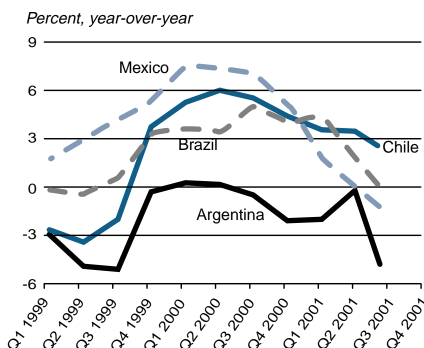
GNI per capita, 2000: $3,670

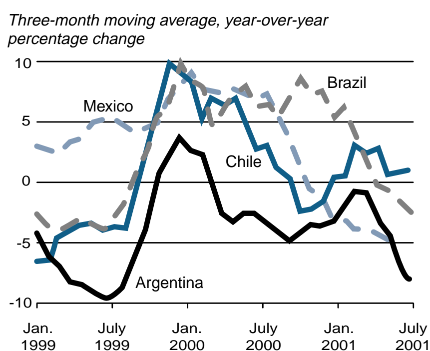
Latin America and the Caribbean

GDP growth in selected Latin America and the Caribbean countries, 1999–2001



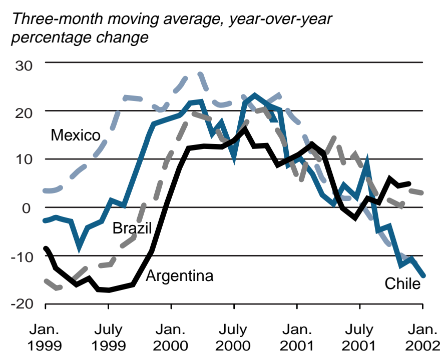
Source: World Bank.

Industrial production in selected Latin America and the Caribbean countries, 1999–2001



Source: Datastream.

Export in dollars, growth for selected Latin American and Caribbean countries, 1999–2002



Source: Datastream.

Recent developments

Regional gross domestic product (GDP) grew 0.6 percent in 2001, about 0.3 percentage points lower than the forecast in *Global Economic Prospects 2002*, and a substantial slowdown from the 3.8 percent growth recorded in 2000. Weak external conditions, a progressive worsening of the political and economic situation in Argentina, and weather-related adversity in Brazil and Central America were the main contributors to the growth slowdown in the region. GDP in the region (excluding Argentina) grew only 1.3 percent, while output growth in Central America was below 1 percent for the first time in a decade.

A sharp fall in world trade growth and steep declines in dollar prices of key commodities exported by the region reduced export revenues. Export volumes are estimated to have grown a paltry 1.4 percent in 2001 after growing by 9 percent in 2000, mirroring the collapse in import demand in export markets. Moreover, falling commodity prices caused aggregate exports, in U.S. dollars, to decline by 1.4 percent, a sea change from the 19 percent rise in 2000. Export revenues fell at a more rapid pace after September 11 as security tightened along the Mexican-U.S. border, commodity prices fell further, and tourism revenues collapsed. Weak exports and limited access to private capital markets slowed output growth, resulting in the region's dollar imports falling by 0.8 percent. Oil exporters saw their trade surpluses diminish while most others had an improvement in their trade balances. The net result was a widening of the region's trade surplus by about $17 billion. The regional current account deficit widened by $5 billion, reflecting the larger trade surplus being offset by lower receipts from tourism and remittances. The current account deficit (2.7 percent of GDP) was financed by drawing down reserves by about $1.2 billion, and by an increase in inflows from official creditors.

Only Chile and the República Bolivariana de Venezuela had the flexibility to embark on expansionary macroeconomic policies to mitigate the growth slowdown. High public debt loads and large external financing requirements prevented most countries from adopting countercyclical policies. However, interest rates were reduced significantly in several countries with floating exchange rates (for example, Colombia, Mexico, and Peru). Argentina benefited little from the fall in international interest rates as domestic interest rates remained high because of heightened exchange and credit risks. Instead, fiscal policy was progressively tightened in the course of the year, further depressing growth. Brazil raised interest rates and fiscal revenues, while Mexico cut spending in order to limit the rise in the fiscal deficit caused by slowing growth and declining oil tax revenues. The result was a general increase in regional unemployment, falling inflation rates in most countries, and little change in real interest rates or in fiscal balances.

The economic and political situation in Argentina deteriorated throughout the year, culminating in a full-blown financial and currency crisis in December. With high debt service payments and limited access to international capital markets, the authorities pursued a "zero" fiscal deficit policy to seek debt relief from creditors. A successful swap for domestic debt was concluded in August, and a similar swap for external debt was planned for the fourth quarter. However, turmoil in international capital markets in the wake of September

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11, as well as mounting civil and political resistance to the tight fiscal policy, proved too great for the government to overcome. Spreads on Argentina's international debt rose to more than 5,000 basis points, production collapsed, and tax revenues fell, causing the economy to enter a downward spiral. GDP declined for a third consecutive year, by 3.8 percent. In December, the de la Rua government fell, and the currency peg was eventually discarded in January.

Brazil suffered mild contagion from deteriorating conditions in Argentina—on top of a drought-induced energy crisis and a sharp decline in foreign direct investment (FDI) inflows. The Brazilian *real* depreciated by 30 percent between January and mid-October, and spreads rose by 570 basis points over the period. However, sharply tightening fiscal and monetary policies and a robust upturn in FDI during the fourth quarter reversed these trends and confirmed a decoupling from events in Argentina by year end. Output growth was about 2 percent in 2001. The smaller Mercosur partners were much more adversely affected by the Argentine situation and saw their GDP either fall (Paraguay and Uruguay) or grow tepidly (Bolivia). In Mexico, GDP was flat as slowing U.S. growth took its toll on exports, while the authorities followed the U.S. lead in lowering interest rates.

The Andean countries fared somewhat better. Growth was about 2.5 percent in the República Bolivariana de Venezuela as the government continued to expand fiscal policy even as oil revenues began to shrink. The economy weakened in the second half of the year as capital flight intensified, resulting in the level of reserves falling sharply and little new investment. Relations between the government, the private sector, and labor unions deteriorated over the course of the year, raising risks of a political crisis. In Ecuador, construction of an oil pipeline boosted growth to more than 5 percent and, along with falling oil prices, caused the current account to move from a sizable surplus in 2000 to deficit. Colombian growth slowed from income losses tied to lower coffee prices and falling oil revenues, and the current account deficit widened. Peru had a successful political transition in mid-year, and the investment climate improved thereafter, allowing growth to begin a modest recovery in the second half of the year.

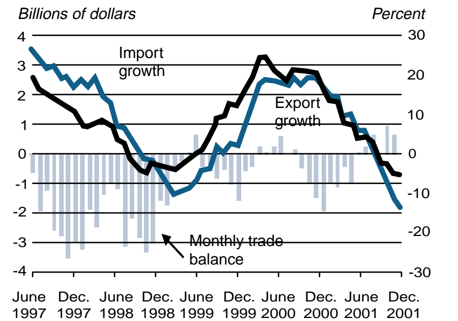
Central America and the Caribbean experienced a particularly difficult year. Drought in some Central American countries adversely affected agricultural production at the same time as coffee prices collapsed. This created famine conditions and raised the incidence of poverty sharply. Weakening labor markets in North America contributed to a falloff in remittances to the region, while Caribbean tourism revenues fell steeply in the fourth quarter, tied to generalized risk aversion on the part of travelers in the wake of September 11. Costa Rica, in addition to suffering from low coffee prices and weakened tourism revenues, was also negatively affected by the global slowdown in high-tech sectors.

Capital market flows fell

Capital market commitments to Latin America totaled about $75 billion in 2001, 17 percent below 2000 levels. The decline was due to sharp falloffs in commercial bank lending and international equity placement, while bond financing remained at 2000 levels. Were Argentina to be excluded from the year's outturns, bond volumes would have risen by 38 percent and bank lending and equity issues would have declined moderately, leading to a fall in total capital market commitments of just 4 percent.

Merchandise trade growth in Latin America and the Caribbean countries, 1997–2001

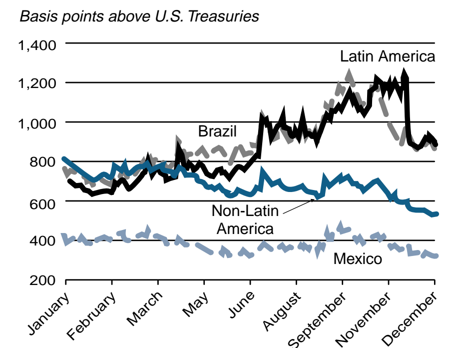
Three-month moving average, year-over-year percentage change



Note: Excluding the República Bolivariana de Venezuela. Monthly trade balance on left axis. Import and export growth calculated as a three-month moving average in current U.S. dollars.
Source: Datastream.

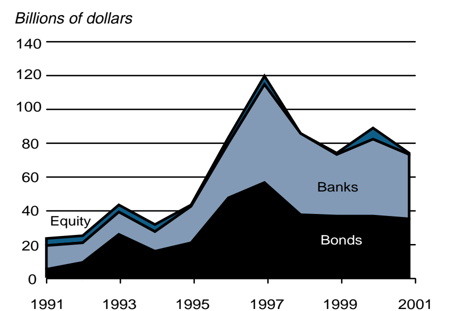
Latin American spreads, 2001

Basis points above U.S. Treasuries



Source: J.P. Morgan Chase through Bloomberg.

Gross capital market flows to Latin America and the Caribbean countries, 1991–2001



Source: Euromoney.

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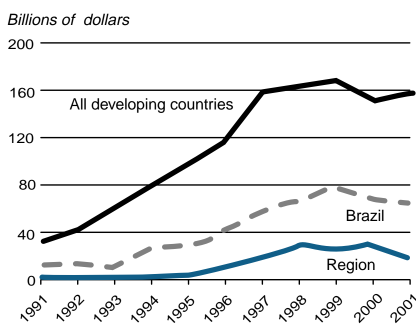
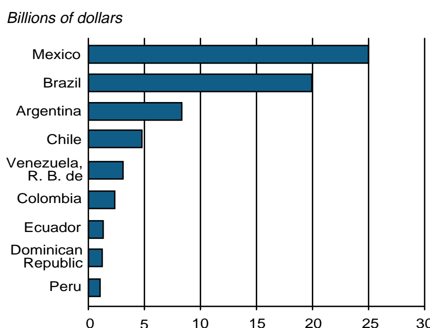
Foreign direct investment, 1991–2001



Source: World Bank.

Foreign direct investment by country, 2001



Source: World Bank.

Access to international bond markets in 2001 was good for most countries but intermittent. Spreads on secondary market debt—one indicator of investor risk perception regarding emerging markets—were fairly steady in the first half of the year, with those for investment-grade countries (such as Chile and Mexico), as well as for Colombia, compressing. As the Argentine situation began to deteriorate in July, spreads rose for most Latin countries (Colombia and Peru are exceptions) even while those for countries outside the region continued to narrow. Immediately after September 11, spreads for all emerging markets rose, but this trend was short-lived. Brazilian spreads followed Argentine spreads for most of the year, but the market made a decisive break in mid-October, with Brazilian spreads falling by 250 basis points by December. Bond volumes followed the pattern of spreads, with little issuance in September and October (after subdued flows in July and August). However, the bond market flourished in the last two months of the year. Many countries in the region raised more from bond issuance in 2001 than in 2000. Argentina was the exception, as bond issuance collapsed from over $12 billion in 2000 to about $1.5 billion in 2001.

Bank lending to Latin America fell by 18 percent in 2001, fairly uniformly across countries. This reflects the weaker international environment—smaller trade flows and fewer cross-border mergers and acquisitions—but the fall was less than the 25 percent decline in developing-country bank flows. International equity issuance was down more than 80 percent, also in line with the fall experienced by all emerging markets.

FDI flows held up

FDI flows to the region reached about $71 billion, 6 percent below the $75 billion registered in 2000. FDI to Argentina and Brazil (to a lesser extent) fell, but this was made up by increases in virtually all other countries. Mexico, with flows of approximately $25 billion, surpassed Brazil as the favored destination of investors in Latin America, and was second only to China among developing countries.

FDI has become the most important source of financing for the current account in many countries. More important, the size of last year's FDI inflow is a sign of improvement in macroeconomic management within the region and improved investor confidence, as large-scale privatization programs have begun to abate.

Prospects and risks

Prospects for 2002 have dimmed considerably in light of the weakening of the global environment after September 11 and the Argentine crisis. Growth rates in a number of countries softened into the fourth quarter of 2001, with negative carryover effects running into early 2002. The region's GDP is likely to grow by about 0.5 percent in the year.

While most countries could achieve somewhat faster growth this year than in 2001, Argentina and the República Bolivariana de Venezuela face difficult challenges. In Argentina, the combination of default, devaluation, and the freeze on deposits (instituted to stem a run on banks and capital flight) at the start of the year, and in the context of a fragile social situation, could result in protracted output reduction and instability. One risk is exchange rate "overshooting," causing inflation to rise significantly and output to decline sharply. Whether this scenario continues into 2003 depends on how quickly a credible program can be put into place. In the República Bolivariana de Venezuela, the political situation is deteriorating and capital flight is continu-

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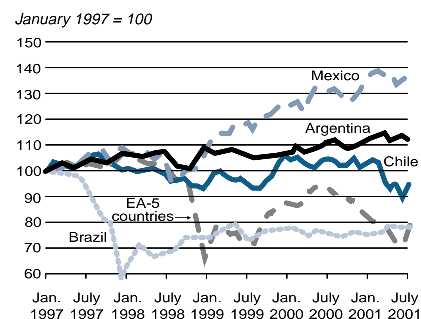
ing while oil prices are softening, limiting the authorities' ability to continue pursuing expansionary policies.

Expected regional growth for both 2003 and 2004 is 3.8 percent, reflecting a much improved external environment as well as different timing in the acceleration of growth across countries (particularly in Argentina). The baseline forecast is predicated on the assumption that countries will maintain macroeconomic stability, that the Argentine situation will stabilize and economic growth will resume during the course of 2003.

However, downside risks remain significant. Public sector debt remains high (above 50 percent of GDP) in a number of countries, and significant policy slippage could place public debt dynamics on an unsustainable path. Markets perceive that this risk is higher for countries facing presidential elections (Bolivia, Brazil, Colombia, and Ecuador) this year—although Brazil has implemented sound macroeconomic policies in recent years. Many countries in the region remain highly indebted and require debt rollovers on a continuing basis. And international interest rates are likely to rise in 2003 and 2004, raising debt-servicing costs. While the adoption of more flexible exchange rate regimes in recent years has improved export growth potential for many countries, for smaller countries in Central America and the Caribbean, export markets continue to be more narrowly based. Developing the institutional capability to break into global markets is still critical for many.

Real effective exchange rates, 1997–2001



Note: EA-5 countries comprise Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand.
Source: J.P. Morgan Chase.

Latin America and the Caribbean forecast summary

(percent per year)

Growth rates/ratios	1991–2000	1999	2000	Estimate 2001	Baseline forecast 2002	2003	2004
Real GDP growth	3.3	0.0	3.8	0.6	0.5	3.8	3.8
Consumption per capita	1.2	–1.9	2.1	–0.5	–1.3	1.8	2.1
GDP per capita	1.6	–1.6	2.2	–1.0	–1.0	2.3	2.4
Population	1.7	1.6	1.6	1.6	1.5	1.4	1.4
Gross domestic investment/GDP[a]	19.5	19.6	20.2	19.9	19.8	20.0	20.5
Inflation[b]	12.7	4.8	8.6	5.5	4.3	4.1	4.0
Central government budget balance/GDP	–3.5	–4.4	–2.7	–2.6	–2.8	–2.6	–2.2
Export market growth[c]	9.0	5.1	12.0	–0.4	1.6	7.7	7.3
Export volume[d]	8.5	6.9	9.1	1.4	5.3	11.5	8.9
Terms of Trade/GDP[e]	0.1	0.3	0.6	0.9	–0.4	0.0	0.1
Current account/GDP	–2.8	–3.2	–2.4	–2.7	–2.7	–2.8	–3.0
Memo items							
GDP growth:							
excluding Brazil	3.8	–0.4	3.4	–0.4	–0.7	3.6	3.9
Central America	4.4	4.4	2.7	0.7	1.6	3.6	3.8
Caribbean	3.5	5.0	5.3	1.4	3.0	3.7	3.8

a. Fixed investment, measured in real terms.
b. Local currency GDP deflator, median.
c. Weighted average growth of import demand in export markets.
d. Goods and nonfactor services.
e. Change in terms of trade, measured as a proportion of GDP (percent).
Source: World Bank baseline forecast, February 2002.