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## Situation and outlook for Latin America and the Caribbean 2014-2015

### Note by the Secretary-General

The Secretary-General has the honour to transmit herewith a report on the situation and outlook for Latin America and the Caribbean for the period 2014-2015.

# Situation and outlook for Latin America and the Caribbean 2014-2015

[Original: Spanish]

*Summary*

In 2014 the Latin American and Caribbean economy continued the slowdown that began after the upturn of 2011, when the region emerged from the aftermath of the global financial crisis. At a modest 1.1 per cent, the region's 2014 growth rate represented a virtual standstill in per capita gross domestic product (GDP). As well as specific aspects of economic performance in each country, this regional rendering reflected the slack global growth and its differentiated impacts on the economies.

Falling prices for the region's principal export commodities worsened the terms of trade and kept the current account deficit at 2.7 per cent of regional GDP, despite the contraction of imports.

Domestic demand was not strong enough to offset weak external demand. The contribution of consumption to growth fell sharply, and gross fixed capital formation contracted at the regional level, albeit with large differences from one country to another.

The insipid economic growth weakened job creation, especially wage employment. Nevertheless, thanks to a heavy decline in the participation rate, the drop in the employment rate did not push up unemployment, which came down again, although only slightly, from 6.2 per cent a 6.0 per cent. With unemployment low and inflation stable, real wages rose moderately in most of the countries.

Fiscal policy efforts were geared towards expansionary measures to contain the slowdown, which contributed to a wider deficit — 2.7 per cent of GDP in 2014 compared with 2.4 per cent in 2013 — although again with significant differences among countries. On the monetary and exchange-rate front, countries in the region adopted a clearly countercyclical approach in 2014, regardless of policy regime. More emphasis was placed on stimulating aggregate demand and setting and monitoring medium-term inflation targets.

The region continues to post modest economic growth in 2015, with a projected rate of 1.0 per cent. There are sharp differences between the subregions in this regard; however, projections are 4.0 per cent for Central America, 3.0 per cent for Mexico, 1.9 per cent for the English- and Dutch-speaking Caribbean and 0.0 per cent for South America.

# I. Introduction

1. In 2014 the Latin American and Caribbean economy continued the slowdown that began after the upturn of 2011, when the region emerged from the aftermath of the global financial crisis. At 1.1 per cent the region's 2014 growth rate represented a virtual standstill in per capita GDP). As well as specific aspects of economic performance in each country, this regional rendering reflected the slack global growth and its differentiated impacts on the economies.

2. Falling prices for the region's principal export commodities worsened the terms of trade and kept the current account deficit at 2.7 per cent of regional GDP, despite the contraction of imports.

3. Domestic demand was not strong enough to offset weak external demand. The contribution of consumption to growth fell sharply, and gross fixed capital formation contracted, although with large differences from one country to another.

4. The insipid economic growth weakened job creation, especially wage employment. Nevertheless, thanks to a heavy decline in the participation rate reflecting the procyclical behaviour of the region's labour supply, the drop in the employment rate did not push up unemployment, which edged down again. With unemployment low and inflation stable, real wages rose moderately in most of the countries.

5. Fiscal policy efforts were geared towards expansionary measures to contain the slowdown, which contributed to a wider deficit — 2.7 per cent of GDP in 2014 compared with 2.4 per cent in 2013 — although again with significant differences among countries. In Latin America public debt remained contained at about 32 per cent of GDP. Some of the Caribbean countries still have high debt burdens, however, with an average of 80 per cent of GDP for the subregion, including a significant external component.

6. On the monetary and exchange-rate front, countries in the region adopted a clearly countercyclical approach in 2014, regardless of policy regime. More emphasis was placed on stimulating aggregate demand and setting and monitoring medium-term inflation targets. At the same time, authorities sought to mitigate the effects of external volatility on the region's financial markets by using international reserves and making changes to macroprudential regulations.

7. The region has continued to post modest economic growth in 2015, with a projected rate of 1.0 per cent. There are sharp differences between the subregions in this regard: projections are 4.0 per cent for Central America, 3.0 per cent for Mexico, 1.9 per cent for the English- and Dutch-speaking Caribbean and 0.0 per cent for South America.

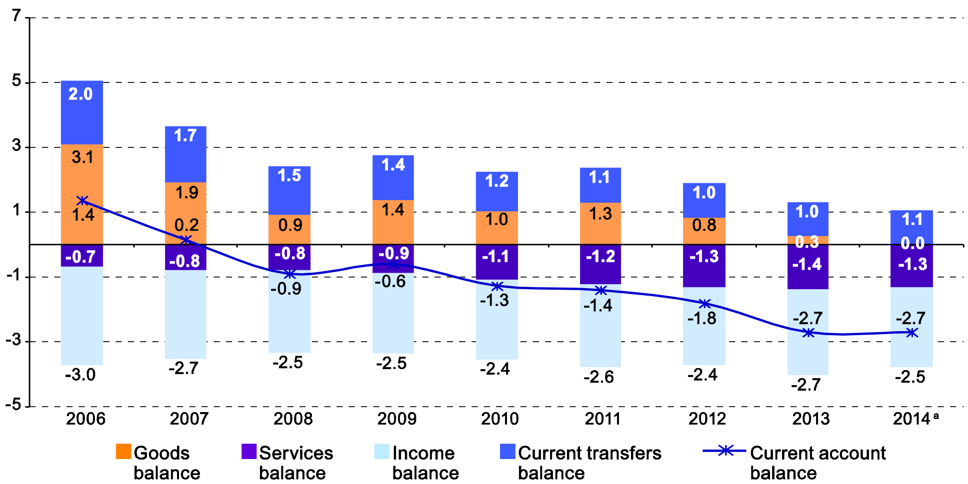
# II. The external context and its impact on Latin America and the Caribbean

8. Global growth picked up slightly in 2014 to 2.6 per cent (compared with 2.5 per cent in 2013), leading to an equally weak increase in world trade with respect to the previous year. However, the various country groupings showed very different performances and the stronger growth of the developed countries (the end of the contraction in the eurozone and stronger growth in the United States), was almost completely offset by the slower growth in the transition and developing economies.

9. The international financial markets continued to show relatively high liquidity and limited risk perception. These markets' interest rates remained low, with no surge ensuing after the withdrawal of monetary stimulus in the United States, although financial flows did show some volatility in 2014. The European Central Bank embarked upon a programme of quantitative easing, which was expanded in 2015.

10. Global conditions affected the performance of the external sector in Latin America and the Caribbean in various ways, and the region's current account deficit remained at the same level as in 2013 (2.7 per cent), breaking a four-year run of widening deficits (see figure I).

Figure I
**Latin America: current account structure, 2006-2014**
(Percentages of GDP)




*Source*: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary data.

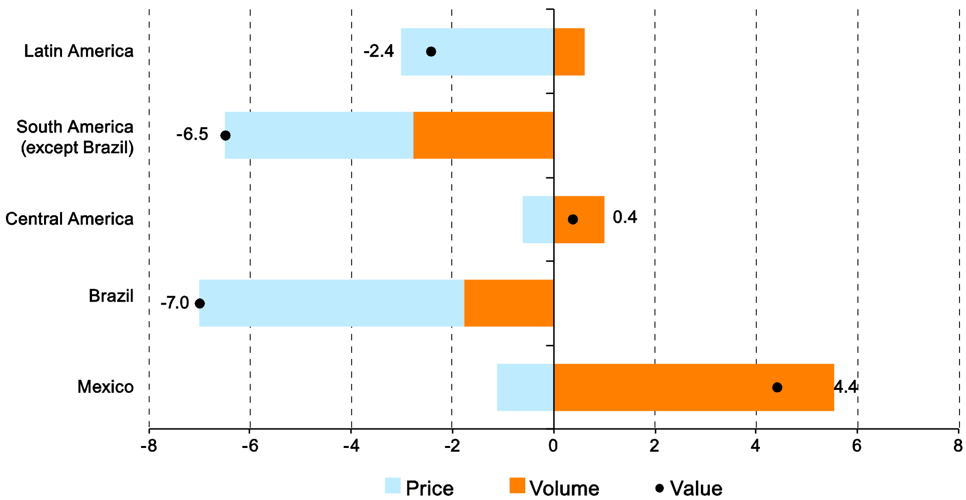
11. In a context of slow growth in the regional economy and in global trade, the goods trade balance worsened as a proportion of GDP (from 0.3 per cent in 2013 to 0.0% in 2014), since imports fell less than exports.

12. The drop in export values was attributable chiefly to a fresh downtrend in prices for raw materials, especially in the second half-year, although unevenly from one country to another. Average prices for the region's basket of raw materials were down by 24.4 per cent year-on-year in December 2014, following a drop of 2.7 per cent in 2013. Metals prices were down by 21.9 per cent year-on-year in December 2014, compared with 8.9 per cent in 2013. Prices for foods, tropical beverages and oils and oilseeds fell by 7.4 per cent, versus a drop of 5.6 per cent in 2013. Lastly, the price of energy, after showing a rise of 3.2 per cent in December 2013, plunged 37.3 per cent in 2014. In particular, oil prices slumped heavily in the second half, with a drop of 44.1 per cent between June and December 2014. On average for the year, the oil price was down by 6.4 per cent compared with 2013, owing mainly to the weakness of demand in the European Union and China, in a context of stable global supply.

13. Consequently, sluggish external demand and rising commodity supply in some markets (oil and gas, soybeans and copper) also caused a drop in external prices (unit export values fell by 3.0 per cent), which countered the region's export effort and pulled down export values (-2.4 per cent) more heavily than in 2013 (-0.3 per cent).

14. As figure II shows, South America sustained a drop in export prices and volumes, whereas in Mexico export volumes rose but unit prices fell.

Figure II
**Latin America: estimated variation in export values, by volume and price, 2014**
(Percentages)




*Source*: ECLAC, on the basis of official figures.

15. Mexico, Central America and the Caribbean services-exporters benefited from steady economic recovery in the United States, the main export destination for several of these countries.

16. Imports, too, showed a differentiated pattern by subregion. In most South American countries, the sharp slowdown in domestic demand led to heavy falls in import volumes (-4.1 per cent). By contrast, import volumes continued to climb in Colombia, Mexico and most of the Central American countries. The overall result was that import values for Latin America as a whole contracted for the first time since 2009, by 1.0 per cent.

17. The differentiated developments regarding external trade prices led to a 2.3 per cent terms-of-trade loss for the region overall, but with a mixed performance across the region. In South America and Mexico the downturn (of 2.7 per cent and 1.8 per cent, respectively) was the result of falling prices for export commodities.

18. The terms of trade for the Central American countries, Haiti and the Dominican Republic climbed by 1.4 per cent, thanks to rising prices for some of the subregion's export products and to falling prices for energy imports. Terms of trade for the Caribbean food- and fuel-importing economies ( not including Trinidad and Tobago) rose by 2.0 per cent.

19. Tourism in the region picked up somewhat, especially in Mexico and Central America, which helped to narrow the deficit on the services trade balance (from 1.4 per cent in 2013 in 1.3 per cent of GDP in 2014). International tourist arrivals in Mexico actually rose by a hefty 19.3 per cent in the first 11 months of 2014. The tourism sector grew faster in Mexico than in any other country in the region, thanks to economic recovery and increasing consumer confidence in the United States. Tourist arrivals were also up in the Caribbean (by 6.6 per cent) and in the Central American countries (5.7 per cent), for the same reason. In the case of South America, the football world cup contributed to a rise in tourist arrivals (5.7 per cent).

20. Although higher flows of family remittances from the United States were partially offset by smaller remittances coming from Spain, the overall result was an improvement in the transfer balance, which edged up to 1.1 per cent of GDP in 2014, from 1.0 per cent in 2013. Specifically, the upturn in the United States labour market led to a strong gain in remittances to Mexico (up 8 per cent in 2014) and to Central America and the Dominican Republic (9.9 per cent in both cases). Because of the persistently poor economic situation in Spain, remittance flows into the South American countries which receive most of their remittances from that country (Bolivia (Plurinational State of), Colombia, Ecuador and Paraguay) fell by a heavy 4.8 per cent.

12. Lastly, the deficit on the income balance narrowed (from 2.7 per cent of GDP in 2013 to 2.5 per cent in 2014) thanks to smaller remittances of profits on foreign direct investment (FDI), as a result of the lower prices for the region's export commodities during the year.

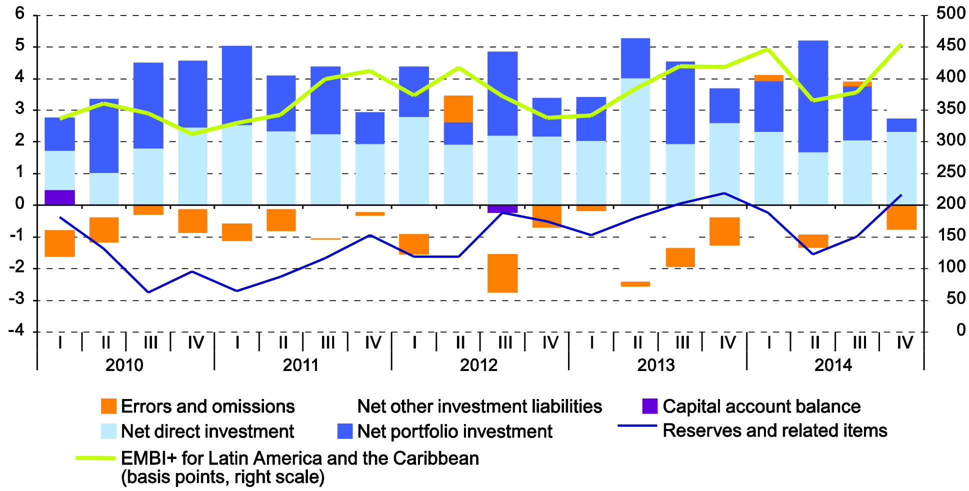
22. With regard to the financial account, in 2014 the region in general retained ready access external financing. The net flow of financial resources into the region was more than enough to cover the balance-of-payments current account deficit, and the stock of international reserves of the region overall expanded by about 3 per cent.

23. However, as shown in figure III, the current account behaved differently in the first and second halves of the year. In the second half, net flows of capital into the region declined and shifted in structure: FDI remained stable while portfolio investments fell sharply.

Figure III

**Latin America (18 countries): components of the capital and financial account and the balance of payments and average sovereign risk, quarterly,[a] 2010-2014[b]**

(Percentages of GDP and basis points)




*Source*: ECLAC, on the basis of official figures.

[a] According to the Emerging Markets Bond Index (EMBI+).

[b] The data for the final quarter of 2014 do not include the Bolivarian Republic of Venezuela owing to lack of information.

24. This decline in portfolio flows occurred in parallel with a relative increase in average sovereign risk in the countries of the region; the spread on the EMBI+ index for the region — which had narrowed in the second quarter of 2014 — widened again in the third and fourth quarters and closed the year at 508 basis points.

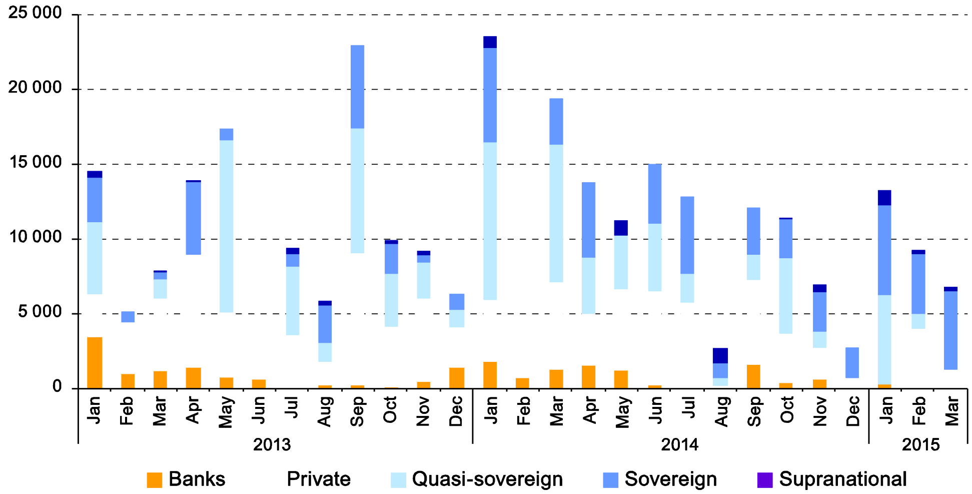
25. Sovereign spreads rose slightly (just 10 basis points on average) for almost all the countries in 2014. The exceptions were the Bolivarian Republic of Venezuela and Ecuador, which are both highly dependent on exports of hydrocarbons and therefore very exposed to the effects of the sudden steep fall in oil prices. For those two countries, sovereign risk expanded by 1,356 and 353 basis points, respectively, to reach 2,457 and 883 basis points at the end of 2014.

26. Bond issues in the external market reached a record figure of $ 133 billion in 2014. Issues increased significantly in the first half of the year, chiefly because of the steep rise in sovereign, quasi-sovereign and State bank issues. In this period, Brazil, Chile and Mexico were especially active in the external bond markets in a context of still-low interest rates.[1]

27. In the second half of 2014, however, issues dropped to just over half the level in the first half-year ($49 billion, compared with $84 billion in the first semester) (see figure IV).

[1] ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean*, (United Nations publication, Sales No. E.15.II.G.2).

Figure IV
**Latin America and the Caribbean: external bond issues by institutional sector, January 2013-March 2015**
(Millions of dollars)




*Source*: ECLAC, on the basis of figures from the Latin Finance Bonds Database, JP Morgan and Merrill Lynch.

28. Much of this fall reflects the downturn in quasi-sovereign issues, especially in Brazil. The State oil company, Petrobras, which issued large amounts in January and March 2014, has not returned to the market since and shows no signs of doing so in the near future.

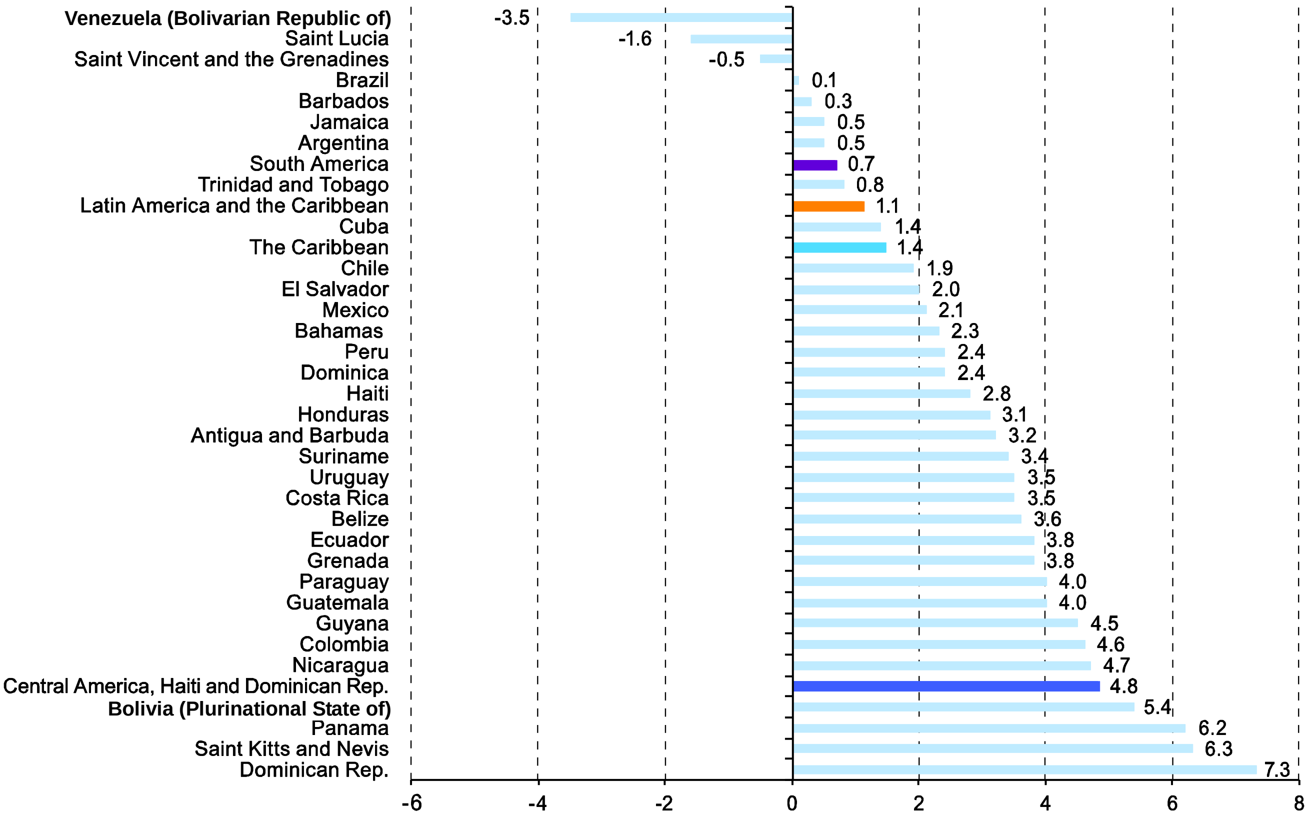
# III. Economic growth, employment and wages

## A. Economic activity

29. The GDP of the Latin American and Caribbean region grew by 1.1 per cent in 2014, which was the slowest rate of expansion since 2009 and translated into a standstill in regional per capita GDP. The sluggish regional performance was largely determined by slow or negative growth in some of the largest economies, especially Argentina, Brazil and Venezuela (Bolivarian Republic of). Nevertheless, there were substantial differences in growth rates from one country to another.

30. The region's fastest-growing economies were the Dominican Republic and Panama, followed by the Plurinational State of Bolivia, Nicaragua, Colombia and Guyana, then Guatemala and Paraguay. By subregion, South America posted economic expansion of 0.7 per cent (as against 2.8 per cent in 2013), while Central America expanded by 3.7 per cent (4.0 per cent in 2013). The Caribbean economies (not including Cuba, the Dominican Republic or Haiti) carried the 2013 growth rate of 1.4 per cent through to 2014, a stronger rate than in previous years and the highest since 2008 (see figure V).

Figure V
**Latin America and the Caribbean: GDP growth rates, 2014[a]**
(Percentages, on the basis of dollars at constant 2010 prices)




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

31. The pattern of economic activity was differentiated in the region throughout 2014. The slowdown took firmer hold in the second quarter, as investment contracted in several South American economies and consumption weakened across the board. The third quarter brought the beginnings of an upturn in economic activity which carried over into the fourth quarter, but was not enough to offset the poor showing of the first three quarters or to regain the rate from early in the year.

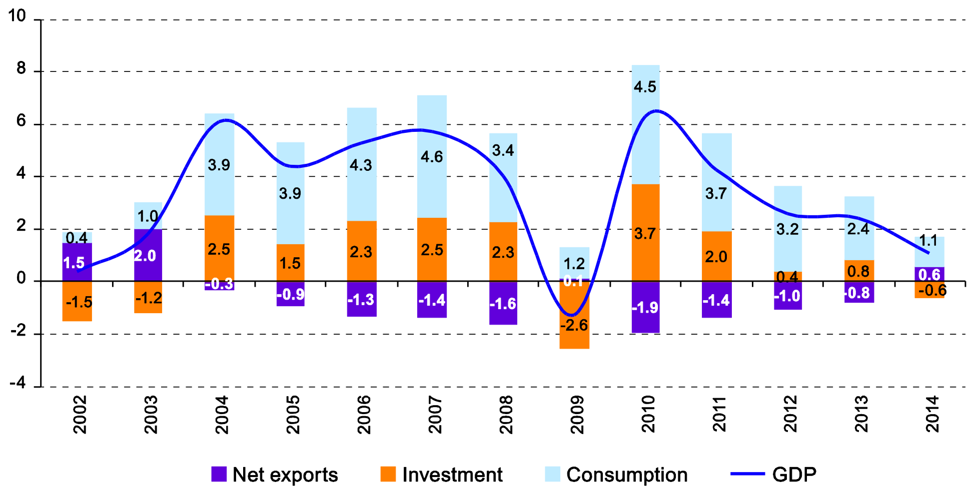
32. The lacklustre regional growth may be attributed in large part to a slowdown in private consumption which, in turn, reflected weak job creation and slacker credit growth in the financial system. This was in addition to the contraction in gross fixed capital formation attendant on lower economic growth and, in some countries, the contraction of the construction sectors, as well as a fall across the board in investment in machinery and equipment.

33. Gross fixed capital formation contracted by almost 1.5 per cent, which translated into a drop in the investment rate at the regional level. Measured as a percentage of GDP based on dollars at constant 2010 prices, the regional investment rate dropped to 19.7 per cent of GDP — below the 2010 figure (19.8 per cent) — having hovered at about 20.5 per cent between 2011 and 2013.

34. Net exports made a positive, although slight, contribution to regional growth, since exports of goods and services posted stronger growth (about 2.0 per cent), in real terms, than in 2013 (-0.6 per cent). The upturn in exports was strongest in Mexico and some Central American economies, which benefited from the economic upswing in the United States and a recovery in tourism, an important source of foreign exchange for these countries. Imports of goods and services stagnated in real terms, reflecting slower growth in private consumption and the contraction in gross fixed capital formation (see figure VI).

Figure VI
**Latin America: GDP growth rate and contribution to growth by the components of domestic demand and net exports, 2002-2014[a]**

(Percentages and percentage points, on the basis of US dollars at constant 2010 prices)



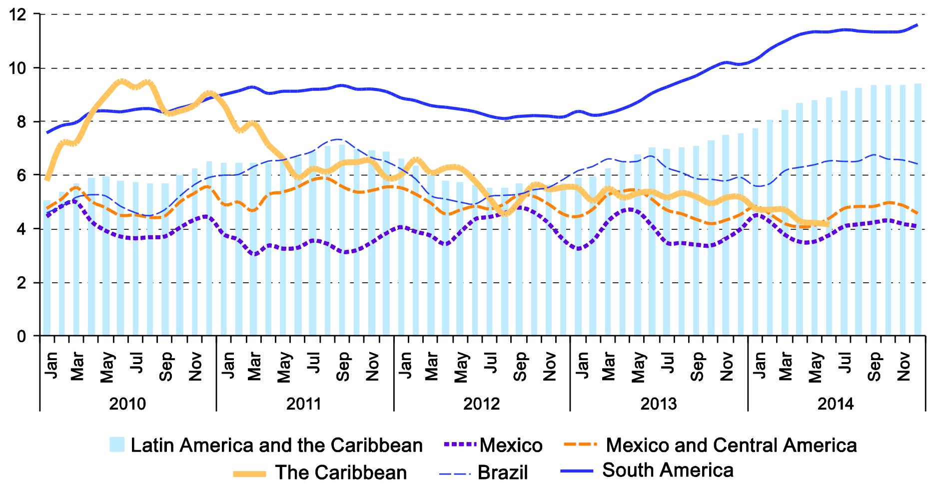

*Source*: ECLAC, on the basis of official figures.
[a] Preliminary figures for 2014.

## B. Domestic prices

35. Cumulative 12-month inflation in the Latin American and Caribbean region was 9.2 per cent to October 2014, compared with 7.6 per cent % in December 2013. Inflation rose above the 2013 figure in most of the countries, but with significant differences between them. The regional figure is heavily influenced by the two-digit rise in inflation registered in Argentina and the Bolivarian Republic of Venezuela.

36. The rate of inflation was 8.3 per cent in the 12 months to December 2014 in Uruguay, and 9.0 per cent and 7.8 per cent, respectively, in the 12 months to September in Jamaica and Trinidad and Tobago. Consumer inflation was lowest in El Salvador (0.5 per cent), the Bahamas (0.2 per cent), Belize (0.7 per cent) and some economies of the Eastern Caribbean Currency Union. By subregion, South America posted the highest average rate, at around 11.6 per cent, with Central America and Mexico posting rates slightly over 4 per cent on average. Several economies in the Caribbean also saw inflation rise over the December 2013 figure (see figure VII).

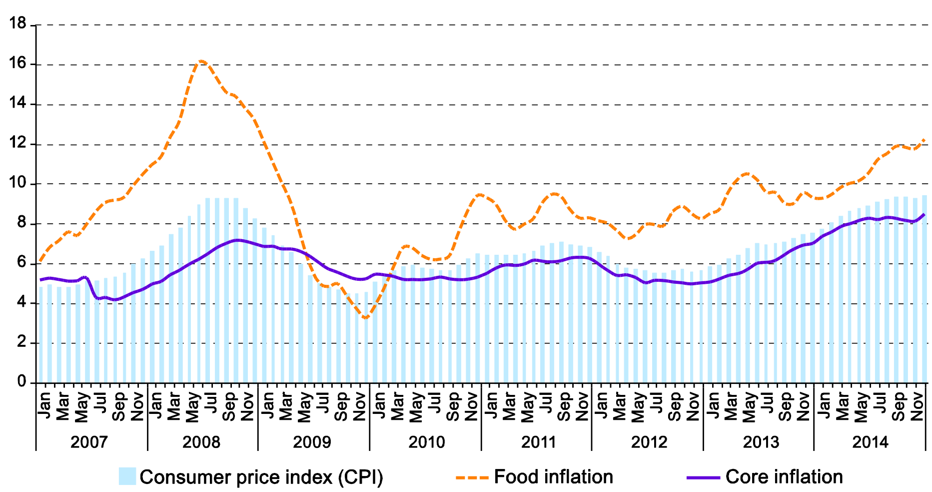
Figure VII
**Latin America and the Caribbean: 12-month cumulative variation in consumer price index, 2010-2014**
(Percentages)




*Source*: ECLAC, on the basis of official figures.

37. The higher regional inflation figure reflected a rise in both food prices and core inflation. Food inflation ticked up sharply as of May 2014, and core inflation increased in most of the countries in the first half of the year. In the regional average, food prices were up by 12.2 per cent in the 12 months to December 2014 (as against a 9.3 per cent cumulative rise in the 12 months to December 2013 and 8.3 per cent in 2012), while core inflation rose to 9.1 per cent in the 12 months to October 2014, compared with 7.0 per cent in the 12 months to December 2013 and 5.1 per cent in 2012 (see figure VIII).

Figure VIII
**Latin America and the Caribbean: 12-month cumulative rates of consumer price inflation, food inflation and core inflation, 2007-2014**
(Percentages)



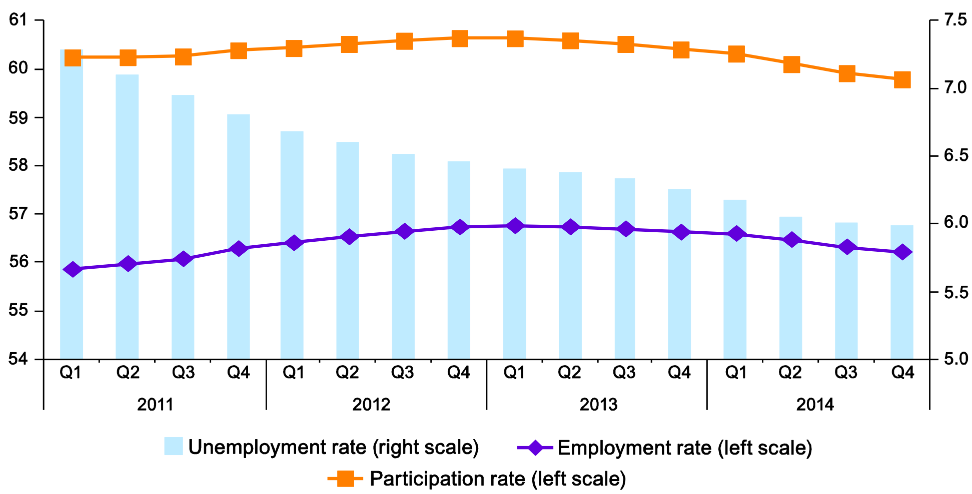

*Source*: ECLAC, on the basis of official figures.

## C. Employment and wages

38. The patterns of the main labour variables in 2013 carried over into 2014 in Latin America and the Caribbean, with sluggish economic growth keeping labour demand subdued and limiting growth in the number of wage workers, which led to a fall in the employment rate. The region's participation rate also continued to fall faster than the employment rate, however, so urban unemployment eased down once again, notwithstanding the lacklustre economic conditions. For 2014 overall, the urban employment rate is estimated to have edged down to 56.5 per cent from 56.8 per cent in 2013, and urban participation to 60.1 per cent in 2014 from 60.6 per cent in 2013. As a result, the region's open unemployment rate came down again, although slightly, from 6.2 per cent to 6.0 per cent. The number of urban unemployed is estimated to have fallen by 300,000, to about 13.2 million.

39. Until 2012 (except for 2009), declining unemployment reflected a faster rise in employment than in participation, but in the rolling year from the third quarter of 2012 to the second quarter of 2013, when regional employment came down slightly, it was instead the result of a reversal in the participation rate, which began to fall faster than employment. As shown in figure IX, this pattern took firmer hold in 2014, with a steeper decline in both participation and employment.

Figure IX
**Latin America and the Caribbean (10 countries):[a] participation, employment and unemployment rates, rolling years, first quarter 2011 to fourth quarter 2014**
(Percentages)



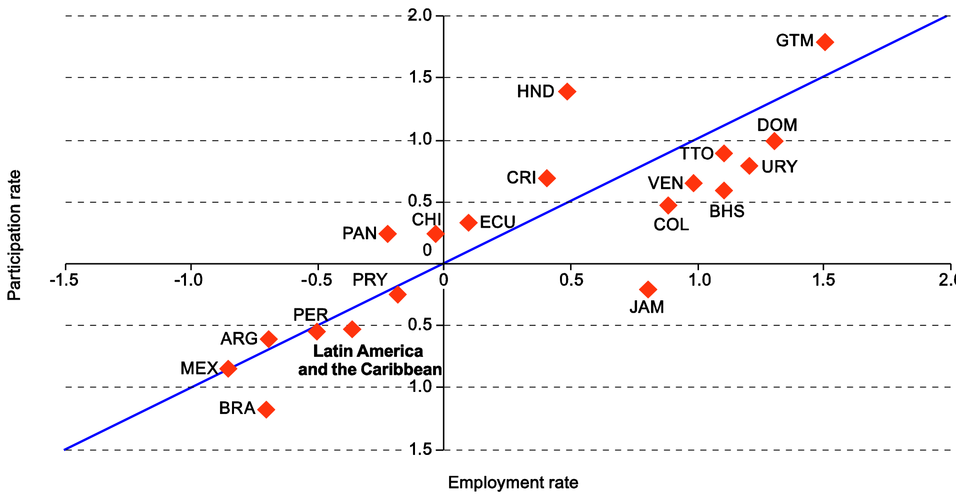

*Source*: ECLAC, on the basis of official figures.
[a] Argentina, Brazil, Chile, Colombia, Ecuador, Jamaica, Mexico, Peru, Uruguay and Venezuela (Bolivarian Republic of).

40. At the same time, this pattern regarding the main labour variables in the region did not occur evenly across all the countries. Figure X shows variation in the participation and employment rates for a group of countries in Latin America and the Caribbean. The diagonal line separates the countries with rises and falls in the unemployment rate. Brazil was the only country in which unemployment declined because of participation falling more than employment. However, a lower

participation rate also averted a hefty rise in unemployment in Peru and contained the increase in Argentina and Mexico. By contrast, the employment rate rose in several countries and helped to bring down unemployment in some of them, though not all. In fact, among the 18 countries for which these data are available, apart from Argentina and Mexico as mentioned above, only Chile, Costa Rica, Ecuador, Guatemala, Honduras and Panama posted (slightly) higher urban unemployment.

Figure X
**Latin America and the Caribbean (18 countries): variation in urban participation and employment rates, average for 2014 with respect to average for 2013**

(Percentage points)




*Source*: ECLAC, on the basis of official figures.

41. However, the cooling of economic growth at the regional level could not avoid impacting on labour demand. This took the form of weak wage employment creation in many countries, including Argentina, Brazil, Chile, Panama, Paraguay and Peru, where this category of employment grew less than 1 per cent or the absolute numbers contracted.

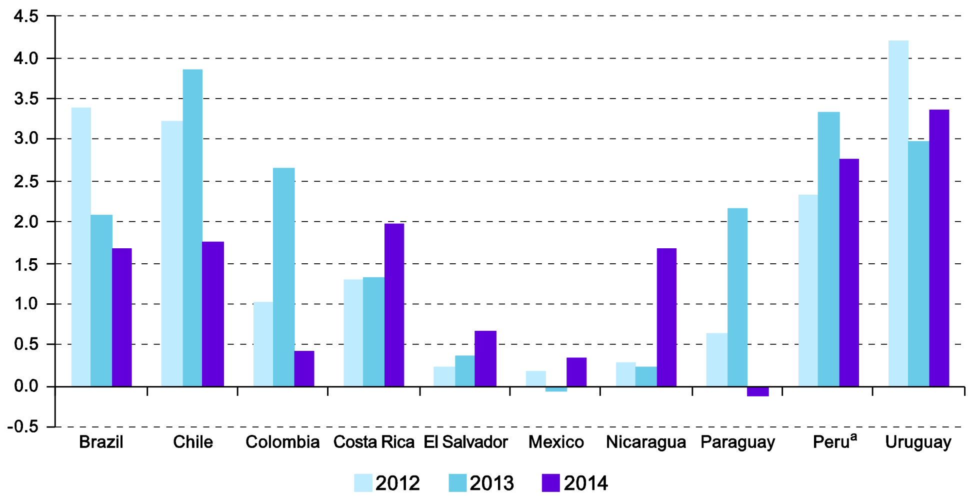
42. Own-account employment, which is usually of poorer quality than wage employment, expanded more than total employment in most of the countries, suggesting an incipient resurgence in informal activities in the context of weak labour demand from firms. In the median for 11 countries, total employment expanded 1.5 per cent, as did wage employment, while own-account employment grew 3.3 per cent.

43. The weaker creation of quality employment was also observed in the data on the evolution of registered employment. Although formal employment continued to expand in the yearly average in all the countries for which information is available, it did so at falling rates which in very few cases exceeded 2 per cent. The main exception was Mexico, where policies recently launched to encourage employment formalization helped to increase the momentum in employment registration in the second half of 2014, leading to an annual rate similar to that of 2013.

44. The fact that the region's labour markets were not yet under heavier supply-side pressure in 2014, which would have generated new imbalances, was reflected not only in the falling participation rate and the fact that there was no strong expansion of the informal sector, but also in the evolution of formal sector real wages. In the simple average for the countries, real wages rose 1.8 per cent, similarly to the 2013 figure. However, they rose less than in 2013 in almost all the South American countries for which information is available, while in the Central American countries with information available and in Mexico, they rose above 2013 rates.

Figure XI
**Latin America (selected countries): variation in real average wage in formal employment, 2012-2014**

(Percentages)




*Source*: ECLAC and the International Labour Organization (ILO), on the basis of official information from the countries.

[a] Refers to dependent workers in Metropolitan Lima.

45. Real wage stability or slight rises were aided by minimum wage policies. In the simple average for 20 countries, real minimum wages were up by 3.1 per cent, with two-digit increases in the Plurinational State of Bolivia and Panama. The minimum wage rose below inflation or not at all in a very few countries only.

# IV. Economic policy responses in Latin America and the Caribbean

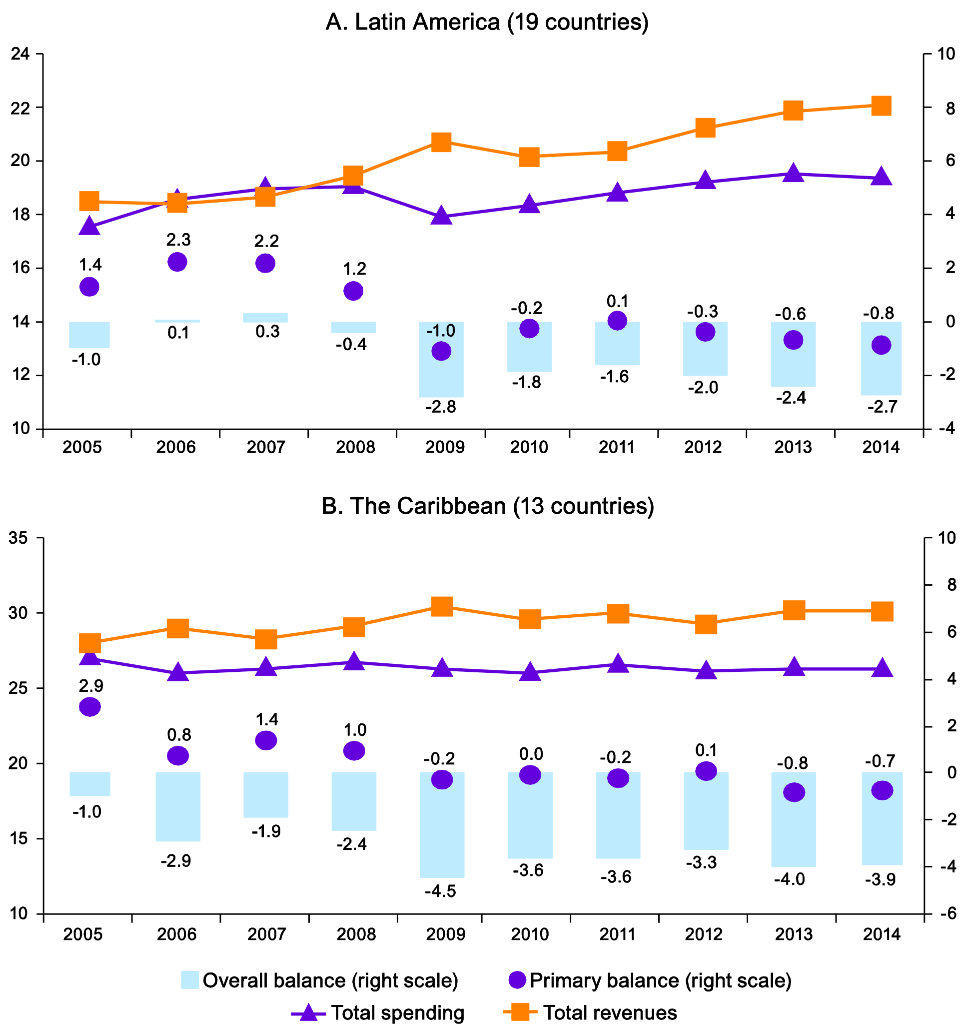
## A. Fiscal policy

46. Preliminary information on the fiscal accounts of Latin America and the Caribbean show the fiscal balance deteriorating slightly, on average, in 2014. The region's primary deficit (before public debt interest payments) is expected to stand at 0.8 per cent of GDP, and the overall central government deficit will widen from 2.4 per cent of GDP in 2013 to 2.7 per cent in 2014 (see figure XII), with a drop in

total revenues and a slight upturn in public spending. The region as a whole has posted a fiscal deficit since 2009, but this has not pushed up public debt, which has held steady at about 32 per cent of GDP, with an external component of less than 15 percentage points of GDP.

47. The Caribbean should see its fiscal position remain relatively stable in 2014, with the overall average deficit at the central government level shrinking from 4.0 per cent of GDP in 2013 to 3.9 per cent in 2014 (see figure XII). Nevertheless, the subregion's debt levels remain high, at close to 80 per cent of GDP on average, with a substantial external component.

Figure XII
**Latin America and the Caribbean: central government fiscal indicators, 2005-2014[a]**
(Percentage of GDP)




*Source*: ECLAC, on the basis of official figures.
[a] Simple averages. The data for 2014 are estimates.

48. Total fiscal revenues fell in the oil-exporting countries and tax revenues rose slightly in several of the region's economies. Estimates for Latin America show total fiscal revenues down by 0.2 percentage points of GDP on average in 2014. In 12 of the 19 countries analysed, the year-on-year variation was less than 0.5 percentage points of GDP, though some countries did see more significant changes. Fiscal revenues rose markedly in Argentina (by the equivalent of 2.9 percentage points of GDP), Honduras (1.8 percentage points) and the Dominican Republic (0.6 percentage points). By contrast, fiscal revenues fell considerably in Venezuela (Bolivarian Republic of) (3.7 percentage points), Haiti (1.8 percentage points), Ecuador (1.7 percentage points) and Mexico (1.3 percentage points).

49. The performance of tax revenues in the Caribbean diverged by type of exporter, falling in countries that export non-renewable natural resources but climbing strongly in exporters of services, thanks to the economic upturn.

50. Several countries in the region have carried out tax reforms in recent years.[2] Although a variety of changes have been made, one of the most notable developments with respect to previous decades has been the focus on income tax, not only for the purpose of improving revenue collection, but also to strengthen one of the weakest points of regional fiscal policy: the impact of tax systems on income distribution.

51. Overall, the countries of the region were able to maintain public spending and investment as a percentage of GDP. Capital spending also held steady or even increased as a share of GDP in many countries in 2014. It was down in Central America and the Dominican Republic, however, as well as in the oil-exporting countries, which nevertheless — especially in the case of Ecuador and the Plurinational State of Bolivia — kept up very high levels of public investment.

52. The countries with low public debt (and therefore more readily available financing) have reacted to the slowdown with more active fiscal policies. In Peru, a set of initiatives adopted in November 2014, with a view to accelerating growth and reducing the costs and time frame for the implementation of public and private investment projects, is expected to give a boost equivalent to 2 per cent of GDP. Chile has lined up an expansionary budget for 2015, increasing spending on non-financial assets (investment and capital transfers) by 27.5 per cent. Meanwhile, the upward trend in investment spending will continue in the Plurinational State of Bolivia, with much of it going to the infrastructure sector.

53. In countries with higher levels of public debt or financing difficulties, the weaker public accounts forecast for 2015 have prompted announcements of budget cuts for the year ahead. In this regard, spending containment measures should take into account the need to protect investment and avoid vicious circles whereby fiscal overadjustments strangle growth and tax revenues, ultimately widening the deficit and increasing the public debt burden.

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[2] See ECLAC, *Fiscal Panorama of Latin America and the Caribbean: Tax reform and renewal of the fiscal covenant* (LC/L.3580), Santiago, Chile, 2013; J. Gómez-Sabaini and D. Morán, "Tax policy in Latin America: Assessment and guidelines for a second generation of reforms", *Macroeconomics of Development* series, No. 133 (LC/L.3632), Santiago, Chile, 2014.

## B. Monetary, exchange-rate and macroprudential policies

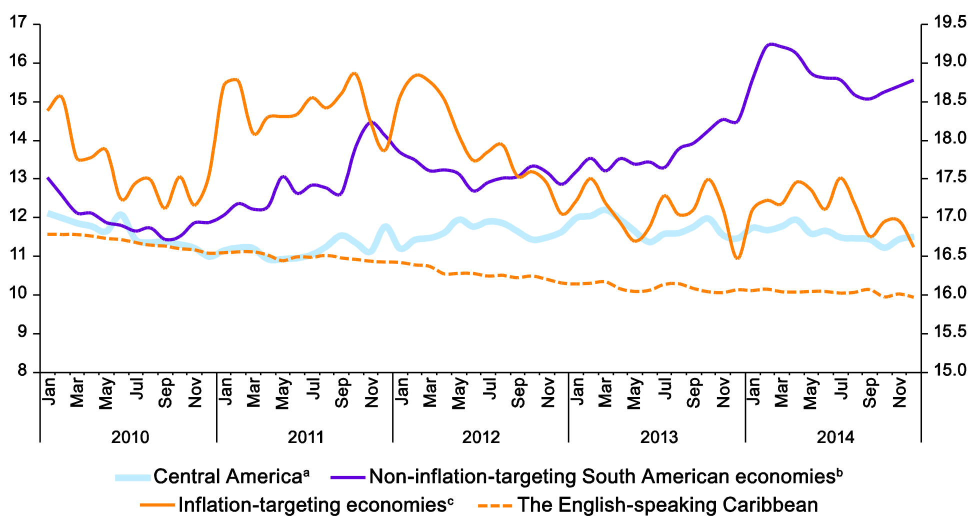
54. On the monetary and exchange-rate front, countries in the region adopted a mainly countercyclical approach in 2014, regardless of policy regime. More emphasis was placed on stimulating aggregate demand and setting and monitoring medium-term inflation targets. At the same time, authorities sought to mitigate the effects of external volatility on the region's financial markets by using international reserves and making changes to macroprudential regulations.

55. Thus, in Chile, Mexico and Peru, three of the five economies that use inflation targeting, monetary authorities reduced policy rates to stimulate aggregate domestic demand, even though inflation breached the upper limit of the target range in 2014. In Brazil and Colombia, the authorities adopted a prudent stance and increased policy rates as the gap between utilized and installed capacity narrowed and consumption growth threatened to exceed forecast scenarios.

56. In most of the economies that use monetary aggregates as their principal policy instrument, the monetary base grew at a slightly faster pace in 2014. Since mid-2013 the expansion of the monetary base had been slowing in most of the region's economies, but this trend was reversed in 2014.

57. This monetary policy slant has led to a marked reduction in lending rates in the inflation-targeting economies (except Brazil), in the English-speaking Caribbean and, to a lesser extent, in Central America. In the non-inflation-targeting South American economies, average lending rates were higher than in 2013, though they did fall in absolute terms over the year, as in the rest of the region.

Figure XIII
**Latin America and the Caribbean: average lending rates by subregion, 2010-2014**
(Percentages)




*Source*: ECLAC, on the basis of official figures.

[a] Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Panama.

[b] Argentina, Bolivia (Plurinational State of), Ecuador, Paraguay, Uruguay and Venezuela (Bolivarian Republic of).

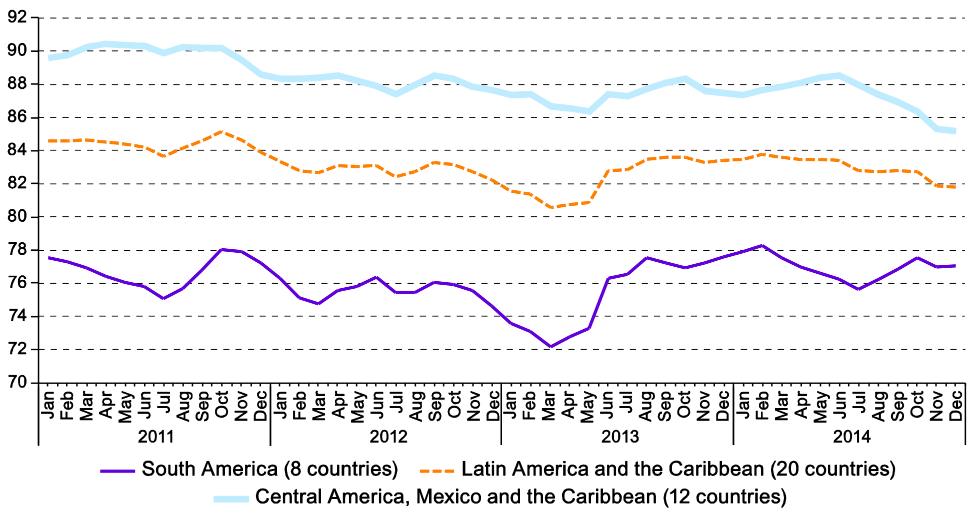
[c] Brazil, Chile, Colombia, Mexico and Peru.

58. However, despite the monetary stimulus and predominantly declining interest rates, growth in domestic credit to the private sector continued to slow in 2014. The exception was the South American economies, where this variable picked up somewhat, especially in the Bolivarian Republic of Venezuela. The prevailing conditions in international financial markets, particularly the announcements of monetary policy normalization in the United States, heightened exchange-rate volatility in the region and resulted in the depreciation of some currencies under flexible exchange-rate regimes. The Brazilian real, the Chilean peso and the Colombian peso continued to reflect the volatility seen since late 2013, when the United States Federal Reserve announced the tapering of its liquidity injection programme. Between December 2013 and December 2014, the Chilean peso depreciated by 16 per cent, the real by 13 per cent and the Mexican peso by 12 per cent. In the same period, the Colombian peso declined by 22 per cent and the Peruvian sol by 6 per cent.

59. These exchange-rate developments, together with the relative paces of inflation in the region's economies, resulted in an appreciation of the real effective extraregional exchange rate, especially in the economies of South America.

Figure XIV
**Latin America and the Caribbean: real effective extraregional exchange rates, 2011-2014**

(Index: 2005=100)




*Source*: ECLAC, on the basis of official figures.

60. In response to these developments, authorities in the region drew on international reserves in order to mitigate exchange-rate volatility. The central banks of Costa Rica, the Dominican Republic, Jamaica, Peru and Trinidad and Tobago, among other economies, intervened in the foreign-exchange markets in an effort to stave off local currency depreciation, while authorities in other economies, including Colombia, maintained their foreign-currency purchase programmes, thus boosting their reserve position.

61. In spite of these efforts to reduce exchange-rate volatility, the level of international reserves rose slightly from $830 billion in December 2013 to

$857 billion in December 2014. Nevertheless, the pace of reserve accumulation in 2014 was considerably slower than in the period before 2012. Reserves edged up from 14.0 per cent of GDP in 2013 to 14.4 per cent in 2014, but remained below the late-2012 level of 14.5 per cent.

62. The countries of the region continued to strengthen financial sector regulation and oversight and adapt their management of reserves and capital flows to the new external context. In 2014 several changes were made to macroprudential regulations with respect to the following areas: (a) legal reserve requirements on bank deposits in Bolivia (Plurinational State of), Brazil, Peru and Venezuela (Bolivarian Republic of); (b) minimum capital requirements for financial institutions in Brazil and Nicaragua; (c) investment limits on the basis of residency or currency criteria in Argentina, Costa Rica, Jamaica, Peru and Uruguay; and (d) the regulatory framework of the financial system in Costa Rica, Jamaica, and Trinidad and Tobago.

# V. Outlook and challenges

63. Although projections indicate a trend towards a moderate uptick in global growth, a number of serious risks persist in various world regions that could threaten that outcome. International trade projections also suggest that the region's possibilities of leveraging its export potential could be limited. This is in addition to risks associated with raw materials values; prices for the region's main export commodities are expected to remain low, compared with the highs in 2011, although they did show signs of stabilization and recovery at the start of 2015.

64. However, developments in the global economy will again have a mixed impact on the region. In general, the South American economies will be the worst affected by the drop in commodity prices and by the slower growth in China and Europe, while the Central American and Caribbean economies will benefit from growth in the United States economy and from lower oil prices.

65. Exports are expected to remain weak in South America, but to expand in most Central American countries. Overall, the region's goods trade balance is projected to worsen with respect to 2014 and this will likely cancel out the upturns in the other current account items, which could leave the overall current account balance at a similar level to 2014.

66. Another factor shaping the region's performance is the great uncertainty prevailing in international financial markets, generated on the one hand by the effects of monetary policy normalization in the United States, which will depend on the pace and magnitude of the adjustment, and on the other by uncertainty in the eurozone. These factors could complicate prospects for financing the current account deficit in 2015.

67. Bond issues in the first quarter of 2015 appear to be continuing the downturn begun in the second half of 2014: at $29 billion, they represented just a third of the amount issued in the prior-year quarter. This more limited access to external financing could continue for the rest of the year while, apart from the negative impact of falling commodity prices on most of the region's countries, external financing will also be affected by increasing risk aversion, the lower growth outlook for some of the countries — and even economic contraction in some cases — and the prospects of a rise in external interest rates.

68. The regional economy is projected to post average growth of 1.0 per cent in 2015. As in 2014, growth patterns will vary between countries and subregions, owing, among other things, to the differentiated impact of the external context. Projections are for growth of 4.0 per cent for Central America, including the Spanish-speaking Caribbean and Haiti, a standstill in output for South America stand and growth of 1.9 per cent for the English- and Dutch-speaking Caribbean.

69. Inflation is expected to slacken in most of the region's economies, owing to the impacts of falling prices for primary goods, especially energy.

70. In addition, the urban employment rate is likely to fall for a third year running, owing to the weak labour demand — and therefore weak wage job creation — attendant on low economic growth. Employment quality could well suffer as a result and, with formalization probably being insufficient to offset weak wage employment creation, registered employment will continue its lacklustre gains in most of the countries.

71. In this context, the fall in labour market participation cannot be expected to continue at the regional level, at least not at the rate seen in 2014. Accordingly, the decline in the employment rate will probably be reflected in a rise in the open unemployment rate in 2015. This rise could reach around 0.2 percentage points, taking unemployment back to 6.2 per cent, the rate posted in 2013. For most of the countries, average real wages in the formal sector should hold steady or rise slightly, since unemployment rates will generally continue relatively low and, with few exceptions, inflation should tend to ease.

72. To offset the effects of increased volatility, reduced availability of funds and slacker external demand from emerging economies, policymakers will be obliged to make greater use of the policy tools at their disposal. On the monetary policy front, where possible this will mean boosting aggregate demand through measures to stimulate financial intermediation.

73. Stimulating economic growth and reversing the slowdown poses broad challenges for the region in the current global conditions. Weak growth in the developed countries and modest expansion in the emerging economies, together with the post-crisis dynamics of world trade, suggest that boosting the region's external demand will be a slow and difficult process, which will limit the contribution of exports to growth. Therefore, although international trade remains a source of opportunity, the region must redouble its efforts to build competitiveness in existing external markets and open up new ones.

74. In this context, regional integration processes can help to boost aggregate demand through trade integration. They can boost productivity and competitiveness through value chains and the integration of production and infrastructure. Through financial integration, regional cooperation builds capacity to withstand external shocks.

75. Since the 2009 financial crisis, domestic demand has been the main driver of growth in the region, while net exports made a negative contribution to growth between 2010 and 2013. Against this backdrop, along with boosting its export potential, the region must sustain and increase domestic demand to reverse the slowdown. Loss of momentum in investment — a key component of domestic demand — has been one of the key factors behind the slowdown in many of the economies of Latin America and the Caribbean. That is why the primary challenge

now facing the region's countries in terms of boosting economic growth is to increase public and private investment rates.

76. The ability of countries to boost public investment depends on their current fiscal position and their capacity to mobilize resources. In this respect, 2015 will bring significant challenges for the governments of the region. On the one hand, the economic slowdown — and, in some countries, even the possibility of a contraction — will depress public revenues. At the same time, income from non-renewable natural resources, which represents a significant proportion of total revenues in Bolivia (Plurinational State of), Chile, Colombia, Ecuador, Mexico, Peru and Venezuela (Bolivarian Republic of), will fall year-on-year by comparison with 2014. On the other hand, some of the net hydrocarbon importers have significant subsidy schemes, and in these cases the fiscal position will tend to improve.

77. At the same time, Governments are understandably cautious about considering cuts in social spending after the positive impacts on poverty reduction achieved through social expenditure during the past decade, and especially in view of the great needs existing in the region. It is also increasingly recognized that public investment cuts, the typical shortcut to fiscal consolidation in the region, carry significant long-term economic costs. As a result, many of the region's countries are reviewing their budgets with an eye to this complex challenge.

78. In countries with higher levels of public debt or financing difficulties, the weaker public accounts forecast for 2015 have prompted announcements of budget cuts for the year ahead. In this regard, spending containment measures should take into account the need to protect investment and avoid vicious circles whereby fiscal overadjustments strangle growth and tax revenues, ultimately widening the deficit and increasing the public debt burden.

79. In any case, on average the region's fiscal deficit has remained relatively stable and its external and domestic public debt levels, with the exception of the Caribbean, are relatively low. So, notwithstanding differences between countries, the region conceivably has the scope to expand public investment with a view to enhancing production capacity and competitiveness through infrastructure projects. This type of investment not only promotes productivity gains, but also serves as an incentive for private investment.

80. Treating greater public or public-enterprise investment as central to boosting overall investment poses new challenges in terms of countercyclical architecture in Latin America and the Caribbean. The region has made good progress on countercyclical policies to smooth public revenue flows in the event of cyclical changes in the sources of fiscal income, a development that has been crucial to sustaining economic growth and should be pursued further. At the same time, the countercyclical architecture needs to include mechanisms to ensure that investment — as an increasingly key variable of economic performance and growth — can be financed at the different phases of the cycle.

81. Strengthening the investment component not only helps to mobilize domestic demand in the short term and promote growth, but is also the main bridge between the challenges of the economic cycle and medium- and long-term growth and development. In this context, development macroeconomics should aim not only to smooth economic cycles, but also to enhance production development and structural change by armour-plating investment growth over time.