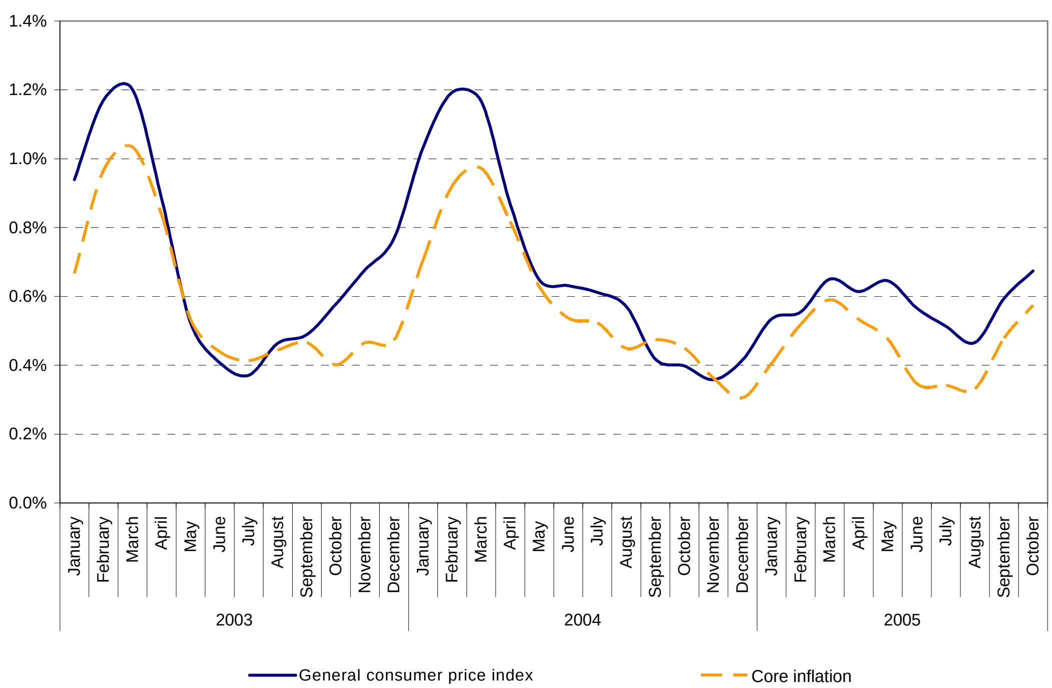
27. The satisfactory regional development of the components of demand was reflected in different economic sectors. The increase in mining and hydrocarbon production was in response to persistent external demand, which, together with the rise in domestic demand, continued to boost the industrial sector, thanks to the greater profitability of the tradables-producing sectors as a result of the devaluations in the biennium 2002-2003. Although in nominal terms the exchange rates have been appreciating in relation to the United States currency, in real terms they remain favourable for most of the countries of the region. The performance of the agricultural sector has been uneven, while in most countries growth in construction contributed to the higher level of gross fixed capital formation. Trade was stimulated by a rise in household consumption, while the general expansion of domestic activity gave a significant boost to the transport sector. The buoyancy of the international economy also had a positive impact on tourist-related activities. Available data for 2005 shows the number of tourist arrivals up by 13.6 per cent in Central America and 12.7 per cent in South America. In the Caribbean countries, the number of arrivals increased by 5.4 per cent over the same period, although cruise-ship tourism was affected by the hurricanes that ravaged the region, with the number of cruise ship passengers down by about 2 per cent in aggregate terms.

28. In 2005, Latin America and the Caribbean recorded an inflation rate of 6.2 per cent (as against 7.4 per cent in 2004), a continuation of the downward trend in the region, reflecting the drop in the inflation rates of Brazil and Mexico (5.7 per cent and 3.3 per cent, respectively, in 2005, compared to 7.6 per cent and 5.2 per cent in 2004). The inflation rate was also down in the Bolivarian Republic of Venezuela (from 19.2 per cent to 14.4 per cent), the Dominican Republic (from 28.7 per cent to

7.4 per cent), Haiti (from 20.2 per cent to 15.4 per cent), Peru (from 3.5 per cent to 1.5 per cent) and Uruguay (from 7.6 per cent to 4.9 per cent). In contrast, Argentina, Chile, Ecuador and Paraguay posted higher rates. The other countries in the region had inflation rates similar to those of 2004. Although some countries continued to post two-digit growth rates for consumer prices, for the first time no country in the region had an inflation rate higher than 20 per cent.

Figure 5
Latin America and the Caribbean: consumer price index and core inflation index

(*Three-month moving average* (*weighted average*))



Source: ECLAC, on the basis of official figures.

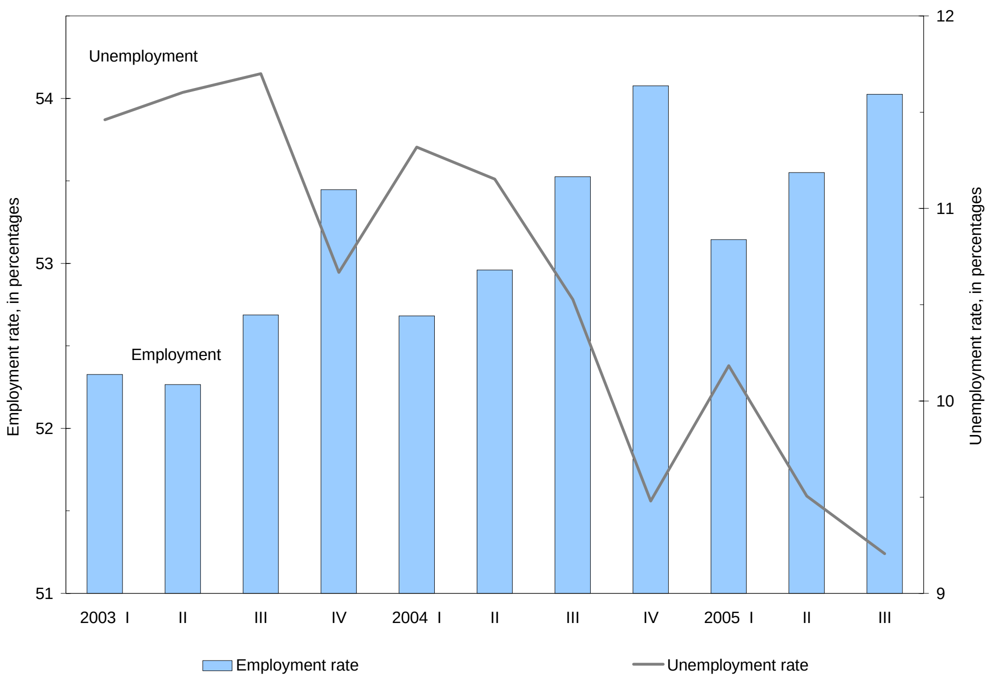
29. Domestic prices in the countries of the region in 2005 continued to follow the trends that had first appeared in the second half of 2004. In aggregate terms, the rise in international prices for foods and agricultural commodities slowed down, with the exception of coffee and sugar prices, which increased more rapidly in 2005 than in 2004. Metal and mineral prices continued to post substantial rises, although lower than in 2004. In the first half of 2005, oil and fuel prices rose more slowly than in 2004, but in the second half the trend was reversed. International prices for manufactures did not change very much in 2005. The exchange rate appreciations of the national currencies of various countries mitigated the price rises for imported products to some degree. In 2005, real salaries and wages showed varied results, with changes that were mainly too minor to cause inflationary pressures.

30. The relatively rapid rate of job creation that began in the region in 2003 continued in 2005. The employment rate was estimated to have risen by 0.5 per cent, equal to an increase of 3.3 per cent in urban employment. The accumulated increase over the three-year period from 2003 to 2005 was 1.5 per cent, a key factor in lifting 13 million people above the poverty line over the past two years.

31. While the increase in the employment rate was similar to the level recorded in 2004, the unemployment rate showed a much clearer improvement, dropping by more than one per cent to 9.1 per cent, while in the previous year it had decreased from 10.9 to 10.3 per cent. The lowering of the unemployment rate in 2005 means a 10 per cent reduction (almost 2 million people) in the number of urban unemployed. As in the case of the increase in the employment rate, the reduction in unemployment was a fairly widespread phenomenon, observed in 14 of the 19 countries for which information was available.

Figure 6
Quarterly employment and unemployment rates in nine Latin American countries

(Percentage)



Source: ECLAC, on the basis of official figures.

32. The higher level of employment was not the only reason for the drop in the unemployment rate; the reduction was also due to a significant slowdown in the labour supply. In fact, the economically active urban population grew by only 1.7 per cent (as against 2.6 per cent in 2004), owing to a reduction of 0.3 per cent in the labour participation rate of the working age population. In a number of countries, that appeared to be partly because fewer young people were joining the labour market, apparently opting to remain longer in the educational system.

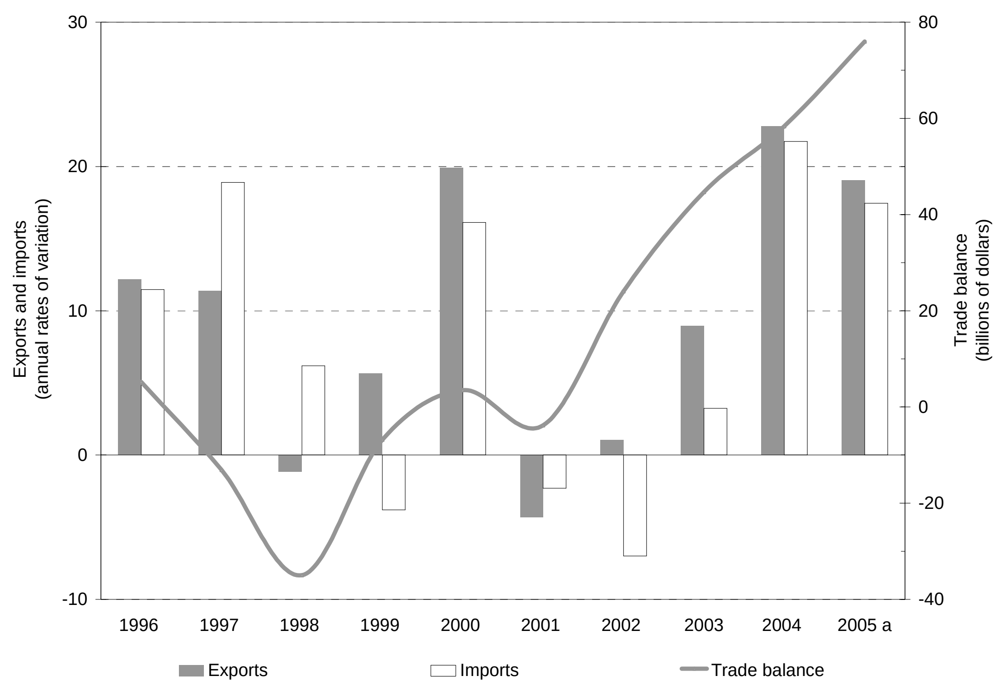
33. Most jobs created in 2005 were in the wage sector. Formal wage employment grew at high rates in a number of countries. However, there were signs of growing instability in formal employment, with a substantial increase in the number of temporary contracts.

34. In view of the persistent high unemployment rates and the restructuring of the global labour market, which has brought a massive influx of low-income workers (especially in Asia), wages stagnated in real terms in most countries. The real average regional wage in the formal sector rose by 0.2 per cent as a weighted average and 0.1 per cent in the median.

IV. External performance

35. As noted above, external conditions provided a boost to the international trade of Latin American and the Caribbean countries. In 2005, total exports plus imports amounted to more than $1 trillion dollars (49 per cent of regional GDP), while trade grew by 18.3 per cent during the year. Exports increased by 19.1 per cent and imports by 18 per cent, which represented a slight slowdown in relation to the unprecedented growth of 21.6 per cent and 20.2 per cent respectively in 2004. The merchandise trade balance, which was positive for the fourth consecutive year, stood at $77.8 billion, equal to 3.2 per cent of regional GDP ($19.4 billion higher than in 2004).

Figure 7
Latin America and the Caribbean: external trade, 1995-2005



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

36. Export performance in the region was linked to subregional specializations. In MERCOSUR countries, external sales rose by 21.1 per cent and by 31.3 per cent in the Andean Community and Chile. In most countries, the performance of exports was largely due to strong markets for some commodities combined with the satisfactory performance of manufactured exports from Argentina and Brazil.

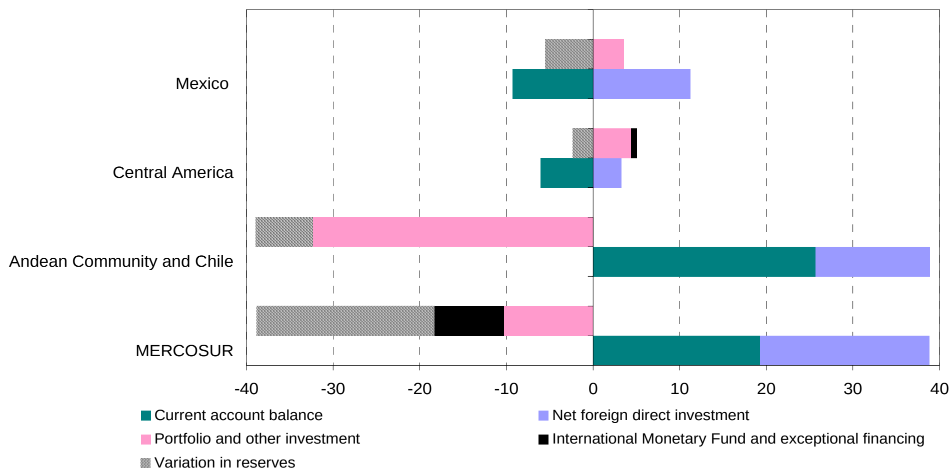
37. External sales of Mexico and Central American countries, which supply a high proportion of labour intensive manufactures, grew at rates similar to those of 2004. Some countries recorded increases, which were linked to high prices of certain traditional export commodities. Mexico’s exports increased by 11.8 per cent (around 9 per cent excluding petroleum), compared with growth of 13.9 per cent in 2004.

38. Of the 19.1 per cent growth in regional exports, 10.6 per cent was due to price effects, while the rest was attributable to variations in volume. Price increases were more significant for oil producing economies (such as the Bolivarian Republic of Venezuela and Colombia) and those that produce certain minerals (such as Chile and Peru). In some of the countries that had benefited from the boom in oilseeds in 2004 (for instance, Argentina and Uruguay), volume had a greater effect on the increase in exports. Growth of export volumes reached double figures in nine economies (including Argentina, Brazil, Colombia and Peru). Mexico’s export volume grew by less than the average (4.6 per cent); the country’s relative size brought down the rate for the region as a whole. Other major exporters, such as the Bolivarian Republic of Venezuela and Chile, also recorded export volume growth that was below the regional total.

39. Imports also rose significantly in 2005, although somewhat less so that the previous year, partly because the expansion constituted a recovery from abnormally low levels in certain countries. Import growth was in double figures for the second year in a row: 20.2 per cent in 2004, 18 per cent in 2005.

40. For the third year in a row, the region posted a surplus on the balance of payments current account, reaching $30.6 billion (equivalent to 1.3 per cent of GDP), almost $12.2 billion more than in 2004. Over the past three years, the average current account surplus has represented 0.9 per cent of GDP, a figure unprecedented in the region’s economic history.

Figure 8
Latin America and the Caribbean: estimated balance of payments components, 2005
(Billions of United States dollars)



Source: ECLAC, on the basis of data from IMF.

41. The regional surplus resulted from a positive merchandise trade balance of $77.8 billion, which was almost 30 per cent higher than in 2004. Combined with the positive current transfers balance, mainly made up of emigrant remittances ($47.6 billion), it generated a joint balance of $125.4 billion. Remittances increased considerably again in 2005 (by 14.8 per cent), while the balance of services displayed a deficit of $20 billion and the income balance deficit stood at $74.8 billion. The balance of services deficit widened, while net profit remittances from investment rose by 11.9 per cent (lower than the increase of almost 15.8 per cent recorded in 2004).

42. The good current-account results in 2005 were coupled with a positive flow of foreign direct investment into the Latin American countries as a whole. The region received flows of foreign direct investment estimated at $47 billion (2 per cent of GDP) in 2005, an increase of 4.3 per cent compared to 2004. The largest recipients were (in descending order) Brazil, Mexico, Argentina and Chile. Almost 35 per cent of inflows were estimated to correspond to greenfield investments. Notwithstanding the downturn in the region’s net external liabilities position, Latin America and the Caribbean had issued international bonds worth almost $46 billion by the end of September, a sum equivalent to 29 per cent of all emerging economy issues and outstripped only by the European emerging economies, which accounted for 34 per cent of the total.

43. Seeking to lessen their external vulnerability, many countries also took steps to restructure and reduce their external liabilities. To that end, external debt was swapped for domestic (as in the case of Argentina, Colombia and Peru) and bonds

issued on the external market were redeemed (as in the case of Argentina, Brazil, Mexico, Panama and Peru). As a result, the region's external debt was expected to decrease, with a ratio of external debt to GDP of just over 30 per cent in 2005, substantially down from the 37.4 per cent of 2004. The restructuring was also directed towards increasing the proportion of total liabilities accounted for by long-term debt and by external debt denominated in local currency. The Governments of Brazil and Colombia did in fact issue local-currency bonds on the international markets.

44. The current-account balance and net foreign direct investment are used to calculate the basic balance. The balance for the region was in surplus by almost $78 billion (3.3 per cent of GDP), of which about $30.6 billion (1.3 per cent of GDP) was used to build up reserves and around $47 billion went to pay down external debt, including net payments for exceptional financing and IMF credits. Consequently, the region was able to run a current-account surplus and reduce its net external liabilities for the third year running. Although that represented a net outward flow of capital in accounting terms, the outflow was not the result of a lack of investor confidence in regional economies, as was clear from trends in the region's risk premiums, which are at an all-time low.

V. Situation and outlook for 2006

45. In 2006, the region is set to continue growing at a rate similar to that recorded in 2005, with projected growth of 4.4 per cent translating into an expansion in per capita GDP of about 3 per cent. All countries in the region, without exception, are expected to post positive growth rates, although the South American and Caribbean subregions will outpace Mexico and the countries of Central America. The inflation rate is likely to remain stable at around 6 per cent, which is similar to the level seen in 2005, although with some differences between countries.

Table 3
Latin America and the Caribbean: growth in gross domestic product, 2005-2006[a]
(Annual rates of variation)

Country	*2005*[b]	*2006*[c]
Argentina	9.2	7.0
Bolivia	4.0	3.3
Brazil	2.3	3.3
Chile	6.3	5.7
Colombia	4.3	4.2
Costa Rica	4.2	3.7
Dominican Republic	9.3	6.0
Ecuador	3.0	2.5
El Salvador	2.8	3.5
Guatemala	3.2	4.0
Haiti	1.8	2.3
Honduras	4.2	4.0

Country	*2005*[b]	*2006*[c]
Mexico	3.0	3.5
Nicaragua	4.0	4.0
Panama	6.4	6.0
Paraguay	2.7	3.0
Peru	6.6	5.6
Uruguay	6.4	4.0
Venezuela (Bolivarian Republic of)	9.3	7.0
Caribbean	**4.3**	**6.1**
Latin America and the Caribbean	**4.4**	**4.4**

Source: ECLAC, on the basis of official figures.

[a] The Government of Cuba estimates growth of 11.8 per cent for 2005. Since ECLAC does not have its own figures, the calculation for the regional average does not include Cuba. For this reason, ECLAC is currently evaluating the estimate provided by Cuba in accordance with United Nations methodologies.

[b] Estimate.

[c] Projection.

46. Some countries of the region will see the growth rates of their economies begin to return to more normal levels, after having soared in the wake of crises that overtook them at the start of the decade (also explaining the slower growth rate projected for Latin America and the Caribbean in 2006). The region’s two largest economies, Brazil and Mexico, will expand at higher rates than in 2005.

47. Although the serious risks facing the world economy have not disappeared altogether, and since imbalances in the United States economy persist, no sudden changes are anticipated in 2006; the global economy is therefore expected to grow at much the same pace as in 2005. Despite the increase in short-term interest rates triggered by the rate increase by the United States Federal Reserve, longer-term rates have changed much less owing to the scarcity of investment plans and, consequently, the weaker relative demand for long-term financial resources. The flattening of the yield curve on international financial markets suggests that profit-seeking on capital markets will help to prolong the favourable conditions now being enjoyed by emerging economies.

48. Thanks to above conditions and the benefits they have yielded for Latin America and the Caribbean over the past few years, the region may be able to further improve its debt profiles and thus continue to reduce its vulnerability to external factors. In many of the countries, the strategy would best be coupled with a continued effort to achieve primary fiscal surpluses, which can then be drawn upon to pay down the debt. In addition, given the current sound fiscal basis, it appears to be a good time for regional Governments to reform the tax structure, in order to ensure that they receive a sufficient inflow of revenues and that those receipts are not dependent upon the price trends of non-renewable commodities.

49. If current forecasts regarding financial returns are borne out, the favourable conditions that emerging markets will continue to enjoy will keep exerting pressure on supply in foreign exchange markets. In such circumstances, the region’s central banks will have to work to strike a balance between the need to avoid any loss of

competitiveness and the maintenance of a firm stance in preserving domestic macroeconomic stability.

50. The region's democracies are expected to meet the challenge, as they have in the past, of ensuring that the elections that many of them are holding in late 2005 and 2006 will not negatively influence their macroeconomic situation. However, in order to achieve a growth rate high enough to reduce poverty more quickly, reforms are needed in a number of areas, including the tax structure, social expenditure, regulation and competition in some sectors. The countries should therefore take advantage of the current period of intense political activity to build a broad social and political consensus as a basis for strengthening governance and leveraging the region's future growth prospects by enhancing its ability to attract more investment.

51. In the medium term, the need to maintain a high level of competitiveness calls for a more rapid increase in investment and the use of a policy strategy for enhancing the quality and content of the value that the countries add to their exports. Both elements are necessary conditions for sustaining a growth rate high enough to lower the region's still high levels of unemployment and thus help to mitigate the social imbalances that beset the region.