LATIN AMERICA and THE CARIBBEAN

Output in Latin America and the Caribbean is estimated to have contracted 1.4 percent in 2016, the second consecutive year of negative growth. This weakness was due to the combined effects of low commodity prices and domestic economic challenges in large economies. In South America, where a large share of countries are commodity exporters, GDP growth contracted 2.8 percent. Growth in Mexico and Central America slowed to 2.3 percent, while growth in the Caribbean decelerated to 3.2 percent. Regional growth is projected to recover, reaching 2.6 percent in 2019, as domestic constraints loosen and fiscal consolidation is completed. Downside risks to the outlook include rising policy uncertainty among advanced economies, a renewed slide in commodity prices, and weaker-than-expected activity among the region's largest economies. A key policy challenge is to nurture the nascent and fragile recovery, particularly in South America, while completing the fiscal adjustment to lower commodity revenues.

Recent developments

Overview

Weighed down by depressed commodity prices, slowing global growth, and domestic challenges among its largest economies, economic activity in the Latin American and the Caribbean (LAC) region contracted for the second consecutive year in 2016—the first time this has happened since the debt crisis of the early 1980s (Figure 2.3.1). The contraction in regional output, estimated at 1.4 percent in 2016, was more than double that of the previous year. For the third successive year the region registered the lowest growth rate among the six EMDE regions.

South America, with a large share of major commodity exporters, saw GDP contract 2.8 percent in 2016, larger than the 1.9 percent contraction in 2015. In Mexico and Central America, growth slowed from 2.8 percent in 2015 to 2.3 percent, in line with the slowdown in the U.S. economy. The Caribbean economy decelerated to 3.2 percent in 2016 after growing 3.4 percent in 2015.

Domestic economic challenges among the region's largest economies were major factors behind the weakness in activity. Argentina and Brazil implemented tighter policies and reforms to reduce macroeconomic distortions. República Bolivariana de Venezuela suffered double-digit negative growth in 2016 due to a combination of persistent distortionary policies and low oil prices, which have led to severe economic imbalances.

The region also faces challenges stemming from international economic conditions. Despite some recent gains, commodity prices remain low relative to the immediate post-crisis years, contributing to the broad-based slowdown in economic activity across the region. Several countries experienced equity market turbulence and currency depreciation following the U.S. elections.

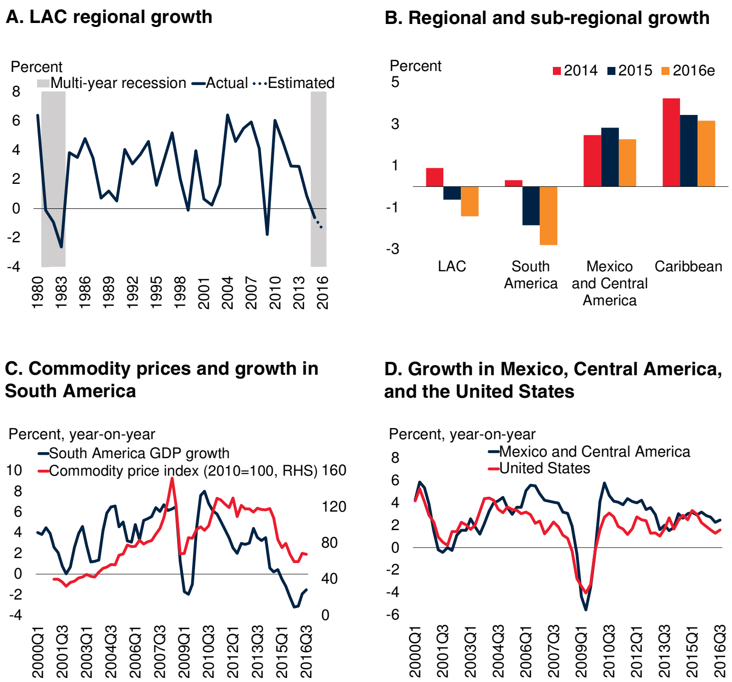
Financial sector

Through most of 2016, accommodative monetary policy in advanced economies encouraged investors to seek out higher yields in EMDE assets. Investors' sentiment toward the LAC region also improved thanks to the modest recovery in oil

Note: This section was prepared by Derek H. C. Chen and Dana Vorisek, with contributions from Lei Ye, Jongrim Ha, Hideaki Matsuoka, and Eung Ju Kim. Research assistance was provided by Liwei Liu.

FIGURE 2.3.1 Growth

Regional growth contracted for the second consecutive year in 2016—the first multi-year recession in more than 30 years. The weakness is underpinned by the severe contraction in South America, which has a large share of major commodity exporters. The other two sub-regions—Mexico and Central America and the Caribbean, which have closer links with the United States—posted positive growth.



Sources: Haver Analytics, World Bank.
Notes: Regional and sub-regional aggregates are presented as GDP-weighted averages. e=estimated.
B. Regional and subregional country coverage is as in Table 2.3.1.
C. South America includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, Paraguay, Uruguay, and República Bolivariana de Venezuela. Commodity price index is calculated as a weighted average of the World Bank's energy (60 percent) and non-energy (40 percent) commodity indexes.
D. Mexico and Central America include Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama.

prices and stabilization of other commodity prices. Business-friendly and market-oriented governments in Argentina and Brazil, and Argentina's settlement with "holdout" creditors, also benefited sentiment. Also, LAC assets were trading at large discounts, making them attractive to investors. After two consecutive years of outflows, capital inflows to the region resumed in 2016, with rallies across various asset classes for most of the year, including bonds and equities.

After rising from a monthly average of $10.8 billion between January and October 2016, up from a monthly average of $5.5 billion in 2015, regional bond issuance plunged to $1.1 billion in November. The increase prior to November was led by Argentina, which returned to the market with a $16.5 billion sovereign issue in April—the second-largest international bond sale ever by an EMDE. With prospects of policy change, Brazil issued $17.5 billion in the first nine months of 2016, despite the loss of its investment-grade credit rating. Some small countries (the Dominican Republic, Ecuador, Guatemala, Trinidad and Tobago, Uruguay) also took advantage of investor appetite and issued bonds. Jamaica went to the market in August to exchange $785 million high-coupon bonds coming due in 2017–19 for lower-cost bonds maturing in 2039. LAC bond spreads have declined by more than those of other regions, signaling improving investor confidence (Figure 2.3.2).

Similarly, equities across the region rallied in 2016. Stock indexes gained in Argentina, Brazil, Chile, Colombia, Mexico, and Peru, with Peru's S&P Lima General Index rising more than 50 percent on improving investor confidence. Meanwhile, several currencies strengthened, led by the Brazilian real and the Colombian peso. Both the Argentine and Mexican peso depreciated, however, especially following the U.S. elections.[1]

The South American banking system is vulnerable to rising financing costs due to the downturn in the mining sector and soft general economic activity. In particular, the share of non-performing loans has increased (Figure 2.3.3).

Inflation and monetary policy

Regional consumer price inflation continued to edge up in 2016, with divergent paths among the sub-regions (Figure 2.3.4). In South America, rates remain elevated relative to inflation target bands, reflecting depreciated currencies and high food costs due to adverse weather conditions. Accordingly, South American central banks kept a tight monetary policy stance for most of 2016. In contrast, inflation continued to be benign among Central American and Caribbean economies, the vast majority of which are oil importers and have benefited from low oil prices.

[1]Coppola, Lagersborg, and Mustafaoglu (2016) find that the Argentine peso was overvalued by 39 percent before the 2015 exchange rate reunification.

Inflation in Brazil moved down through 2016, though exchange rate depreciation is keeping the cost of imports high. The central bank maintained the Selic policy rate at a 10-year high of 14.25 percent for 15 months, before making two rate cuts, in October and November. Inflation in Colombia has been boosted by higher food costs, reflecting supply problems caused by drought in 2015 and by a truckers' strike in July 2016. The central bank has raised its policy interest rate 11 times since September 2015. In Argentina, the central bank announced the adoption of a formal inflation targeting regime, to begin in 2017, in order to bring inflation to the single digits by 2019. And in República Bolivariana de Venezuela, chronic monetization of the public sector deficit has caused an acceleration of prices toward hyperinflation.

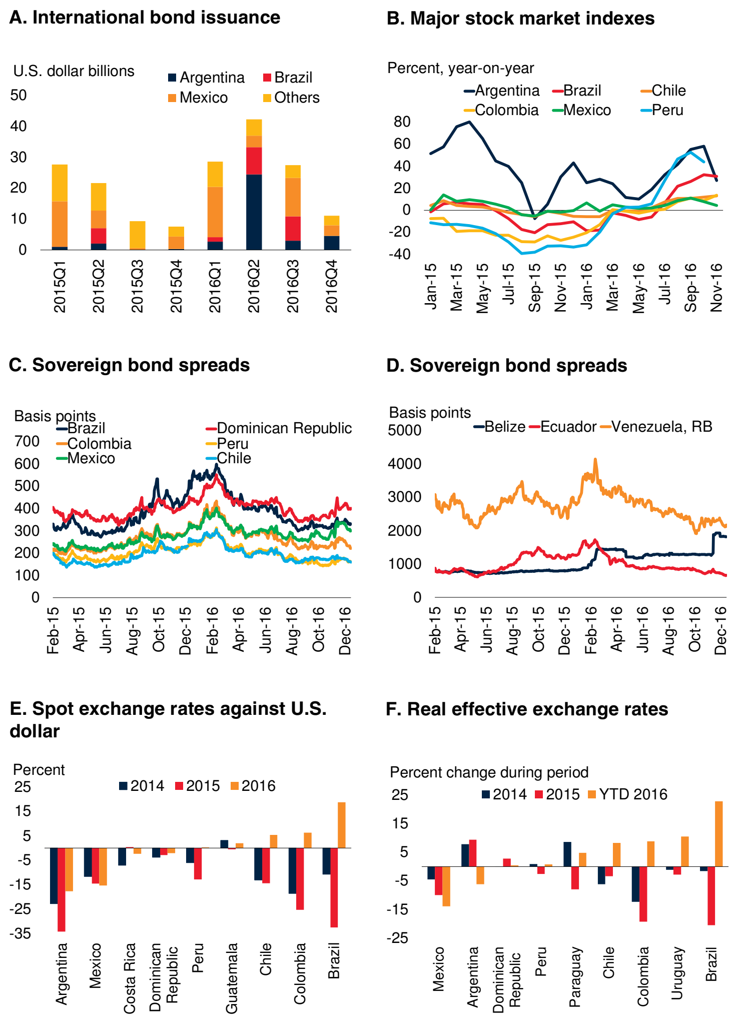
In Central America and in the Caribbean, where inflation and growth have been low, central banks have mostly implemented accommodative monetary policies. Falling consumer prices in Costa Rica, for example, encouraged its central bank to keep its policy interest rate at a 10-year low. In Jamaica, inflation reached record lows of below 2 percent in the second half of 2016. Mexico was an exception in the sub-region, with its central bank tightening policy rates to stem the depreciation of the peso, most recently in mid-December. While inflation has been creeping up, it has remained well within the 2–4 percent target band.

Fiscal policy

Low commodity prices and weak economic activity have reduced fiscal revenues and increased pressure on fiscal balances and public debt levels across the region (Figure 2.3.5). Oil exporters—such as Colombia, Ecuador, Trinidad and Tobago, and República Bolivariana de Venezuela—have been particularly hard hit. Similarly, Central America has been affected by low agricultural and metal prices. Most countries have been undergoing fiscal consolidation—except for Chile and Peru, which have been implementing expansionary fiscal policies to support growth.

FIGURE 2.3.2 Financial sector

Investor sentiment toward the region improved through much of 2016, in part reflecting the installation of new and more business-friendly and market-oriented governments in Argentina and Brazil. Bond issuance to the region resumed, easing regional financial conditions, before plunging in November. Several countries experienced equity market turbulence and currency depreciation following the U.S. elections.

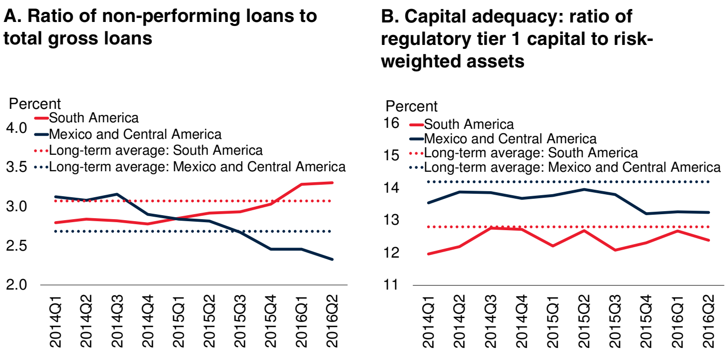


Sources: Dealogic, Haver Analytics, J.P. Morgan, World Bank.
A. Data includes sovereign and corporate bond issuance. "Others" are Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Jamaica, Panama, Paraguay, Peru, Trinidad and Tobago, and Uruguay. 2016Q4 includes October and November data.
C.D. Last observation is December 15, 2016.
E. 2016 covers January 1, 2016 to December 19, 2016.
F. Last observation is November 2016.

In several South American commodity-exporting economies, deficits have ballooned since 2013. Colombia's deficit widened under the impact of depressed oil revenues, while higher interest payments have pushed up expenditures. With the sharp contraction in economic activity, Brazil's overall deficit had been widening until recently.

FIGURE 2.3.3 Banking systems

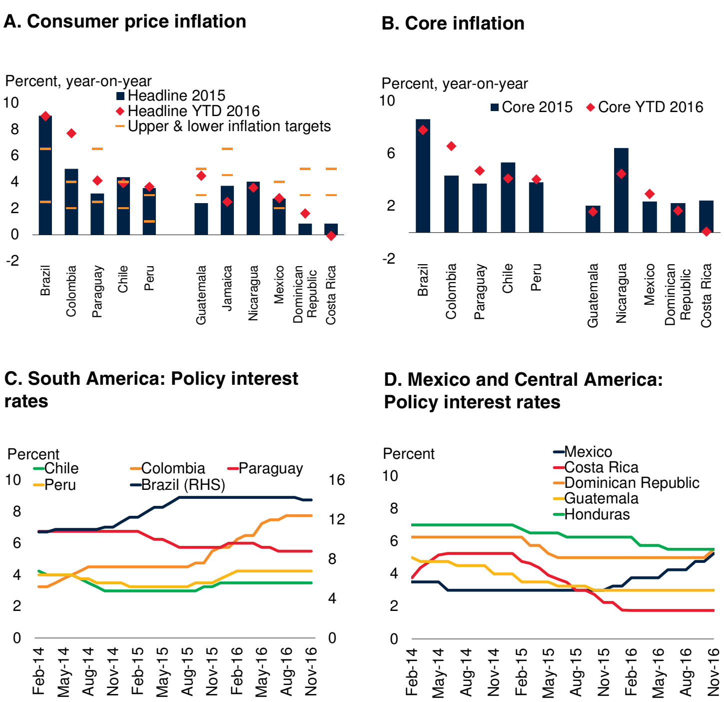
Banking systems in South America have reported a rise in non-performing loans, while capital ratios in Mexico and Central America have declined.



Sources: Haver Analytics, World Bank.
Note: Subregional aggregates are presented as GDP-weighted averages. South America includes Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay and Peru. Mexico and Central America includes Costa Rica, El Salvador Guatemala, Honduras, Mexico, and Panama. Long-term average 2008Q1-2015Q4.

FIGURE 2.3.4 Inflation and monetary policy

Inflation remains elevated in South America but moderate in Mexico and Central America and in the Caribbean, providing scope for monetary policy accommodation in these two sub-regions.



Source: Haver Analytics, Central Bank News, World Bank.
Note: GDP-weighted averages. e = estimate.
A.B. 2015 data shows the simple average of monthly observations of year-on-year inflation from January to December 2015. YTD 2016 shows the simple average from January 2016 to November 2016.

Budget deficits in Mexico and Central America have been shrinking. In Mexico, this reflects numerous expenditure cuts and the 2014 tax reform, which introduced new revenue sources. Several Caribbean economies are expected to see fiscal improvement in the medium term, on the basis of consolidation efforts. However, the overall sub-regional balance was weighed down by the sub-region's two largest economies, the Dominican Republic and Trinidad and Tobago. Compared to an exceptional surplus in 2015, the Dominican Republic's overall fiscal deficit widened in 2016 to around its post-financial crisis average. Despite numerous reforms over the years, revenue-generating capacity in the Dominican Republic remains weak, largely because of persistently high levels of informality, tax evasion, and existing tax exemptions. Trinidad and Tobago's fiscal deficit widened on weak oil revenues.

External sector

A number of countries in the region (Mexico excepted) saw more robust export growth in 2016 than in 2015. Together with muted import demand due to the economic slowdown, the uptick in exports contributed a significant narrowing of current account deficits in 2016 (Figure 2.3.6). In South America, Peru saw an export surge of more than 8 percent in the first half of 2016, mainly reflecting a large increase in copper production. In Brazil, the still weak real lifted exports in the first half of 2016, sharply reducing the country's current account deficit.

In Mexico, moderating demand from the United States weighed on export growth. Other Central American and Caribbean econo-mies saw accelerating exports, despite slowing U.S. demand. Costa Rica's exports to the United States for January to August 2016 rose by 5 percent year-on-year. The current account balance for the Dominican Republic switched to a surplus in the first half of 2016 on strong receipts from remittances and tourism, and low oil prices.[2]

[2]World Bank (2016i) analyzes the variations in export performance across countries by looking at differences in exchange rates and external demand.

Poverty

Poverty rates remain lower in South America than in Mexico, Central America, and the Caribbean. However, with unemployment rates stable or rising and real wages stagnating in 2016, poverty may have increased in South America (Figure 2.3.7). This threatens to reverse some of the poverty reduction achieved earlier in the decade. In contrast, poverty rates are still on the decline in the Mexico and Central America and the Caribbean sub-regions. A reduction in unemployment rates and higher real wages since 2013 underpin this improvement.

While there have been significant gains in reducing poverty over the past decades, income inequality remains high relative to other emerging and developing regions. Eight of the ten most unequal countries in the world (as measured by Gini indexes) are in Latin America and the Caribbean (World Bank 2016j). While inequality in Central America declined notably in the most recently available data, it increased in some Southern Cone countries. Increasing growth in income or consumption expenditure of the poorest 40 percent of people in these highly unequal countries is key to further reducing poverty (World Bank 2016j).

Outlook

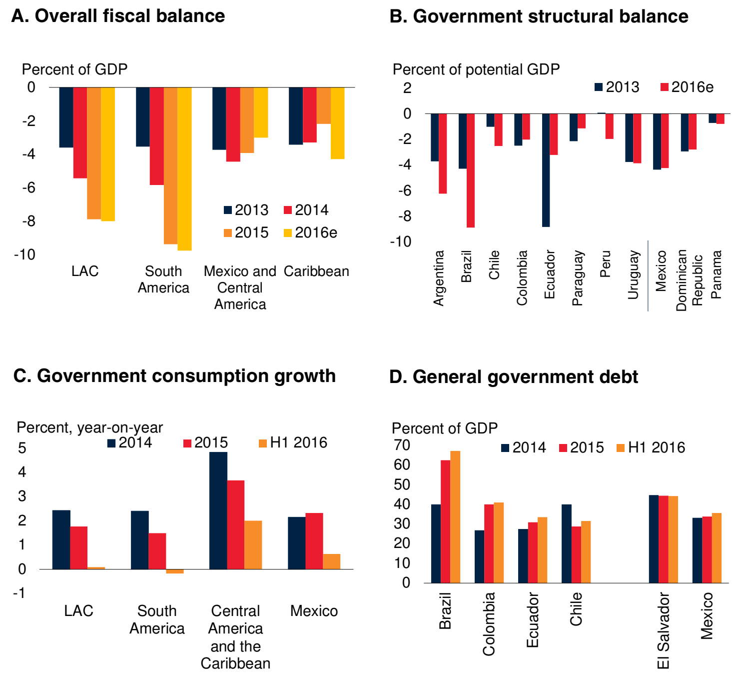
Regional output growth is projected to resume in 2017, and to rise steadily to 2.6 percent in 2019 (Figure 2.3.8). The improving outlook is largely driven by an envisaged return to positive growth in Brazil, the region's largest economy.

The timing of the growth pickup in the region is expected to be different across the sub-regions. Growth in South America is assumed to bottom out in 2016 and then gain momentum from 2017, reaching 2.4 percent in 2019. In Mexico and Central America, growth is projected to begin accelerating in 2018, reaching 2.9 percent in 2019.

Global headwinds, such as policy uncertainty in the United States and subdued growth among other major trading partners, will weigh on

FIGURE 2.3.5 Fiscal policy

Low commodity prices and slow economic growth have led to lower fiscal revenues and greater pressures on fiscal balances and debt levels across the region. Despite fiscal consolidation in a number of countries, deficits have continued to rise in South America and the Caribbean, and debt is rising in several South American countries.



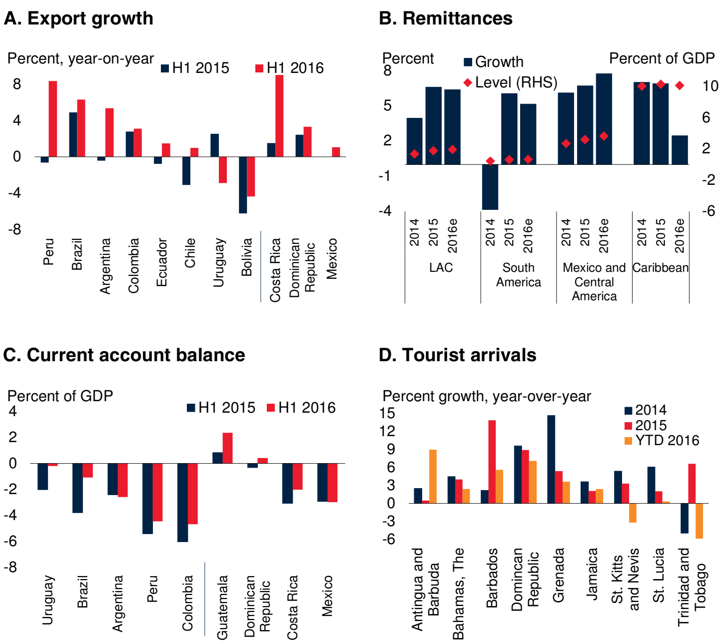
Sources: International Monetary Fund, Haver Analytics, World Bank.
Notes: Regional and subregional aggregates are presented as GDP-weighted averages.
e = estimate.
A. Regional and subregional country coverage is as in Table 2.3.1.
B. Structural balances are cyclically adjusted.
C. South America includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, and Uruguay. Central America and the Caribbean includes Costa Rica, Dominican Republic, Guatemala, Honduras, and Nicaragua.
D. Data reflects gross government debt.

economies across the region, at least in the near term. However, commodity prices are projected to stabilize and to gradually recover, providing modest relief for regional commodity exporters with improved terms of trade and increased fiscal and export revenues.

Within the region, several countries are implementing fiscal consolidation and reforms. As these are completed, economies will be on a better fiscal footing, with space for urgently needed public investment projects to promote growth in the medium term. Economic activity will be supported by exports, which are still benefiting from a competitive edge derived from prior depreciations. These competitiveness effects will

FIGURE 2.3.6 External sector

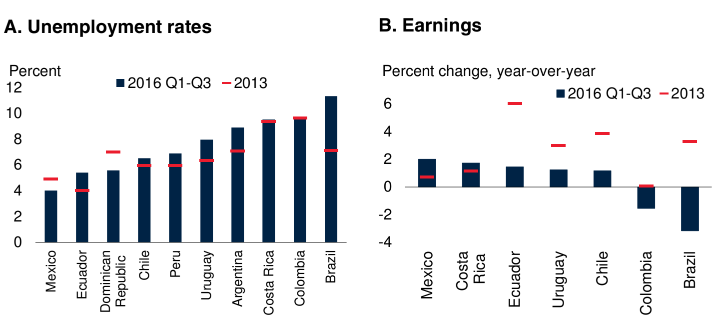
Relative to their peaks in 2012-13, regional currencies are still weak in real terms, despite some recent appreciation. This has supported export growth in many countries and contributed to a reduction in current account deficits. In Mexico and Central America, continued strong growth of remittance inflows has also supported falling current account deficits. Tourism growth in a number of Caribbean countries, which had been robust, slowed or declined in 2016.



Sources: Haver Analytics, UN World Tourism Organization, World Bank.
A. Export data reflects good s and services.
B. South America includes Bolivia, Brazil, Colombia, Ecuador, Paraguay, and Peru. Mexico and Central America includes Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama. Caribbean includes Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Lucia, St. Vincent and the Grenadines, and Suriname.
D. 2016 data is quarterly. For Antigua and Barbuda, the Dominican Republic, and Trinidad and Tobago, YTD 2016 reflects data through Q3. For all other countries, YTD 2016 reflects data through Q2.

FIGURE 2.3.7 Unemployment and earnings

Unemployment was stable or rising and wage growth was lackluster in most LAC countries 2016. Mexico was a notable exception, however. These conditions may have contributed to an increase in poverty.



Sources: Haver Analytics, World Bank.
A. Data for Q1-Q3 2016 is the average during that period; data for 2013 is the average for Q1-Q4 2013. For Argentina, 2016 data is available in only Q1 and Q2. For Ecuador, 2013 data is available only for Q2 and Q4.
B. "Earnings" is earnings or wages, deflated by the CPI. Data for Q1-Q3 2016 is the average during that period. Data for 2013 is the average for Q1-Q4 2013.

be partially offset by weak growth in advanced economies.

South America saw a sharper recession in 2016 than in 2015, but the sub-region is expected to rebound in 2017. Domestic constraints appear to be easing in Argentina and Brazil, with the new governments focused on implementing reforms to ease macroeconomic and fiscal imbalances. Colombia and Ecuador, which are struggling with low fiscal revenues from depressed oil prices, will see weak growth in 2017. República Bolivariana de Venezuela continues to suffer from severe economic imbalances, and economic contraction is expected to persist. Due to elevated government deficits, and the accelerating inflation rate, reforms are needed to consolidate the budget and to end the monetizing of the deficit.

While the outlook for Mexico and Central America is relatively better than for South America, growth expectations have deteriorated since mid-2016. Investment in Mexico is envisaged to weaken in 2017, in part due to policy uncertainty in the United States and policy uncertainty around domestic elections in 2018. Mexico is expected to see robust private consumption, however, buoyed by low inflation, low unemployment, increasing real wages, and strong remittance inflows. Reforms in some countries in the Mexico and Central America sub-region have enhanced tax collection and reduced fiscal deficits (Mexico, Panama), making expansionary fiscal policy an option, if needed. Although global conditions are not conducive to robust growth in international trade, weak currencies may give a competitiveness boost to the sub-region's exports.

In the Caribbean, growth is expected to rise modestly in the medium term after remaining broadly stable in 2017. In the Dominican Republic, the sub-region's largest economy, growth will ease in 2017 on the completion of large construction projects and lower government outlays.

Risks

Risks to the regional growth outlook are tilted to the downside. While each risk, if realized, would likely have differentiated effects across the sub-regions, the realization of an individual risk or a combination of risks would weigh on regional growth.

Rising policy uncertainty among advanced economies. Policy uncertainty increased in the United States and the Euro Area last year. Given that these two economies are the largest economic partners of the LAC region, policy changes, such as restricting trade with the region or migration from the region, could have sustained repercussions on Latin America and the Caribbean (Figure 2.3.9). Estimates show that an increase in financial uncertainty (proxied by an increase in the VIX index) is likely to lead to a notable reduction in investment growth in EMDEs generally, and LAC countries in particular. Moreover, should policy uncertainty weigh on advanced economy growth, slower U.S. and Euro Area growth could have additional negative effects on EMDE growth and investment (Figure 2.3.10).

Renewed slide in commodity prices. Given the region's large exposure to commodity prices, and the weakened state of fiscal balances in several economies, renewed declines in commodity prices would be severely detrimental to the regional outlook, as well as the prospects of regional commodity exporters. (Fernandez, Gonzalez, and Rodriguez 2015).

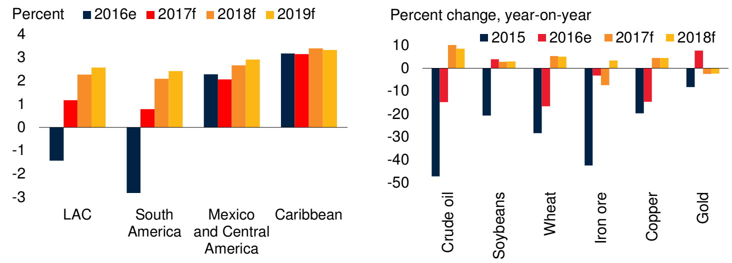
Protracted weakness in large economies in the region. The outlook is predicated on a bottoming out in Brazil and Argentina between the end of 2016 and the first half of 2017. Should the weakness in Brazil, Argentina, or República Bolivariana de Venezuela persist for longer than expected, regional growth would be lower than projected.

Sharper-than-expected tightening by the U.S. Federal Reserve. The U.S. Federal Reserve is expected to further tighten monetary policy gradually. However, a reassessment of the pace of U.S. tightening by market participants could lead to swings in interest rates, volatility in capital flows, and marked depreciations of leading Latin America and the Caribbean currencies, which could increase borrowing costs and have negative

FIGURE 2.3.8 Regional outlook

Regional growth is expected to recover to positive territory in 2017 and gradually strengthen, underpinned by a recovery in South America. Commodity prices are expected to gradually recover, improving fiscal and export revenues of commodity exporters.

A. Regional growth forecasts **B. Selected commodity prices**



Sources: World Bank.
Notes: Regional and subregional aggregates are presented as GDP-weighted averages. e=estimated, f=forecast.
A. Regional and subregional country coverage is as in Table 2.3.1.

repercussions for debt repayment in the region's more vulnerable economies.[3]

Policy challenges

The Latin America and Caribbean region is on the verge of recovery after two years of recession. Given low growth among the region's major trading partners, and with commodity prices stabilizing around current lows, supporting a cyclical recovery is an immediate high-priority challenge. For the medium term, economies must focus on structural reforms to rebuild policy buffers, to reduce dependence on primary commodities, and to increase investment. Such reforms will harness advances in productivity as the engine of growth (de la Torre, Didier, and Pinat 2014).[4]

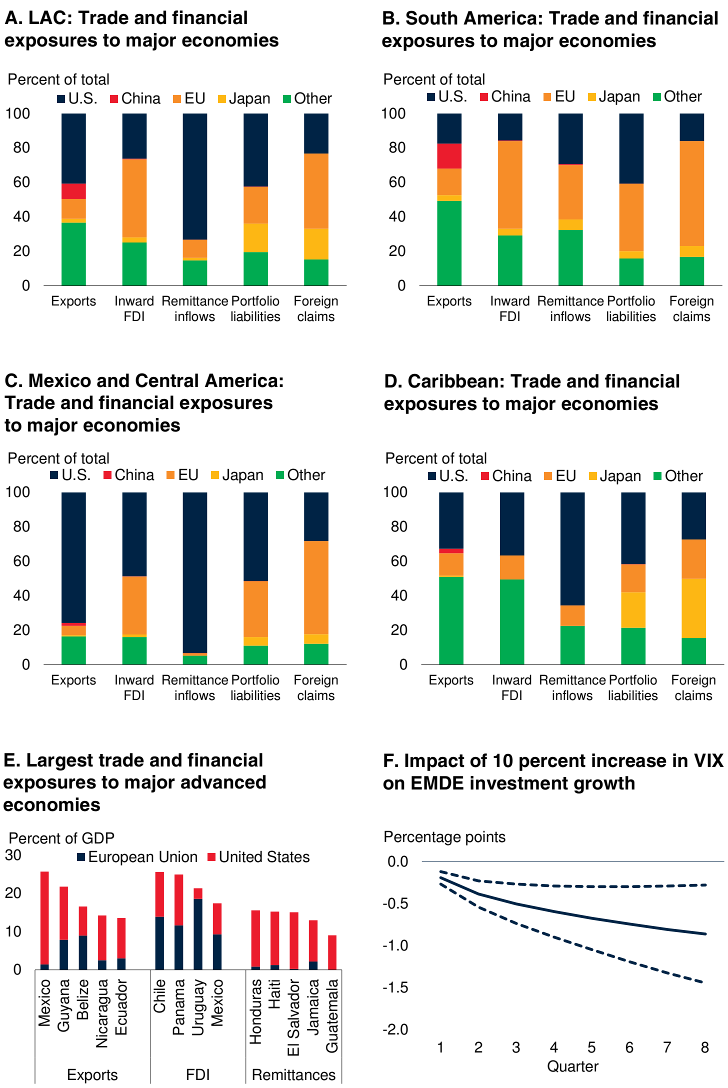
Supporting the recovery. The regional outlook assumes a bottoming out and recovery of the

[3]LAC economies have continued to de-dollarize (in terms of bank deposits in dollars) since the global financial crisis (Catao and Terrones 2016). This could have positive or negative impacts on debt repayment obligations, depending on the direction of exchange rate movements.

[4]Celasun et al. (2015) argue that rebuilding fiscal buffers, which deteriorated in the aftermath of the global financial crisis, should be an important priority for large LAC economies. They show that, across Brazil, Colombia, and Mexico consolidations of about 2-3 percentage points of GDP are necessary to allow debt ratios to trend down.

FIGURE 2.3.9 Risks of uncertainty in major advanced economies

The United States and the European Union account for more than half of exports and over four-fifths of remittance inflows. For South America, the Euro Area is the largest economic trading partner and source of capital flows, while Mexico and Central America and the Caribbean are deeply connected to the United States. Heightened policy uncertainty in the United States could decrease investment in EMDEs and impact growth, including in the LAC region.



Sources: Bank for International Settlements, Haver Analytics, International Monetary Fund, World Bank.
A.-D. 2010-15 averages. Exports include goods exports only. Foreign claims refer to total claims of BIS-reporting banks on foreign banks and nonbanks. Stock market capitalization is the market value of all publicly-traded shares. FDI data is available only to 2014. “U.S.” stands for United States; “EU” stands for European Union.
E. Figure shows goods exports to the United States/European Union, remittances from the United States/European Union, and FDI from the United States/European Union (all in percent of LAC countries’ GDP). FDI is presented as a stock. Other indicators are flows. FDI calculations exclude LAC countries with populations of less than 3 million.
F. Cumulative responses of EMDE investment to a 10 percent increase in the VIX. Solid lines indicate the median responses and the dotted lines indicate 16-84 percent confidence intervals. The model includes, in this order, the VIX, MSCI Emerging Markets Index (MXEM), J.P.Morgan Emerging Markets Bond Index (EMBIG), aggregate real output and investment growth in 18 EMDEs with G7 real GDP growth, U.S. 10-year bond yields, and MSCI World Index as exogenous regressors and estimated with two lags. Vector autoregressions are estimated with sample for 1998Q1-2016Q2.

South American economy by the first half of 2017. While it will be important for governments to nurture and support the nascent recovery, most governments in South America have limited policy space for counter-cyclical policies. Revenues have deteriorated sharply over the past couple of years, due to weak economic growth and depressed commodity prices. Monetary policy continues to be constrained by a combination of weak growth, elevated inflation, and volatile currencies, despite some recent easing of inflationary and exchange rate depreciation pressures. A carefully crafted fiscal-monetary policy mix will be necessary to provide a conducive environment for stronger domestic demand, especially in light of larger downside risks to global growth.

Fiscal reforms and public capital investment. Fiscal adjustment often entails slashing investment to key areas such as infrastructure. While this policy path quickly eases fiscal pressures, it fails to address the structural weaknesses hindering governments’ ability to decrease current spending or increase revenue. Decreased infrastructure investment may also inflict further harm to long-term growth. Given that investment levels in Latin America and the Caribbean are already low compared to other EMDE regions, and have been contracting since 2014, it is critical for governments and the private sector to increase capital investment to expand potential growth (Garcia-Escribano, Goes, and Karpowicz 2015; Cerra et al. 2016; Box 2.3.1; Chapter 3). To narrow fiscal deficits, governments will need to engage in deeper reforms to achieve better-quality revenue and spending, while maintaining investments that increase long-term growth (Corral et al. 2016). Measures to improve tax revenue collection—such as broadening the tax base, reducing tax evasion, and diversifying away from commodity-based taxes—will help improve fiscal positions and instill confidence.

In Brazil, the National Congress recently approved a constitutional amendment that introduces a cap on real federal expenditure growth, and is also discussing a pension reform. Both of these reforms will improve medium- and long-term fiscal prospects. In other countries, there have been delays in implementing reforms. For example, in

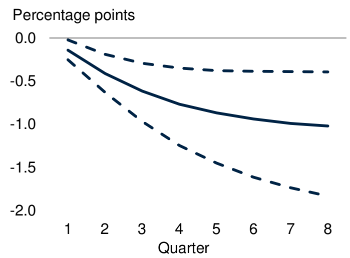
Argentina, gas tariff hikes were temporarily suspended by the Supreme Court in August, on the grounds that the government had not conducted mandatory public hearings. More moderate gas tariff hikes were reinstated after the hearings were held in September.

Attracting higher value-added FDI. Given the low savings rates in Latin America, one way of increasing investment, while maintaining a healthy fiscal balance, is to attract more foreign direct investment (FDI) (Becerra, Cavallo, and Noy 2015). While FDI into the region is expected to increase, experience suggests that it will likely be concentrated in the natural resources sector. Ideally, the region should make knowledge or technology-intensive FDI a priority. But to assimilate new knowledge and technology, comprehensive reforms to domestic education and innovation systems will be required across the region (EIU 2016). The soft outlook for the Euro Area is a related concern, as Europe has traditionally been the main source of FDI in higher value-added and R&D sectors in the region.

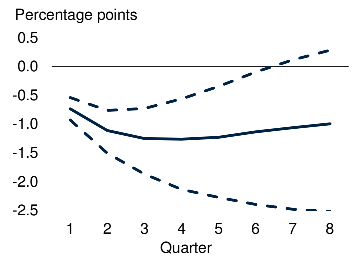
FIGURE 2.3.10 Spillovers from the United States and the Euro Area

A slowdown in U.S. or Euro Area output growth would reduce output growth in EMDEs considerably. EMDE investment would respond more strongly, possibly reflecting investor concerns about long-term growth prospects.

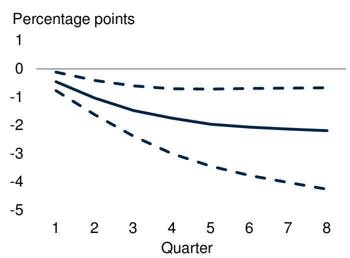
A. Output growth: Impact of 1 percentage-point slowdown in U.S. output growth on EMDEs



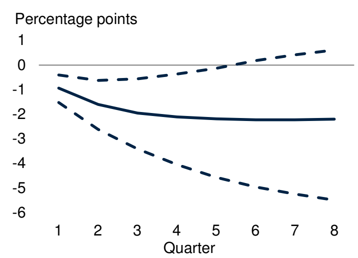
B. Output growth: Impact of 1 percentage-point slowdown in Euro Area output growth on EMDEs



C. Investment growth: Impact of 1 percentage-point slowdown in U.S. output growth on EMDEs



D. Investment growth: Impact of 1 percentage-point slowdown in Euro Area output growth on EMDEs



Sources: Haver Analytics, International Monetary Fund, World Bank.
Notes: Cumulative impulse response of weighted average EMDES output growth (A.B.) or investment growth (C.D.) at 1-8 quarter horizons to a 1 percentage point decline in growth in real GDP in the United States (A.C.) and Euro Area (B.D.). Growth spillovers based on a Bayesian vector autoregression of world GDP (excluding the source country of spillovers), output growth in the source country of the shock, the U.S. 10-year sovereign bond yield pulse JP Morgan's EMBI index, investment (C.D.), or output (A.B.) in EMDEs excluding China and oil price as an exogenous variable. Solid lines indicate the median responses and the dotted lines indicate 16-84 percent confidence intervals.

TABLE 2.3.1 Latin America and the Caribbean forecast summary

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

	2014	2015	2016	2017	2018	2019	2015	2016	2017	2018
			Estimates	Projections			(percentage point difference from June 2016 projections)			
EMDE LAC, GDP[a]	**0.9**	**-0.6**	**-1.4**	**1.2**	**2.3**	**2.6**	**0.1**	**-0.1**	**0.0**	**0.2**
(Average including countries with full national accounts and balance of payments data only)[b]										
EMDE LAC, GDP[b]	0.9	-0.6	-1.4	1.2	2.3	2.6	0.1	-0.1	0.0	0.2
GDP per capita (U.S. dollars)	-0.2	-1.7	-2.5	0.1	1.2	1.6	0.1	-0.1	0.0	0.2
PPP GDP	1.1	-0.1	-0.9	1.4	2.4	2.6	0.0	-0.1	-0.1	0.2
Private consumption	1.0	-0.6	-1.5	0.9	2.2	2.4	0.2	-0.2	0.3	0.4
Public consumption	2.2	0.9	-1.2	-1.2	0.5	0.9	0.2	2.1	-0.1	0.1
Fixed investment	-1.5	-5.1	-4.9	0.4	2.3	3.4	0.4	-0.3	-0.6	-0.5
Exports, GNFS[c]	1.6	3.6	1.5	3.3	3.3	3.5	0.1	-2.4	-1.1	-1.5
Imports, GNFS[c]	0.1	-2.2	-2.4	0.2	2.1	2.8	0.8	-1.5	-1.0	-1.7
Net exports, contribution to growth	0.3	1.2	0.8	0.7	0.3	0.2	-0.1	-0.2	0.0	0.0
Memo items: GDP										
South America[d]	0.3	-1.9	-2.8	0.8	2.1	2.4	0.0	0.0	0.3	0.4
Mexico and Central America[e]	2.5	2.8	2.3	2.1	2.7	2.9	0.1	-0.4	-0.9	-0.4
Caribbean[f]	4.2	3.4	3.2	3.1	3.4	3.3	0.0	0.6	-0.1	0.2
Brazil	0.5	-3.8	-3.4	0.5	1.8	2.2	0.0	0.6	0.7	1.0
Mexico	2.3	2.6	2.0	1.8	2.5	2.8	0.1	-0.5	-1.0	-0.5
Argentina	-2.6	2.5	-2.3	2.7	3.2	3.2	0.4	-1.8	-0.4	0.2

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, Grenada, and Suriname.
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.
For additional information, please see www.worldbank.org/gep.

TABLE 2.3.2 Latin America and the Caribbean country forecasts[a]

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

	2014	2015	2016	2017	2018	2019	2015	2016	2017	2018
			Estimates	Projections			(percentage point difference from June 2016 projections)			
Argentina	-2.6	2.5	-2.3	2.7	3.2	3.2	0.4	-1.8	-0.4	0.2
Belize	4.1	2.9	-1.0	1.5	2.0	2.5	2.0	-1.8	-0.3	-0.2
Bolivia	5.5	4.8	3.7	3.5	3.4	3.4	0.0	0.0	0.1	0.0
Brazil	0.5	-3.8	-3.4	0.5	1.8	2.2	0.0	0.6	0.7	1.0
Chile	1.9	2.3	1.6	2.0	2.3	2.5	0.2	-0.3	-0.1	0.0
Colombia	4.4	3.1	1.7	2.5	3.0	3.3	0.0	-0.8	-0.5	-0.5
Costa Rica	3.0	3.7	4.3	3.9	3.7	3.7	0.9	1.0	0.3	-0.3
Dominica	3.7	-2.5	1.3	2.8	2.7	2.7	1.5	-1.2	0.8	0.7
Dominican Republic	7.6	7.0	6.8	4.5	4.2	4.0	0.1	1.8	0.2	0.2
Ecuador	4.0	0.2	-2.3	-2.9	-0.6	1.0	-0.1	1.7	1.1	-0.6
El Salvador	1.4	2.5	2.2	1.9	2.0	2.0	0.0	0.0	-0.4	-0.3
Guatemala	4.2	4.1	2.9	3.2	3.4	3.4	0.0	-0.6	-0.3	-0.2
Guyana	3.8	3.2	2.6	3.8	3.9	4.1	0.2	-1.4	-0.1	0.1
Haiti[b]	2.8	1.2	1.2	-0.6	1.5	2.0	0.0	0.3	-2.5	-0.7
Honduras	3.1	3.6	3.7	3.5	3.4	3.2	0.0	0.3	0.0	-0.1
Jamaica	0.7	1.0	1.6	2.0	2.3	2.5	0.1	0.1	-0.2	-0.3
Mexico	2.3	2.6	2.0	1.8	2.5	2.8	0.1	-0.5	-1.0	-0.5
Nicaragua	4.6	4.9	4.5	4.0	3.9	3.8	0.0	0.1	-0.2	-0.2
Panama	6.1	5.8	5.4	5.4	5.5	5.5	0.0	-0.6	-0.7	-0.7
Paraguay	4.7	3.1	3.8	3.6	3.3	3.3	0.1	0.8	0.4	-0.1
Peru	2.4	3.3	4.0	4.2	3.8	3.6	0.0	0.5	0.7	0.6
St. Lucia	-0.7	1.3	1.0	1.8	2.2	2.5	-0.3	-0.5	-0.2	0.2
St. Vincent and the Grenadines	0.2	0.6	2.0	2.2	2.4	2.4	-1.2	-0.4	-0.9	-0.7
Suriname[c]	0.4	-2.7	-7.0	0.5	1.1	1.3	...	...	...	...
Trinidad and Tobago	0.8	-1.8	-2.8	2.3	3.6	3.2	0.2	-0.8	0.3	1.1
Uruguay	3.2	1.0	0.7	1.6	2.5	3.7	0.0	0.0	0.0	0.0
Venezuela, RB	-3.9	-5.7	-11.6	-4.3	0.5	1.0	0.0	-1.5	-0.9	-1.1

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.
c. Growth rates for Suriname were not published in June 2016.
For additional information, please see www.worldbank.org/gep.

BOX 2.3.1 Recent investment slowdown: Latin America and the Caribbean

Investment growth in the region dropped from 12.5 percent in 2010 to -4.8 percent in 2015, reflecting political and policy uncertainty in several of the region's major economies, a severe terms-of-trade deterioration, and a broad-based slowdown in economic growth across the region. Remaining investment needs are sizable, especially in education and infrastructure.

Latin America and the Caribbean (LAC) accounted for 7 percent of global investment in 2010-15.[1] During this period, investment growth slowed sharply in the region, from about 12.5 percent in 2010 to -4.8 percent in 2015, well below its long-term (1990-2008) average of 4.6 percent. Regional investment is projected to decline further, by more than 1 percent, in 2016.

This box discusses the following questions.

- How has investment growth in the region evolved?
- What were the main sources of the investment slowdown?
- What are current and prospective investment needs?
- Which policies can address these investment needs?

The decline in investment growth in the LAC region in 2010-15 was concentrated in commodity exporters. It reflected domestic macroeconomic challenges, a sharp terms-of-trade deterioration resulting from declines in global commodity prices, and slowdowns in economic growth, with outright recessions in some cases. Current and prospective investment needs are sizable, especially in education and infrastructure.

How has regional investment growth evolved?

The LAC region accounted for 7 percent of global investment during 2010-15, less than LAC's 8 percent share of global output. This investment underperformance reflects low investment-to-GDP ratios in LAC, averaging around 22 percent during 2010-15, significantly below the EMDE average of 32 percent. Current private investment-to-GDP ratios have fallen below levels prior to the global financial crisis (IMF 2015e).

Regional investment has contracted since 2014 amid deep recessions in several of the region's largest economies (Argentina, Brazil, República Bolivariana de Venezuela) and growth slowdowns in the rest of the region (Figure 2.3.1.1). In 2015, investment growth was below its long-term average in two-thirds of LAC economies and negative in one-third of them (Brazil, Chile, Ecuador, Jamaica, and Peru). Preliminary data point to a further investment decline in the first half of 2016.

The declines mark a sharp reversal of the region's robust investment growth before 2010, when LAC countries were buoyed by robust overall growth prospects, still-elevated commodity prices, and relative political stability in the region. During 2010-15, investment growth averaged 3.9 percent, significantly below the 7.8 percent average during 2003-08. The recent weakening of investment growth has returned investment-to-GDP ratios near their levels in the early 2000s. The slowdown in investment growth has been broad-based across various sectors, and across public and private investment. In light of the weakened economic growth prospects for the region, investment growth is expected to remain low in the short to medium term.

South America, with a large share of commodity exporters, experienced the sharpest downturn in investment growth in the LAC region as these economies' terms of trade deteriorated sharply (World Bank 2016k; IMF 2015e). Investment in Mexico and many other countries in Central America has been more robust as reform agendas, especially in Mexico, have bolstered confidence. Investment growth has also picked up in the Caribbean, partly due to strong construction growth supporting the tourism sector.

What were the main sources of the investment slowdown?

The post-crisis slump in commodity prices and associated deterioration in the terms-of-trade triggered sharp investment drops in commodity-producing sectors, in particular mining, across the region (IMF 2015e, World Bank 2016l; Figure 2.3.1.2). Investment also declined in non-commodity-producing sectors. Public investment was curtailed as fiscal revenues shrank and fiscal deficits widened as a result of lower commodity prices and slowing growth. Private investment declined as investor confidence in growth prospects waned, especially among major commodity exporters (IADB 2016, IMF 2015b). Political

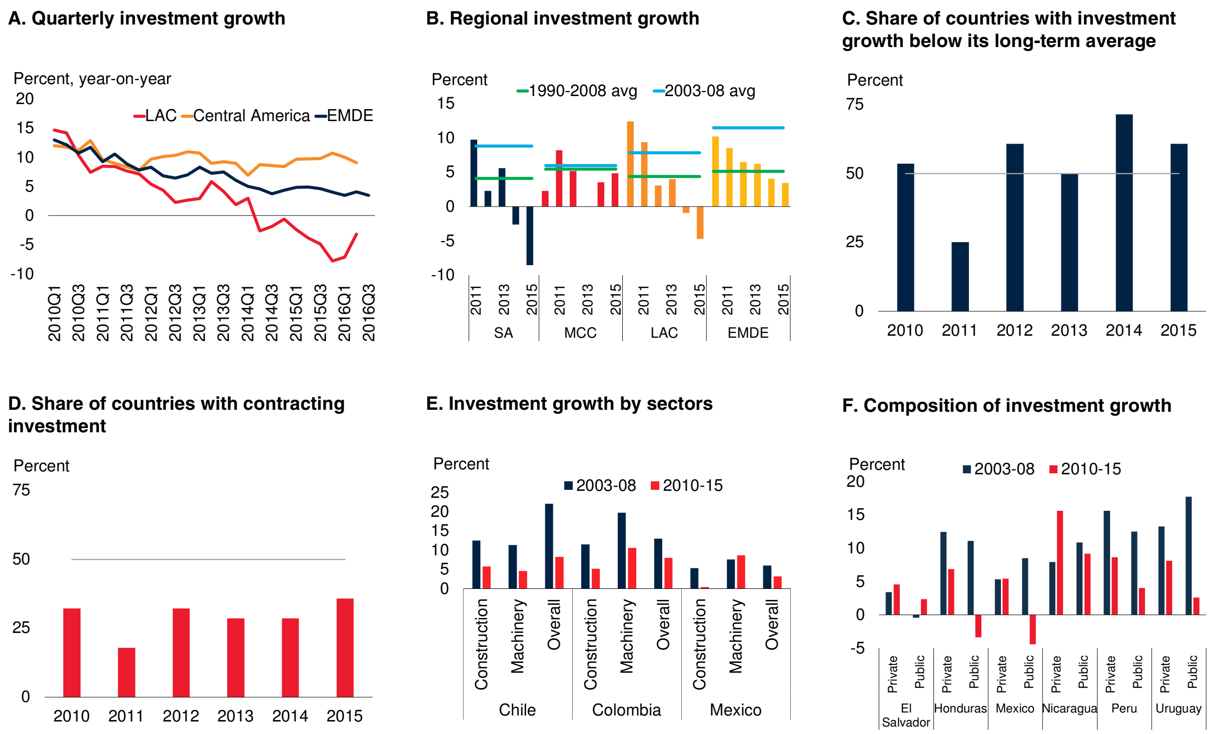
Note: This box was prepared by Derek Chen.

[1]Throughout this box, unless otherwise specified, investment refers to real gross fixed capital formation (public and private combined). For the sake of brevity, "investment" is understood to indicate investment levels. Investment growth is measured as the annual percent change in real investment.

BOX 2.3.1 Recent investment slowdown: Latin America and the Caribbean *(continued)*

FIGURE 2.3.1.1 Investment growth slowdown

Partly due to weak overall economic growth, investment growth slowed sharply during 2010-15. The investment slowdown was broad-based across various sectors and across both private and public investment. Investment growth is expected to remain low and may decline further in the short to medium term.



Sources: Haver Analytics, International Monetary Fund, Oxford Economics, World Bank.
A. GDP-weighted averages. Includes quarterly data for Bolivia, Brazil, Chile, Colombia, Costa Rica, Guatemala, Mexico, Nicaragua, Paraguay, Peru, and Uruguay. Central America includes Costa Rica, Guatemala, Mexico, and Nicaragua. "EMDE" stands for emerging market and developing economies.
B. Averages weighted by investment levels. "SA" stands for South America. "MCC" stands for Mexico, Central America, and the Caribbean.
E. For Chile, 2003-08 data begins in 2004.
F. Figure shows growth rates of gross fixed capital formation in constant 2010 U.S. dollars.

and policy uncertainty has also dampened investor confidence and discouraged investment expenditures in several countries in recent years (Argentina, Brazil, Haiti, República Bolivariana de Venezuela) (IMF 2016l).

Tightening financing conditions in the region further weighed on investment. As the U.S. Federal Reserve began to reduce monetary accommodation in 2014-15, currencies of major commodity exporters in the region depreciated against the dollar, some by around 30 percent in 2015 (Brazil, Colombia). Coupled with severe weather conditions that affected domestic food supplies, upward pressures on inflation led some central banks in the region, especially in South America, to raise interest rates in 2015-16 to contain price rises despite weak output growth (Argentina, Brazil, Chile, Colombia), further dampening investment growth.

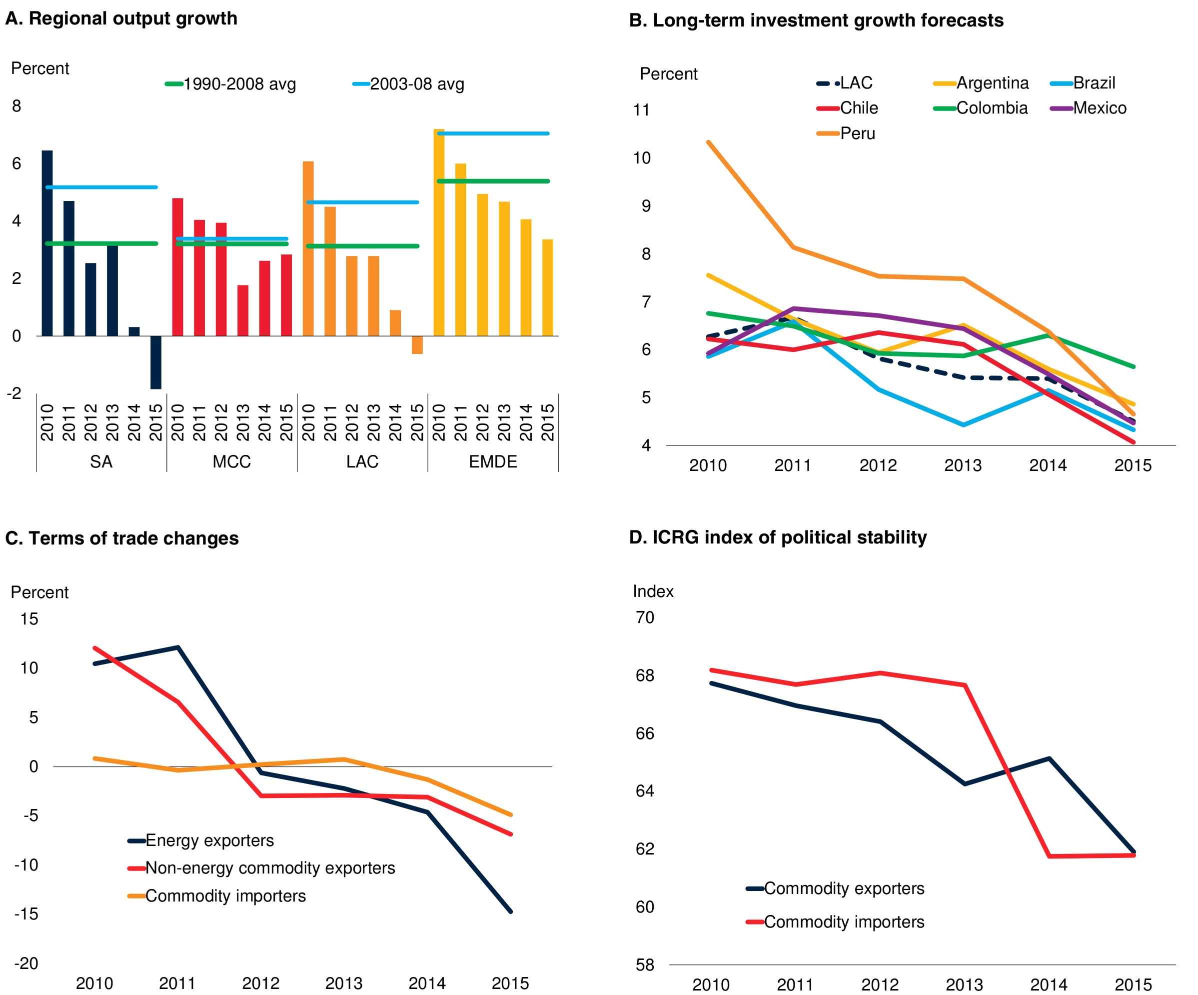
What are current and prospective investment needs?

Investment needs in the region remain significant. The low quality of infrastructure and poor skills of the labor force are bottlenecks to the achievement of faster productivity growth, for example in Brazil (World Bank 2016k), and to poverty reduction. Infrastructure has not kept pace with urbanization in the region (IADB 2010), while the majority of the poor in LAC are in urban areas. Immediate needs for investment in infrastructure and education have also been identified in country studies of Belize, Bolivia,

BOX 2.3.1 Recent investment slowdown: Latin America and the Caribbean *(continued)*

FIGURE 2.3.1.2 Correlates of investment growth slowdown

The investment slowdown has coincided with severe terms-of-trade deteriorations, sharp output growth slowdowns, slowing FDI inflows, political tensions, and domestic policy tightening. Over the medium term, investment growth is expected to remain low.



Sources: Haver Analytics, Consensus Economics, World Economic Forum (2016), World Bank.
A. GDP-weighted averages. “SA” stands for South America. “MCC” stands for Mexico, Central America, and the Caribbean.
B. Consensus Economics five-year ahead investment growth forecasts.
C. GDP-weighted average annual change in terms of trade. Negative value indicates deterioration. Energy exporters include Bolivia, Colombia and Ecuador. Non-energy commodity exporters include Argentina, Brazil, Chile, Costa Rica, Guatemala, Honduras, Nicaragua, Panama, Paraguay, Peru, and Uruguay. Commodity importers include Dominican Republic, El Salvador, Haiti, and Mexico.
D. ICRG is the International Country Risk Guide, an index of political stability produced by the PRS Group. A decline indicates greater political instability.

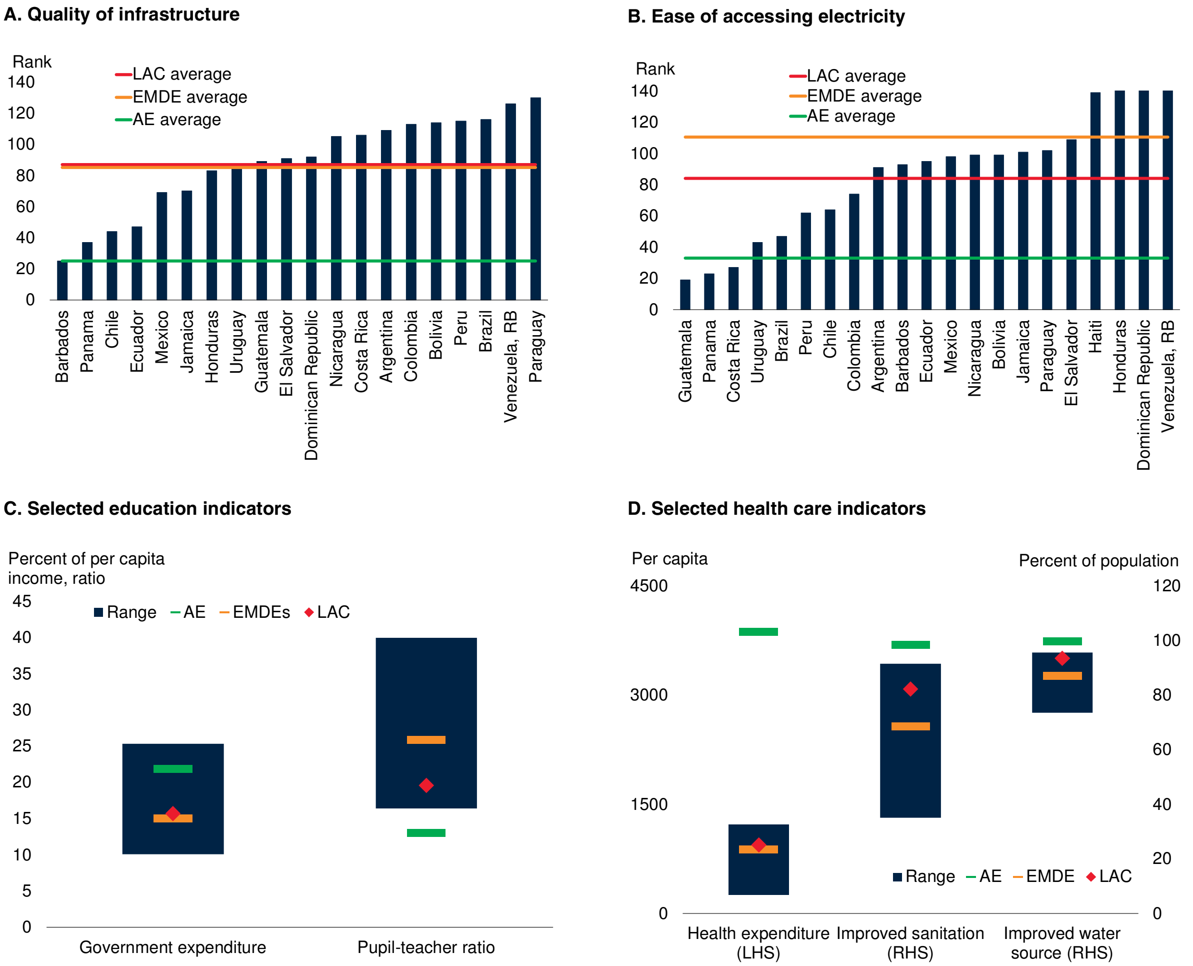
Colombia, Costa Rica, El Salvador, Guatemala, Haiti, Honduras, Panama, and Uruguay (World Bank 2015i-q, and 2016l).

Infrastructure investment. On average across the 16 EMDEs in LAC over 2008-2013, infrastructure investment amounted to just 3.7 percent of GDP, well below the 5-6 percent of GDP required just to sustain current economic growth rates (IADB 2016m; Bhattacharya, Romani, and Stern 2012; Kohli and Basil 2010; Fay and Yepes 2003; Calderón and Servén 2003; and Perrotti and Sánchez 2011). Apart from low investment levels, the quality of infrastructure in the LAC region is poor relative to that of advanced economies and Asian emerging markets. The

BOX 2.3.1 Recent investment slowdown: Latin America and the Caribbean *(continued)*

FIGURE 2.3.1.3 Investment needs

A number of LAC countries rank poorly on access to quality infrastructure. Important among current investment needs are infrastructure and education, in terms of both quantity and quality.



Sources: World Bank (2017), World Economic Forum (2016).
A. Rankings out of 138 countries.
B. Rankings out of 190 countries.
C. Blue bars denote range of unweighted regional averages across EMDE regions. Government expenditure per primary student (in percent of per capita income), unweighted averages of 87 EMDEs, 32 AEs, and 20 LAC economies. Pupil-teacher ratio in primary education (headcount basis), unweighted averages for 165 EMDEs, 31 AEs, and 23 LAC economies. Latest available data available during 2011-15.
D. Blue bars denote range of unweighted regional averages across EMDE regions. Health expenditure per capita in purchasing power parity terms, unweighted averages of 199 EMDEs, 34 AEs, and 31 LAC economies. Access to improved sanitation facilities (in percent of population), unweighted averages for 150 EMDEs, 33 AEs, and 28 LAC economies. Access to improved water sources (in percent of population), unweighted averages for 148 EMDEs, 34 AEs, and 30 LAC economies. Latest available data available during 2011-15.

average LAC economy ranked 82nd out of 138 economies (around the 40th percentile) on quality of infrastructure (World Economic Forum 2016; Figure 2.3.1.3). Priority infrastructure needs in the region include improving road conditions through maintenance and rehabilitation (Uruguay), upgrading infrastructure relating to energy (Panama), increasing access to electricity in rural areas (Bolivia), enhancing the quality of roads and ports (Costa Rica), and reducing the prices of electricity (Costa Rica).

Education. While public education expenditure in the region is on par with the EMDE average, various metrics of the quality of education systems, such as the average student-teacher ratio, fall short of EMDE comparators.

BOX 2.3.1 Recent investment slowdown: Latin America and the Caribbean *(continued)*

Urgent education needs include improved pre-school education and access to early childhood education; better teacher training and quality; and a reorientation of education programs towards employer needs, such as information technology and English language skills (Belize, Bolivia, Costa Rica, El Salvador, Guatemala, Panama).

Public health. The region's public health expenditures are slightly above that of EMDE comparators. Health infrastructure, such as access to improved sanitation and improved water sources, exceeds that of EMDE peers. However, urgent health care investment needs remain (World Bank 2015j, n). These include tackling malnutrition (Guatemala), increasing access to improved sanitation in rural and urban areas, and access to specialized health care services for women and children (Bolivia).

Which policies can help address investment needs?

While policy priorities differ across countries, most economies in the region have limited funds to expand public investment spending. The lack of resources places a premium on the efficiency of public investment, which may be enhanced by leveraging public funds with public-private partnerships and implementing reforms to stimulate private investment.

- Strengthening the efficiency of public investment includes streamlining the process for the development, approval, and selection of projects (IADB 2016). Transparency in the project selection process and its monitoring and coordination between multiple stakeholders can help remove inefficiencies.

- Several countries have begun to develop public-private partnership frameworks (Chile, Colombia, Peru). If designed well, these can improve the efficiency of public investment spending (Engel, Fischer, and Galetovic 2014).

- LAC economies rank low on ease of business startup and tax compliance (South America and Central America), as well as trading across borders and registering property (Caribbean and South America) (World Bank 2017). Reforms to ease these constraints can also encourage investment.

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