

LATIN AMERICA and THE CARIBBEAN



Latin America and the Caribbean is expected to face another year of weak economic performance due to domestic challenges among the region's largest economies, depressed commodity prices, and tighter regional monetary conditions. Output is expected to shrink another 1.3 percent this year, after declining 0.7 percent in 2015, marking a second consecutive year of recession for the first time in more than 30 years. Brazil and the República Bolivariana de Venezuela are in deep recessions, while Argentina is expected to see a modest contraction as it embarks on a period of macroeconomic policy adjustments toward more sustainable growth. In contrast, Mexico, Central America, and the Caribbean are expected to expand at moderate rates in 2016, boosted by robust growth in exports and tourism. The region as a whole is projected to return to growth in 2017-18, as domestic constraints gradually loosen and net exports continue picking up. Significant downside risks persist, as the South American economy has yet to bottom out and commodity prices could resume their declines. Regaining fiscal space, amid the economic slowdown and low commodity revenues, and enhancing productivity growth are major policy challenges for the region.

Recent developments

The Latin America and Caribbean (LAC) region is expected to suffer a second consecutive year of recession in 2016, the first double-year contraction in more than 30 years (Figure 2.3.1, Table 2.3.1).¹ Regional economic activity is projected to decline 1.3 percent this year, deeper than last year's contraction of 0.7 percent. There are, however, substantial differences among the three sub-regions (see Box 2.3.1). South America, the largest sub-region, is expected to remain in recession this year with output contracting 2.8 percent, significantly steeper than last year's 1.9 percent drop. In contrast, Mexico and Central

America will see output continue to expand in 2016 at 2.7 percent, while the Caribbean will grow by about 2.6 percent, slower than the exceptional year in 2015.

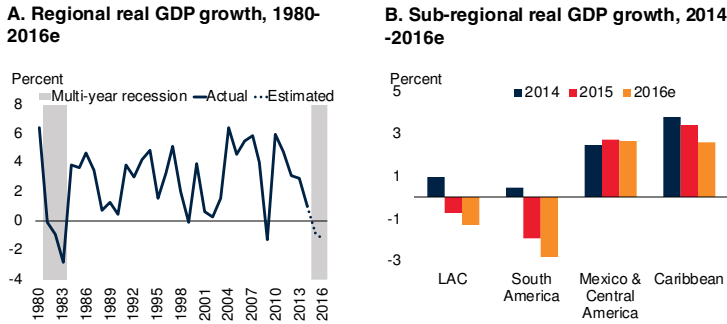
Domestic challenges in Brazil and the República Bolivariana de Venezuela, as well as the ongoing macroeconomic adjustment in Argentina, have weighed on regional growth. This year's disappointing regional economic performance also reflects the protracted decline in commodity prices. Slumping oil prices will weigh most heavily on the major oil exporters (Colombia, Ecuador, República Bolivariana de Venezuela). Yet, with metal and agricultural prices also declining, most economies in the region will be held back by the deterioration in the terms-of-trade, reduced export and fiscal revenues, and weaker investment especially in the commodities sector (Bolivia, Chile, Peru). The significance of commodities prices for LAC growth has been documented in the literature (Gruss 2014). Moreover, financial conditions have tightened, with reduced bond issuance and monetary policy rate increases, particularly in South America. Moderating the slowdown, the real depreciation of regional currencies has improved the competitiveness of exports.

Note: The author of this section is Derek H. C. Chen, with research assistance from Mai Anh Bui and contributions from Lei Ye, Eung Ju Kim, and Yirou Li.

¹The discussion in this section includes both developing and high-income economies in the Latin America and the Caribbean region. The South American sub-region includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, and the República Bolivariana de Venezuela. The Mexico and Central America sub-region includes Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama. The Caribbean sub-region includes Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago.

FIGURE 2.3.1 GDP growth: Latin America and the Caribbean

The LAC region is expected to see another year of economic contraction in 2016, its first multi-year recession since the Latin American debt crisis in 1981-1983. Domestic challenges and the slump in commodity prices have weighed on growth, especially among South American economies.

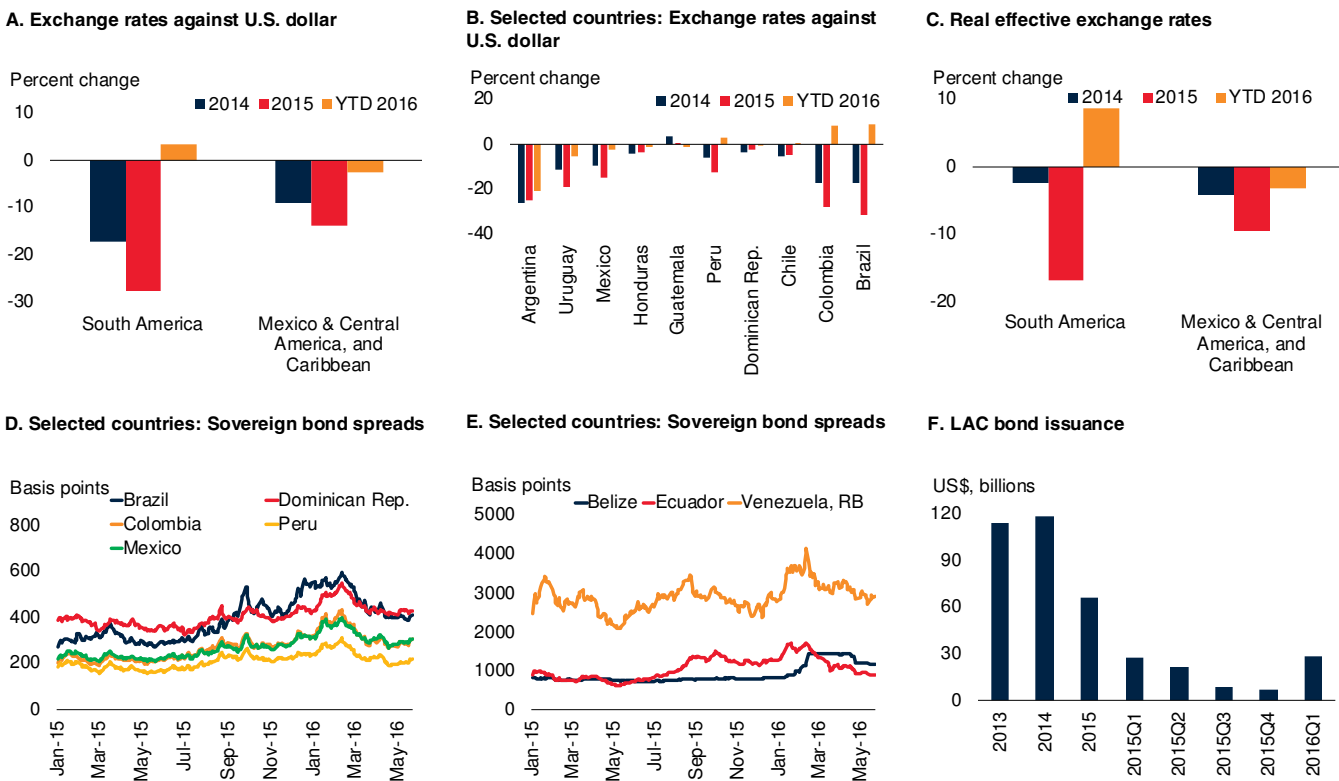


Source: World Bank. Note: e = estimated. GDP weighted average.

Amid market concerns about global prospects and possible further increases in U.S. interest rates, investor risk aversion has increased. Within the region, this aversion has been compounded by domestic political uncertainty, weak regional economic activity, and the renewed decline in commodity prices earlier in the year. The region, particularly South America, saw substantial depreciations at the beginning of 2016, but has since recovered, coming out almost flat for the year. However, given that South American currencies depreciated on average 27 percent against the U.S. dollar in 2015, these currencies are still relatively weakened, both in real and nominal terms (Figure 2.3.2). At the same time, international bond issuance from LAC slumped 61 percent (year-on-year) in 2015Q4, amounting

FIGURE 2.3.2 Exchange rates and sovereign bond spreads

Investor risk aversion spiked in early 2016, amid a renewed decline in commodity prices, leading to sharp increases in sovereign bond spreads and depreciated regional currencies, especially for oil exporters. However since then, nominal exchange rates and bonds spreads have largely recovered to their late 2015 levels.



Sources: Haver Analytics; International Monetary Fund, International Financial Statistics; JP Morgan; Dealogic.
 A. GDP weighted average. South America includes Argentina, Brazil, Chile, Colombia, Paraguay, Peru, and Uruguay. Mexico & Central America, and Caribbean includes Dominican Republic, Guatemala, Honduras, and Mexico. Last observation is April 2016.
 B. Last observation is April 2016.
 C. GDP weighted average. South America includes Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, and Uruguay. Mexico & Central America, and Caribbean includes Mexico, and Panama. Last observation for Bolivia and Paraguay is February 2016. Last observation for the other countries is April 2016.
 D. E. Latest observation is May 2016.

BOX 2.3.1 Sub-regional divergence in Latin America and the Caribbean

In 2015, Latin America and the Caribbean saw its first contraction since the financial crisis. This recession is expected to deepen in 2016. Regional GDP is expected to decline 1.3 percent in 2016, after shrinking 0.7 percent in 2015. However, there is substantial heterogeneity among the three sub-regions.

In South America, a region of major hydrocarbon and metal exporters, domestic policy uncertainty, increasing global risk aversion, and higher policy interest rates contributed to a contraction in activity in 2015.

- In Brazil, LAC's and South America's largest economy, GDP shrank around 3.8 percent in 2015 in its worst recession in decades. Investor confidence has slumped partly due to the uncertainties surrounding the Lava Jato investigations and impeachment process against the president. The substantial depreciation against the U.S. dollar of over 30 percent in 2015 and the removal of energy subsidies have lifted inflation to around 10 percent. To re-anchor inflation expectations, the central bank has maintained its tight monetary policy stance, despite contracting output, and the one-year ahead inflation expectations are coming back into the target range. High inflation and rising unemployment have eroded real incomes and weighed on private consumption, while fixed investment has been on a steep decline since 2014.
- The República Bolivariana de Venezuela is also in a deep recession, contracting 5.7 percent in 2015, according to official data. Annual inflation reached 180 percent in 2015 and is expected to increase multi-fold in 2016. Public finances have deteriorated sharply with the collapse of oil prices and reduced oil production, despite some measures to contain spending pressures, including a 6000 percent increase in domestic gasoline pump prices, which is still heavily subsidized. Even with the introduction of a two-tier exchange rate system, foreign reserves have fallen to US\$12.6 billion in April 2016, the lowest since 1998, prompting CDS spreads to surge.²
- In Argentina, GDP expanded moderately in 2015, weighed down by double-digit inflation rates, a widening fiscal deficit, severe import controls and restricted access to international capital markets. The

new Macri administration has employed a series of policy measures to reduce economic distortions and set growth on a more sustainable path. The administration has thus far significantly reduced export taxes and import restrictions, lifted currency controls on the Argentine peso and adopted a floating exchange rate, and cut energy and transport subsidies. While these policy adjustments should serve to strengthen the Argentine economy in the medium and long-term, economic activity will be subdued in the short-term, with a modest contraction in 2016.

- Other countries in South America (virtually all commodity exporters) continue to struggle to adjust to sharply lower commodity prices. Falling resource revenues were met with expenditure cuts to preserve fiscal buffers (Colombia). Central banks responded to above-target inflation and depreciation pressures with policy rate hikes despite sharply lower growth (Chile, Colombia, Peru). As a result of the terms of trade shock and procyclical policy tightening, growth among the smaller South American countries continued to be below trend and slowed to 2.6 percent in 2015 from 3.3 percent in 2014.

In contrast to South America, growth picked up to a moderate rate in the Mexico and Central America sub-region, largely owing to its close economic ties with a steadily growing United States, competitiveness gains from real depreciation, and consumption supported by rising real incomes amid falling unemployment rates and inflation. In Mexico, excess capacity and lower oil prices have led to lower inflation rates, aided by some improvements brought by the telecom reform. The sub-region has been weighed down by commodity prices and worsening terms-of-trade, although to a lesser extent than South America. Despite being an oil exporter, Mexico's exports are largely diversified away from primary commodities. However, lower oil prices have translated into significant revenue losses, compelling the Mexican government to repeatedly cut fiscal spending, especially on government investments. Supported by low oil prices, low inflation and strong U.S. demand, other countries in Central America also continued to witness moderate growth rates in 2015 (El Salvador, Guatemala, Honduras, Nicaragua). Costa Rica saw a modest slowdown led by a sharp decline in exports, due to the effects of El Niño related drought and the residual effects of Intel's withdrawal of its microprocessor plant in 2014. Meanwhile, Panama, Central America's and the LAC

²The second tier DICOM exchange rate is still heavily managed, being valued at about one-third of the parallel exchange rate in May 2016.

BOX 2.3.1 Sub-regional divergence in Latin America and the Caribbean (continued)

region's fastest growing economy, saw growth broadly unchanged in 2015, with robust consumption and gains from net trade offsetting weaker investment, as many of the capital-infrastructure projects reached completion.

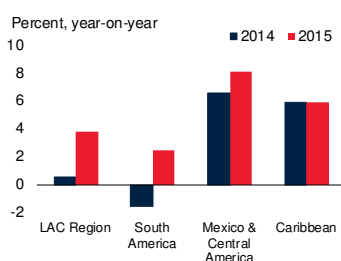
The Caribbean also enjoys close ties to the United States in terms of trade, investment and tourism. With the United States steadily growing in 2015, Caribbean tourism growth was robust, with international visits increasing 7 percent (7.5 percent in the Dominican Republic, the Caribbean's largest tourist destination). Tourism

expenditures also increased 4.2 percent (EIU 2016a). This has resulted in robust growth of more than 3 percent in 2015 at the sub-regional level. However, there was some degree of heterogeneity among Caribbean economies. Poor weather conditions in Belize and Haiti have taken a toll on agricultural production, contributing to a significant slowdown in overall growth in 2015. In contrast, a post-drought rebound in agricultural production supported growth in Jamaica, along with an increase in tourism growth and a recovery in the manufacturing sector.

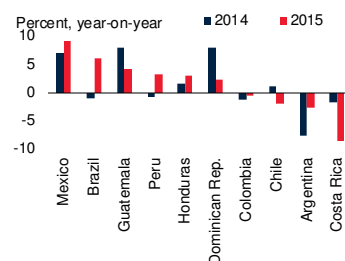
FIGURE 2.3.3 Export growth and current account balances

Exports expanded in a number of countries in 2015, supported by weak exchange rates. Weighed down by low commodity prices and reduced export revenues, current account deficits widened in South America and Central America.

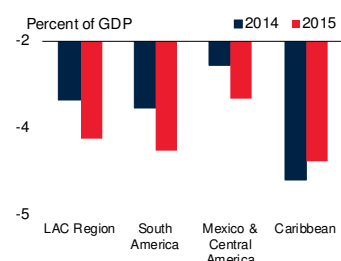
A. Regional exports: Growth of total export volumes



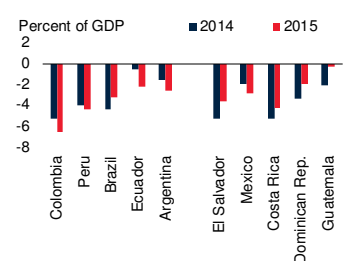
B. Selected countries: Growth of total export volumes



C. Regional current account balances



D. Selected countries: Current account balances



Sources: International Monetary Fund, World Economic Outlook; Haver Analytics.
A. C. GDP weighted average.

to only \$8.4 billion, the lowest level since mid-2009, at the height of the global financial crisis (EIU 2016b). This large reduction is in part because Brazil has been absent from international bond markets until March 2016, reducing the

overall volume of issuance at the regional level last year. Argentina, in its recent return to the global bond market, bucked this trend by selling \$16.5 billion worth of bonds on April 19, the largest one-day issue from an emerging economy. Reflecting higher risk aversion, sovereign bond spreads across the region increased significantly in early 2016, but subsequently fell back to their late 2015 levels in most countries.

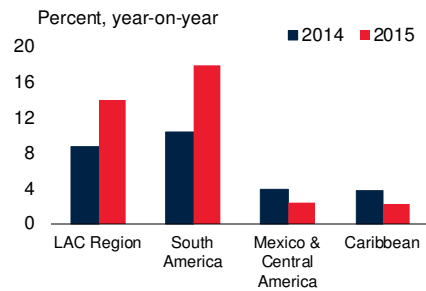
Partly due to improved competitiveness provided by weaker exchange rates, total regional export volumes surged to 3.5 percent in 2015, with the region's share of global merchandise exports expanding from 5.3 percent in 2014 to 7.4 percent in 2015.³ Export volumes expanded in a number of countries in 2015 (Brazil, Dominican Republic, Guatemala, Honduras, Mexico, Peru, see Figure 2.3.3). Most notably, Brazil's and Mexico's total export volumes jumped 6-9 percent in 2015. Costa Rica proved to be the strong exception, with exports dropping more than 8 percent in 2015, largely due to the loss in exports associated with weaker agricultural production and the closing of the Intel chip manufacturing plant in mid-2014. At the same time, weaker exchange rates and slower investment and GDP growth have constrained imports. Nevertheless, current account deficits as share of GDP on average widened 0.7 percentage point across the region, more so in South America due to the slump in

³Based on U.N. Comtrade data with 70 countries (including 12 LAC countries) reporting export data for 2015. 149 countries (including 25 LAC countries) reported export data for 2014.

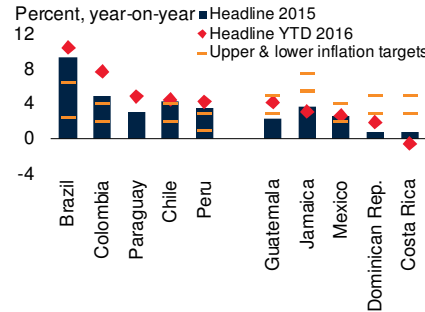
FIGURE 2.3.4 Inflation rates and policy rates

Consumer price inflation rates have increased across the region, particularly in some South American countries, where they have exceeded target bands, prompting central banks to increase policy interest rates. In contrast, central banks in Central America and the Caribbean, except Mexico, have either held steady or loosened rates, as inflation has remained within target bands.

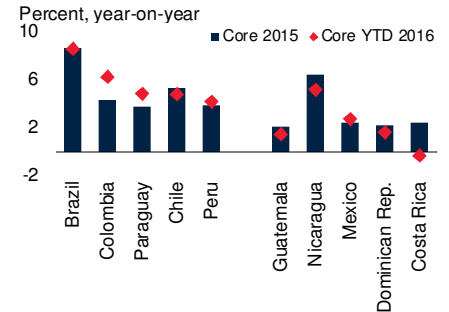
A. Regional headline inflation



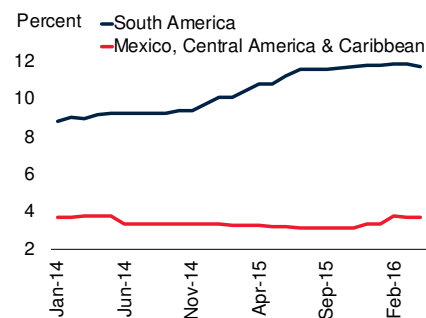
B. Selected countries: Headline inflation



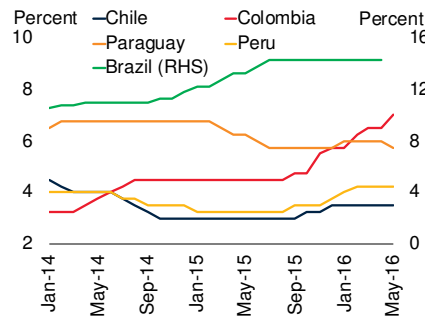
C. Selected countries: Core inflation



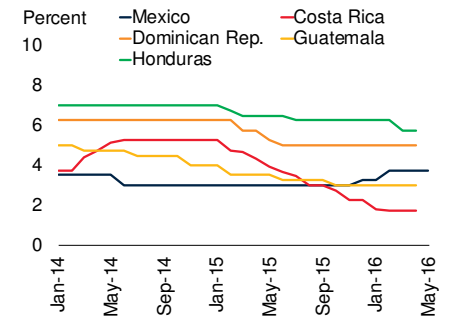
D. Regional policy rates



E. Central bank policy rates in South America



F. Central bank policy rates in Mexico, Central America and the Caribbean



Sources: International Monetary Fund, World Economic Outlook; World Bank, International Financial Statistics; Bloomberg; Haver Analytics.
 A. D. GDP weighted average.
 B. C. D. Last observation is April 2016.
 E. F. Last observation is May 2016 for Chile, Colombia, Mexico, Paraguay, and Peru; and April 2016 for others.

commodity prices (Argentina, Colombia, Ecuador, Peru). Ecuador’s current account deficit reached 2.2 percent of GDP in 2015, the largest since 2010, largely owing to a record trade deficit caused by the slump in oil prices. Since most countries are oil-importers and predominantly linked to a growing U.S. economy, current account balances widened less in Central America. In the Caribbean, with its concentration of commodity importers and hence lower import costs, current account balances narrowed in 2015.

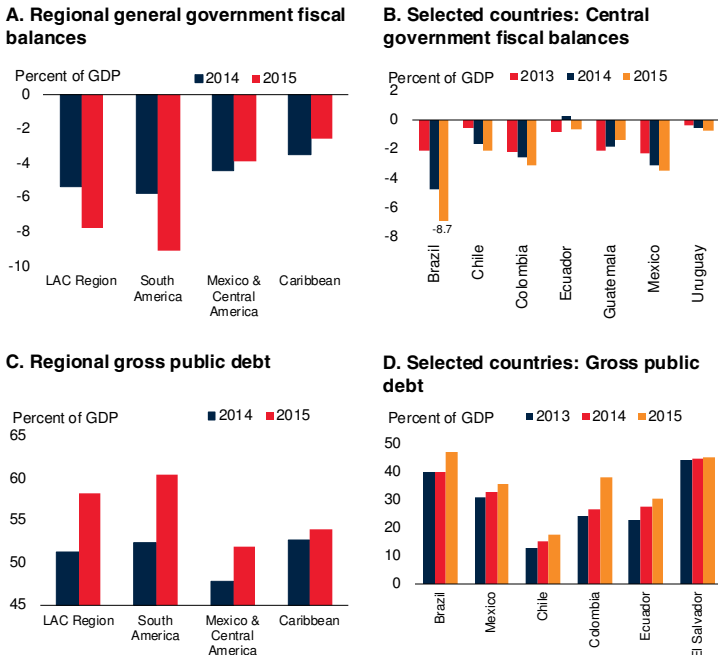
Headline consumer price inflation has increased across the region, in line with weakened exchange rates and higher import prices (Figure 2.3.4). Partly due to the larger depreciations, inflation rates are higher in South American economies, with rates exceeding inflation target bands in a

number of countries, prompting central banks to hike interest rates. Inflation rates have also been increasing in the Mexico and Central America sub-region and in the Caribbean earlier this year, after registering declines in 2015. However, most of the rates still fall below or within inflation target bands, allowing monetary policy to remain accommodative. Mexico has proven to be the exception, with the central bank hiking interest rates as recently as February to support the peso. With excess capacity and lower oil prices, Costa Rica, and to a lesser extent El Salvador, saw periods of deflation in 2015, which carried over into 2016.

As a result of revenue losses from lower commodity prices and weak economic activity, fiscal balances across the region have deteriorated

FIGURE 2.3.5 Fiscal indicators

Fiscal balances are on diverging paths among sub-regions, with lower commodity revenues and slower output growth weighing on fiscal revenues across the region but especially in South America. Wider fiscal deficits have translated to higher public debt ratios in 2015.



Sources: International Monetary Fund, World Economic Outlook; Haver Analytics.
A.C. GDP weighted average.

(Figure 2.3.5). At the regional level, general government fiscal deficits as a share of GDP widened on average from 5.4 percent in 2014 to 7.8 percent in 2015. However, there were distinct differences among the sub-regions. South America, with its concentration of oil and metal exporters, saw deficits increase on average 3 percentage points in 2015, with most countries seeing sharp reductions in government revenues, but also some countries loosening fiscal policy to support growth (Bolivia, Peru). In contrast, fiscal deficits in the Mexico and Central America sub-region, and the Caribbean, narrowed by 0.5 to 1 percentage point in 2015. Across the region, government gross debt levels increased on average to 58.2 percent of GDP in 2015, from 51.3 percent in 2014, with South America seeing debt ratios rise around 8 percentage points in 2015, and Mexico and Central America seeing a rise of 4 percentage points. In response to the deteriorating fiscal position, the Mexican authorities implemented budget cuts for 2016, amounting to 2 percent of GDP.

Outlook

Output is set to shrink another 1.3 percent in 2016, after declining 0.7 percent in 2015. Activity is only projected to begin expanding again in 2017, gradually gaining momentum to around 2 percent in 2018 (Figure 2.3.6). The outlook is predicated on commodity prices stabilizing and domestic political uncertainty moderating. Also, the baseline assumes that the use of expansionary fiscal policies will be limited, reflecting lower commodity prices, lower fiscal revenues, and widening fiscal deficits. Fiscal consolidation across the region will weigh on growth. However, there are contrasting paths among the three sub-regions. Underpinning the regional outlook, South America, after two years of recession, is projected to have a mild recovery in 2017 followed by a gradual strengthening of output growth to 1.7 percent in 2018. In contrast, output growth in the Mexico and Central America sub-region and the Caribbean, are expected to be moderate in 2016, and strengthen to around 3 percent in 2017 and 2018.

Brazil's outlook continues to be challenging. The continuing contraction in 2016 expected to carry over into 2017, amid attempts at policy tightening, rising unemployment, and shrinking real incomes (Table 2.3.2). If political uncertainties persist, the implementation of pertinent fiscal initiatives may be delayed, weighing on investment. While inflation has begun to ease, tight monetary conditions are assumed to continue in the short-term as inflation remains above target. Partially mitigating the adverse effects, the substantially depreciated real is likely to continue boosting net exports in the short-term.

As a result of ongoing macroeconomic adjustments and structural reforms, activity in Argentina is projected to be in a modest recession in 2016, before picking up on a firmer basis in 2017-18. Capital inflows are expected to strengthen from 2016-17, following a formal exit from technical debt default and regained access to international debt markets, and a return of investor confidence. Net exports will be helped by a significantly weaker Argentine peso. The recent

elimination of electricity subsidies will improve the fiscal position and bolster investor sentiment. External factors such as the prolonged recession in Brazil and low commodity prices continue to weigh on the outlook.

The economic downturn in the República Bolivariana de Venezuela has yet to bottom out, with continuing macroeconomic imbalances and elevated policy uncertainty. Oil prices are expected to stabilize around current levels and oil production is projected to decline further, partly due to inadequate maintenance. Fiscal revenues will therefore continue to be under pressure. Foreign reserves have fallen to the lowest level since 1998, and with a substantial amount of sovereign bonds maturing this year and even more in 2017; credit default swap spreads have surged to multi-year highs. The recent 6000 percent jump in petroleum pump prices and further monetizing of the public sector deficit are likely to continue contributing to inflationary pressures, weighing on output.⁴

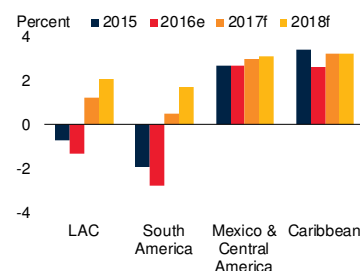
Elsewhere in South America, once commodity prices stabilize, generally sound economic fundamentals will continue to underpin growth in Chile, Colombia, and Peru. However, the outlook for these three countries will be weighed down by relatively tight domestic monetary conditions amid elevated inflation rates, and reduced fiscal revenues. Low commodity prices and reduced demand growth from slowing major trading partners, will continue to be major headwinds that will be met to varying degrees by production and investment adjustments. Oil output in Colombia is expected to dip in the medium term, owing to a lack of major discoveries and a drop in investment and seismic exploration. However, growth should be supported by strong investment in public works, with confidence being buttressed by enhanced security due to the expected internal peace agreement.

⁴A new amendment to the law governing the Central Bank passed by the National Assembly in 2009 allows the Central Bank to purchase bonds issued by PDVSA, thus bridging PDVSA's deficit in domestic currency. The continuous financing of PDVSA has been one of the main causes of the expansion in the monetary base in recent years and has led to a considerable increase in the amount of money in circulation (liquidity) in the economy (Vera 2015).

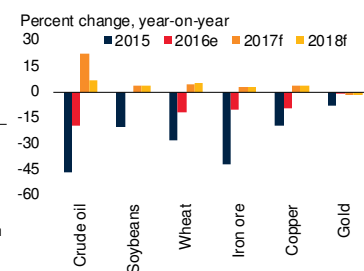
FIGURE 2.3.6 Regional outlook

The region as a whole is expected to rebound in 2017, with growth strengthening to 2.1 percent in 2018, as domestic policy uncertainty moderates, commodity prices stabilize and weakened exchange rates support exports.

A. GDP growth



B. Prices of key commodity exports



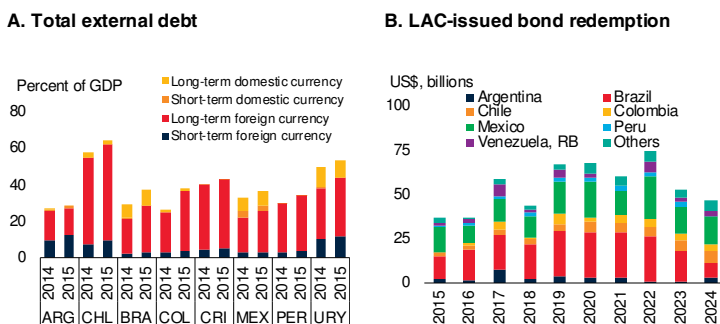
Source: World Bank.
Note: e=estimated; f=forecast.

Chile, the world's largest producer of copper, has either suspended or reduced production in a number of copper mines, slowing economic growth, at least in the near term. In contrast, due to high ore grades and low costs for energy and water, copper production has been surging in Peru with the recent opening of the Las Bambas mine and expansion of existing mines, despite low copper prices. Capacity will be expanding in the medium term with investment in new mines and further development of current mines, lifting Peru's near-term outlook. Ecuador is projected to experience a sharp contraction in the near term, reflecting low oil prices, loss of export competitiveness due to the strong U.S. dollar, and scarce external financing compelling substantial fiscal consolidation. The devastating earthquake on April 16 will compound current economic strains. The government estimates the rebuilding costs may reach 3 percent of GDP.

In contrast to South America, the Mexico and Central America sub-region is more closely linked to the U.S. economy for trade, investment, and remittance flows. With the protracted decline in agricultural commodity prices, growth is expected to remain broadly unchanged in 2016 largely due to fiscal consolidation across the sub-region. A modest increase should follow in 2017-18, as the real depreciation of local currencies spurs net exports and the U.S. economy continues to expand. Household consumption is expected to continue picking up, as real incomes are supported

FIGURE 2.3.7 External debt

External debt as a share of GDP has increased in most countries, especially long-term foreign currency denominated debt. The volume of debt maturing swells in 2017, exerting additional financing pressures.



Sources: World Bank, Quarterly External Debt Statistics; Dealogic; Haver Analytics.
Note: ARG = Argentina, CHL = Chile, BRA = Brazil, COL = Colombia, CRI = Costa Rica, MEX = Mexico, PER = Peru, URY = Uruguay.

by low inflation and falling unemployment, particularly in Mexico. In a number of Central American economies, domestic monetary policy is expected to remain largely accommodative in the short and medium term, with low inflation rates encouraging investment (Costa Rica, Honduras). Stronger investment growth is also expected in Mexico, as benefits from recent structural reforms materialize.⁵

Despite strong tourism growth, the Caribbean region will slow down in 2016 in a normalization from a bumper year in 2015. Major tourism-associated construction is winding down, and a number of Caribbean economies are pursuing fiscal consolidation to strengthen public finances and lower heavy public-debt burdens. While there is a substantial downside risk posed by the Zika virus outbreak, tourism is expected to continue to expand and support growth.⁶ Fiscal consolidation in several countries (Dominican Republic, most OECS economies) will weigh on growth in the medium-term.

In particular, the opening of Cuba presents tourists from the U.S. with an additional

destination within the Caribbean. Total tourist arrivals in Cuba have already been surging, with January 2016 arrivals jumping 12.7 percent (year-on-year). Tourist arrivals from the United States jumped 77 percent in 2015, albeit from a low base, a figure that excludes the hundreds of thousands of Cuban Americans who visited relatives last year. At the sub-regional level, liberalized Cuba–U.S. bilateral tourism could increase overall arrivals, with total Caribbean arrivals increasing 4 percent per year (Romeu 2014), leading to increased employment creation and growth (Garsous, Novoa, and Velasco 2015; Castillo et al. 2015).

Risks

The balance of risks to the regional outlook is markedly tilted to the downside for a number of reasons. First, the baseline outlook for the region assumes that commodity prices will stabilize around current prices in the medium term. Should commodity prices drop further, the terms-of-trade of regional economies will continue to worsen, and falling fiscal and export revenues will trigger additional policy tightening, weighing on growth.

Second, total external debt across the region has been increasing, especially in recent years (Figure 2.3.7). The majority of the region's debt is foreign currency denominated, typically in U.S. dollars. With the recent appreciation of the U.S. dollar relative to domestic currencies, debt servicing costs have increased and debt-to-GDP ratios have risen substantially; the debt burden becomes more onerous if government revenues are mainly denominated in local currencies. Increases in debt ratios could contribute to sovereign credit downgrades, as in Brazil. Moreover, the volume of external debt maturing in 2017 is 60 percent higher than in 2016, adding to government financing pressures.

Third, the recessions in Brazil and the República Bolivariana de Venezuela have yet to bottom out and could last longer than expected due to political uncertainties and continued macroeconomic imbalances. There is additional risk that they may spill over to other countries in the region. In particular, negative growth shocks

⁵For example, the end of 2015 saw further progress in energy reform with the successful completion of the first of three public tenders for oil exploration, paving the way for more investments in the energy sector in the coming years.

⁶As of March 2016, no Caribbean country has reported any downturn in tourist arrivals, despite the widespread media attention to the effects of the virus (World Bank 2016).

from Brazil can lead to statistically significant declines in growth for Argentina, Chile, Colombia, Ecuador, Paraguay, and Peru (World Bank 2016b).

Fourth, the Zika virus has spread rapidly across Latin America in recent months, with more than 25 countries affected. The virus has been associated with a growing number of birth defects in the region, and there are also some indications that the virus is linked to paralysis. The immediate economic impact of the virus will be to reduce tourism, as well as to raise health care costs. The long-term impact of the virus will be the lost or delayed cohort of babies and the consequences on future fertility patterns and the size of the future working-age populations. The near-term economic costs associated with the virus could be considerable this year, especially if the mosquito-borne illness is not quickly contained (World Bank 2016j). However, the estimated economic impact across the region is modest, but could be larger for some countries—especially in the Caribbean, where economies are relatively more dependent on tourism (World Bank 2016k, 2016l).

Policy challenges

Slumping commodity prices, weaker trade flows, and slower global growth have weighed on growth across the region. Moreover, in a number of LAC countries, low fiscal buffers limit the use of counter-cyclical fiscal policy. In addition, some economies, especially those in South America, are also facing above-target inflation, limiting the capacity for counter-cyclical monetary policy. More importantly, given that commodity prices are projected to stabilize at current low prices, and global growth is expected to remain tepid in the medium term, regional economies need to rely on productivity improvements as a driver of sustained long-term growth.

During the financial crisis, regional economies implemented expansionary, countercyclical policies to support growth, leading to a build-up of debt and a narrowing of fiscal space. For many countries, these policies were not fully unwound in the post-crisis years (World Bank 2015c). Amid

the extended decline in commodity prices and the slowdown in economic activity, fiscal balances have therefore further worsened in a number of countries.⁷ A credible medium-term plan to raise revenues and reduce expenditures would help rebuild fiscal buffers and bolster investor confidence (Celasun et al. 2015). Novel approaches to broaden the tax base, levy additional taxes, or strengthen tax administration could be more widely explored.⁸ A number of regional governments have already cut and will continue to trim expenditures in order to prevent further deterioration in their fiscal accounts (Colombia, Ecuador, Mexico). Although such cuts will dampen growth in the short run, it will enhance economic resilience in the medium term. Structuring fiscal consolidation in ways to minimize adverse effects on growth, poverty, and income distribution will be important. Options include consolidating social assistance programs and improving targeting, enhancing access of low-income families to education and health services, expanding coverage of the Personal Income Tax, and pension reform by increasing the retirement age (IMF 2014).

Given that commodity prices are expected to stabilize around the current low levels in the medium term (World Bank 2016k), the ability of the region to boost economic growth in the medium and long-term will increasingly hinge on diversifying the economy and improving the competitiveness of other sectors through productivity improvements, so as to achieve a broader export base.

In support of the economic diversification agenda, governments could focus on the reduction of labor market rigidities and the retraining of workers. This would facilitate the transition of labor away from sunset industries towards blooming ones (de la Torre et al. 2015).

Productivity growth in LAC has been muted for the past few decades, and the productivity gap

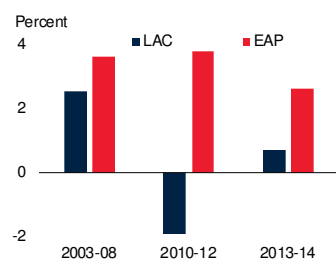
⁷More generally, studies have shown that a number of countries in the region have procyclical monetary and/or fiscal policies (Carneiro and Hnatkowska 2016).

⁸In Costa Rica, increased tax withholding from business sales has been found to reduce tax evasion and increase tax revenues (Brockmeyer and Hernandez 2016).

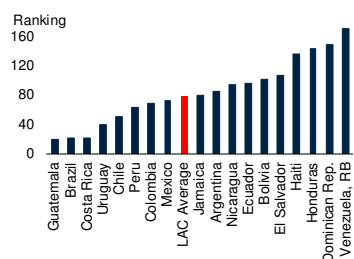
FIGURE 2.3.8 Total factor productivity growth and infrastructure quality

Total factor productivity growth has been low and weakening in the LAC region for a number of years. In particular, low levels of investment, especially infrastructure investment, has created bottlenecks to higher levels of TFP and economic growth. One measure of an adequate and accessible infrastructure is the ease of obtaining electricity, where a number of LAC economies rank poorly.

A. Total factor productivity growth



B. Ease of obtaining electricity



Source: World Bank.

A. LAC is the Latin America the Caribbean region; EAP is the East Asia and Pacific region.

between Latin America economies and the United States widened from 1980 to 2011 (OECD, UN and CAF 2014). Slowing productivity growth was a major contributor to the growth slowdown in LAC economies after 2014 (Didier et al. 2015, De Gregorio 2015; see Figure 2.3.8).

A series of structural reforms would help improve total factor productivity growth. Apart from grooming a sufficiently-skilled and appropriately-trained labor force, and investing in a modern and accessible information and communications, and energy and transport infrastructure, governments could encourage firms to invest in R&D and other productivity enhancing investments. Recent investment projects in LAC have already resulted in productivity improvements in a wide range of sectors.⁹ In the current environment of tight fiscal revenues, fiscal reform will be required to generate the necessary financial resources. Innovative public-private partnership arrangements could be also pursued to fund such medium-term investment projects.

⁹In Brazil, spillover effects from enhancements in agricultural productivity have boosted credit supply and employment in service and industrial sectors through banking linkages (Bustos, Garber, and Ponticelli 2016). In Uruguay, ICT investments have boosted productivity in the service and manufacturing sectors (Aboal and Tacsir 2015).

TABLE 2.3.1 Latin America and the Caribbean forecast summary

(Real GDP growth at market prices in percent, unless indicated otherwise)

							(percentage point difference from January 2016 projections)			
	2013	2014	2015e	2016f	2017f	2018f	2015e	2016f	2017f	2018f
EMDE LAC, GDP^a	2.9	1.0	-0.7	-1.3	1.2	2.1	0.2	-1.3	-0.9	-0.3
(Average including countries with full national accounts and balance of payments data only) ^b										
EMDE LAC, GDP^b	2.9	1.0	-0.7	-1.3	1.2	2.1	0.2	-1.3	-0.9	-0.3
GDP per capita (U.S. dollars)	1.7	-0.1	-1.8	-2.4	0.1	1.0	0.2	-1.3	-0.9	-0.4
PPP GDP	3.0	1.3	-0.1	-0.8	1.5	2.2	0.3	-1.2	-0.7	-0.4
Private consumption	3.6	0.1	-0.8	-1.3	0.6	1.8	0.1	-1.2	-1.2	-0.2
Public consumption	2.6	4.2	0.7	-3.3	-1.1	0.4	0.6	-2.5	-0.6	-0.5
Fixed investment	2.9	-0.9	-5.5	-4.6	1.0	2.8	2.3	-1.7	-1.2	-0.2
Exports, GNFS ^c	1.4	1.6	3.5	3.9	4.4	4.8	0.9	-0.1	-0.1	0.1
Imports, GNFS ^c	2.8	-0.2	-3.0	-0.9	1.2	3.8	0.2	-1.5	-1.0	0.4
Net exports, contribution to growth	-0.3	0.4	1.3	1.0	0.7	0.3	0.1	0.3	0.2	-0.1
Memo items: GDP										
South America ^d	3.3	0.4	-1.9	-2.8	0.5	1.7	0.2	-1.7	-1.2	-0.3
Mexico and Central America ^e	1.7	2.5	2.7	2.7	3.0	3.1	0.0	-0.3	-0.2	-0.3
Caribbean ^f	3.1	3.8	3.4	2.6	3.2	3.2	0.1	-0.6	0.3	0.1
Brazil	3.0	0.1	-3.8	-4.0	-0.2	0.8	-0.1	-1.5	-1.6	-0.7
Mexico	1.4	2.3	2.5	2.5	2.8	3.0	0.0	-0.3	-0.2	-0.2
Argentina	2.9	0.5	2.1	-0.5	3.1	3.0	0.4	-1.2	1.2	0.0

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

a. EMDE refers to emerging market and developing economy. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars. Excludes Cuba.

b. Sub-region aggregate excludes Cuba, Dominica, Grenada, Guyana, St. Lucia, St. Vincent and the Grenadines, and Suriname, for which data limitations prevent the forecasting of GDP components.

c. Exports and imports of goods and non-factor services (GNFS).

d. Includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, República Bolivariana de Venezuela, and Uruguay.

e. Includes Costa Rica, Guatemala, Honduras, Mexico, Nicaragua, Panama, and El Salvador.

f. Includes Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

TABLE 2.3.2 Latin America and the Caribbean country forecasts^a

(Real GDP growth at market prices in percent, unless indicated otherwise)

(percentage point difference
from January 2016 projections)

	2013	2014	2015e	2016f	2017f	2018f	2015e	2016f	2017f	2018f
Argentina	2.9	0.5	2.1	-0.5	3.1	3.0	0.4	-1.2	1.2	0.0
Belize	1.3	4.1	0.9	0.8	1.8	2.2	-2.1	-1.7	-0.8	-0.6
Bolivia	6.8	5.5	4.8	3.7	3.4	3.4	0.8	0.2	0.0	0.0
Brazil	3.0	0.1	-3.8	-4.0	-0.2	0.8	-0.1	-1.5	-1.6	-0.7
Chile	4.3	1.8	2.1	1.9	2.1	2.3	0.0	-0.5	-0.8	-0.8
Colombia	4.9	4.4	3.1	2.5	3.0	3.5	0.0	-0.5	-0.3	0.0
Costa Rica	3.4	3.5	2.8	3.3	3.6	4.0	0.0	-0.7	-0.6	-0.4
Dominica	1.7	3.4	-4.0	2.5	2.0	2.0	-1.0	-1.5	0.0	0.0
Dominican Republic	4.8	7.4	6.9	5.0	4.3	4.0	1.3	0.4	0.5	0.1
Ecuador	4.6	3.7	0.3	-4.0	-4.0	0.0	0.9	-2.0	-4.0	-0.5
El Salvador	1.8	2.0	2.5	2.2	2.3	2.3	0.1	-0.3	-0.3	-0.5
Guatemala	3.7	4.2	4.1	3.5	3.5	3.6	0.4	-0.1	0.0	0.0
Guyana	5.2	3.8	3.0	4.0	3.9	3.8	-0.5	0.2	-0.1	-0.2
Haiti ^b	4.2	2.8	1.2	0.9	1.9	2.2	-0.5	-1.6	-0.9	-0.8
Honduras	2.8	3.1	3.6	3.4	3.5	3.5	0.2	0.0	0.0	-0.1
Jamaica	0.5	0.7	0.9	1.5	2.2	2.6	-0.4	-0.6	-0.2	0.0
Mexico	1.4	2.3	2.5	2.5	2.8	3.0	0.0	-0.3	-0.2	-0.2
Nicaragua	4.5	4.7	4.9	4.4	4.2	4.1	1.0	0.2	0.1	0.1
Panama	8.4	6.2	5.8	6.0	6.1	6.2	-0.1	-0.2	-0.3	-0.4
Paraguay	14.0	4.7	3.0	3.0	3.2	3.4	0.2	-0.6	-0.8	-0.8
Peru	5.9	2.4	3.3	3.5	3.5	3.2	0.6	0.2	-1.0	-1.4
St. Lucia	-1.9	-0.7	1.6	1.5	2.0	2.0	-0.1	-0.1	0.1	-0.1
St. Vincent and the Grenadines	2.3	-0.2	1.8	2.4	3.1	3.1	-0.3	-0.3	0.1	-0.3
Trinidad and Tobago	2.3	-1.0	-2.0	-2.0	2.0	2.5	-2.0	-2.5	0.8	1.0
Uruguay	4.6	3.2	1.0	0.7	1.6	2.5	-0.5	-1.2	-1.2	-0.5
Venezuela, RB	1.3	-3.9	-5.7	-10.1	-3.4	1.6	2.5	-5.3	-2.3	1.6

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

a. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.

b. GDP is based on fiscal year, which runs from October to September of next year

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