The current international context

and its macroeconomic repercussions for Latin America and the Caribbean

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Contents

Introduction

This document identifies the key aspects of the current international economic situation and their principal implications for the macroeconomic performance of Latin America and the Caribbean. These aspects include preliminary indications that the global economic slowdown has come to a halt, which may be reflected by a degree of stabilization in the growth of international trade, although there is still no certain prospect of significant growth in either global GDP or international trade. Two trends combine within this potentially positive, but as yet uncertain, international picture: the first is linked to the effects of fiscal policies applied by the countries hardest hit by the 2008 global financial crisis, and the second to the repercussions of their monetary policies.

One the one hand, risks remain, and adjustments made to narrow persistent fiscal gaps in Europe, Japan and the United States tended to constrain domestic demand in the developed countries. While approaches differed, most countries curbed public spending or raised taxes. Conversely, monetary stimulus measures were used to help lift economies out of recession. The United States Federal Reserve applied a monetary stimulus programme that consisted of acquiring financial and non-financial assets from the private sector in exchange for liquidity, leading to growth in monetary aggregates, subject to varying lags. Japan and the United Kingdom, as well as the European Central Bank, adopted similar policies to help lending recover in their respective economies.

These policies have had differentiated effects. By severely curtailing the growth of domestic demand —including demand for imports— fiscal adjustments in developed countries have tended to entrench the slack growth caused by the global financial crisis, which has dampened international trade. This situation, with its multiplier effects on other economies, such as China, has directly affected the economies of Latin America and the Caribbean by prompting a decline in exports, partly owing to a fall in prices for raw materials exports. Lower growth in developed countries also hurt tourism and remittance flows to the region, while the balance-of-payments current account position worsened in numerous Latin American and Caribbean countries. Despite this, economic activity and employment remained relatively buoyant and posted partial upturns in some cases.

The increase in international liquidity resulting from monetary stimulus fuelled a surge in capital flows to various emerging markets, including those in Latin America and the Caribbean, as expectations of greater yield spreads were fired by prospects of higher rates of interest and economic growth in these markets. At the same time, greater demand for emerging market assets exerted upward pressure on these countries' currencies vis-à-vis the United States dollar, particularly in those economies most integrated with international financial markets and those specializing in commodities, which also attracted international investment.

In May 2013, the Chairman of the United States Federal Reserve announced that the asset purchase programme under way could be wound up, depending on developments in economic activity and employment, in particular. While this announcement was positive in that it suggested a relative recovery in the United States economy, it led to greater instability in the short term, with higher United States bond (and interest rate) yields, falls in world and Latin American stock indexes and more volatile exchange rates, including downward pressures on the currencies of the Latin American countries —and emerging countries in general— that are more fully integrated in international financial markets. The risk premiums of emerging economies, including those of Latin America and the Caribbean, therefore climbed after May 2013, reflecting expectations that external resources would become costlier. This is because more expensive external financing would affect countries whose current account deficits would widen significantly, given that they would be largely reliant on external financing to cover this gap.

With the subsequent announcement, in September, that the withdrawal of monetary stimulus was to be postponed, stock indexes jumped, United States bond yields fell and several Latin American currencies strengthened against the dollar. The danger remains, however, that a stimulus withdrawal announcement could weaken demand for the financial assets of Latin American economies, reducing the prices and the issuance of new emerging market debt instruments and pushing up the cost of the external resources required to cover current account deficits and finance investment. Uncertainty over United States fiscal policy, which threatens to be tighter in future, together with the slower growth of the Chinese economy, could exert a moderating influence on some commodity prices. This means that, from the perspective of revitalizing the world economy and the economy of Latin America and the Caribbean, the withdrawal of monetary stimulus measures would have to coincide with a clear upturn in trade, supported by the fiscal policy stances of developed countries, in order to offset the effects of financial volatility and uncertainty caused by the withdrawal —or the announcement of the end— of quantitative easing.

ECLAC considers that policy responses with both long- and short-term focus are needed to help speed the transition from sluggish trade growth and international financial volatility. In the short term, the new global financial scenario is shaped by expectations of higher returns on United States assets and, possibly, an end to the downturn in the developed economies. Under these conditions, investment portfolios are likely to be rebalanced in favour of the developed country financial assets, especially those of the United States. This usually happens quickly and produces exaggerated short-term variations in key prices, such as exchange rates and export commodity prices. To a certain extent, this portfolio realignment has already taken place, as indicated by net outflows of the most variable and liquid components of the balance-of-payments current account in several of the region's countries (other net investment liabilities, which include cross-border deposits and credit lines). It cannot be ruled out that these outflows will continue over the coming months, albeit less intensively, since the most volatile outflows are likely to have already occurred.

To the extent that there is a credible exchange-rate system (in other words, the nominal exchange rate is not too distant from an appropriate level according to its fundamental determinants), short-term responses should focus on two areas: (i) using international reserves and regulating financial inflows and outflows to strengthen confidence in the system and avert sudden outflows caused by expectations of changes to the exchange-rate regime, and (ii) softening the sharpest exchange-rate fluctuations, in view of their possible effect on inflation and on devaluation expectations, which are often self-fulfilling.

Developed countries' currencies are likely to strengthen in the medium to long term as their economies achieve stronger growth and monetary policy becomes less expansionary. This would help restore equilibrium after the distortions created by the unprecedented surge in global liquidity that originated in developed countries.

The general recommendation would be to let this new scenario settle in, allowing exchange rates to reflect depreciation in the currencies of the less developed countries. While this may mean a relative increase in the prices of goods required for consumption and domestic production, it will allow Latin American and Caribbean tradable (exportable and importable) sectors to regain some of their lost competitiveness. This exchange-rate policy recommendation should be framed within a long-term approach centred on promoting investment in diversifying production in tradable sectors, which would result in a transition from growth driven mainly by consumption, to a situation in which investment and exports make a stronger contribution to growth in a context of increasing equality.

ECLAC studies suggest that labour productivity in Latin America and the Caribbean is shaped by the amount and the destination of investment, as well as by the structural heterogeneity that exists in the region. To increase productivity and lay the foundations for future growth, ECLAC argues in favour of investment in boosting production and diversifying tradable goods and services, based on covenants involving the State, the private sector and social organizations, through institutional arrangements and the implementation of short- and long-term policies. As part of this process, it would be crucial to tap the regional demand that has emerged from consumption growth in Latin America and the Caribbean in recent years, since this could be the starting point for an integration process based on the vigorous expansion of intraregional investment and exports.

Chapter I

The international context

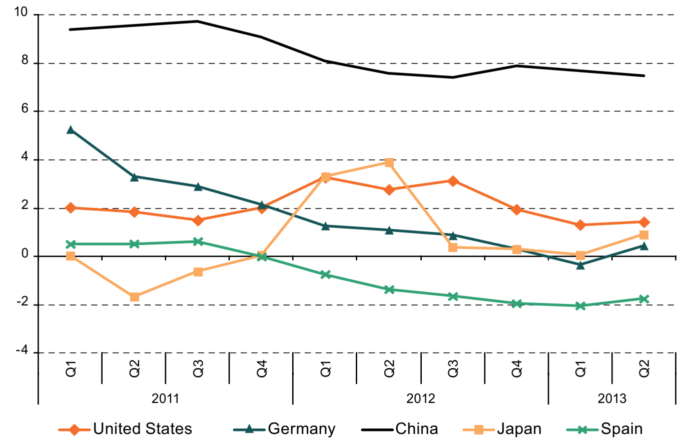
1. Signs are emerging that the global economic downturn has slowed

- After several years of steady decline in the main macroeconomic indicators, the first half of 2013 brought the first signs that the global economic downturn may be coming to an end.
- United States: the economy has continued to grow, albeit slowly, under the various stimulus programmes.
- Germany: the downtrend in growth rates was reversed in the second half of 2013.
- Spain and Italy: the decline has eased, but growth remains negative.
- Japan: with the country's economic stance now geared heavily towards reactivation, signs of recovery are appearing.
- China: growth rates, although lower than in previous years, remained high.

■ **Figure I.1** ■

Selected countries: gross domestic product, 2011-2013

(Year-on-year variation in percentages)



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

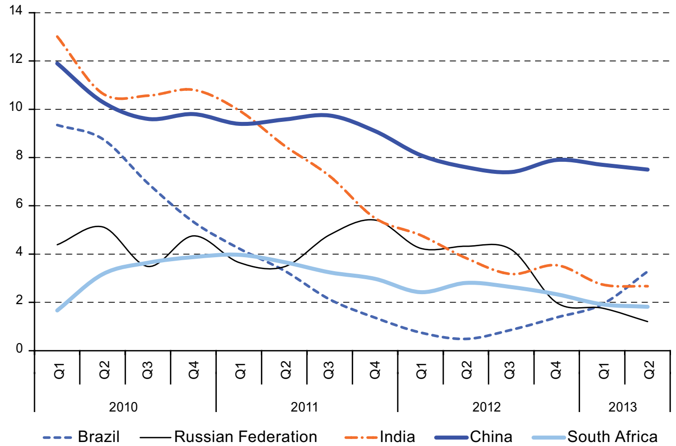
2. Economic growth has slowed in the BRICS (Brazil, Russian Federation, India and South Africa), except for Brazil, which is posting a recovery, and China, which is still growing strongly

- The heaviest slowdowns have occurred in India and, to a lesser extent, in the Russian Federation and South Africa.
- Brazil is experiencing a recovery and China's growth rates remain high.

■ **Figure I.2** ■

Brazil, Russian Federation, India and South Africa (BRICS): variation in gross domestic product, 2010-2013

(Percentages)



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

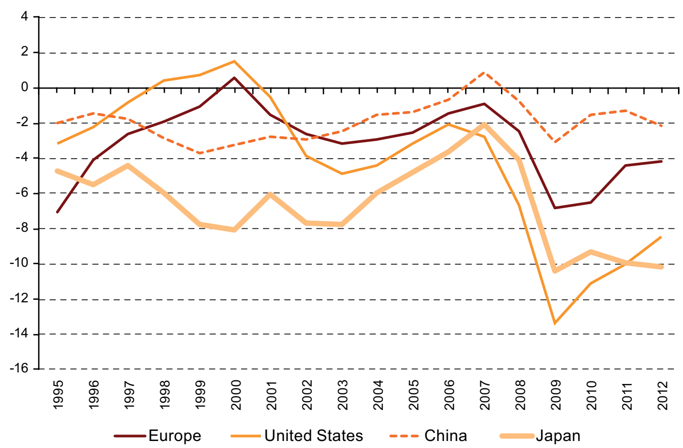
3. Large fiscal gaps remain, encumbered by lagged adjustment processes which continue to cause uncertainty for the global economy

- China, Europe, Japan and the United States have all run countercyclical fiscal policies, which have broadened their deficits. There have been some differences, however: (a) in China the deficit widened temporarily before returning to levels similar to those of previous years; (b) in Europe the gap widened more dramatically, but the fiscal adjustment was faster to start with, then more gradual as of 2012; (c) the United States saw the largest fiscal gap expansion in 2009, then began a gradual adjustment process starting in 2010; and (d) Japan's fiscal deficit also widened significant in 2009, but the country has yet to implement the sort of adjustment made in the other three cases.

■ Figure I.3 ■

Europe, China, Japan and the United States: fiscal balance, 1995-2012

(Percentages of GDP)



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

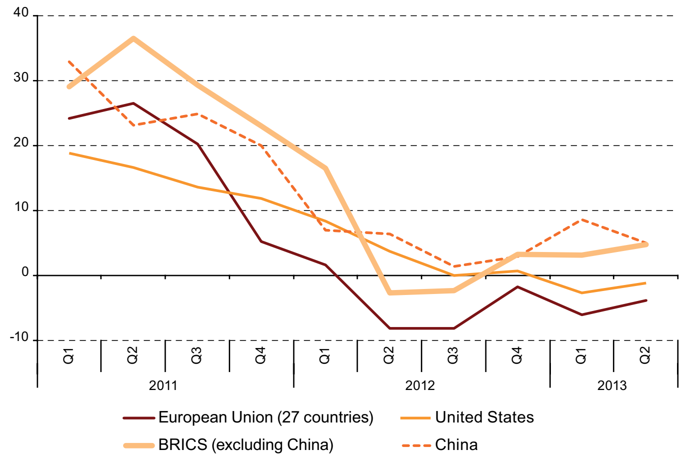
4. Total imports by the Latin American and Caribbean region's main trading partners appear to have stopped falling, but they remain sluggish

- China's imports retained positive growth (year-on-year) in the second quarter of 2013, but at rates well below the average for 2007-2011. This is likely attributable to the slowing in the country's economy.
- Imports into the BRICS countries (not including China) show a slight upturn on 2012, with positive rates in the first two quarters of 2013, albeit much lower than in earlier years.
- Imports by the European Union continued to decline, owing to economic problems in the eurozone, especially in Spain and Italy. The slowdown in total imports into the bloc continued into the first two quarters of 2013, but now appears to have bottomed out.
- Year-on-year variations in United States imports were negative for the second quarter running, reflecting the country's still relatively timid economic growth.

■ Figure I.4 ■

BRICS (excluding China), China, European Union[a] and United States: imports, first quarter 2011-second quarter 2013

(Year-on-year variation, in percentages)



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

[a] Includes extraregional trade of 27 countries.

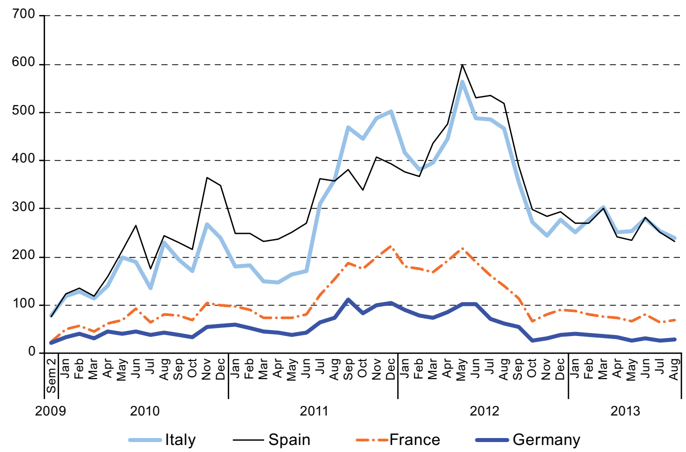
5. Country risk has stabilized in Europe

- Country risk premiums in the eurozone began to fall significantly after the European Central Bank announced its new policy in the second half of 2012. In 2013, they have reached a new, much lower floor.
- Some uncertainty remains, however, as to whether certain countries have successfully exited the crises, as reflected in rising risk premiums in Portugal and warnings in some quarters that Greece may need a new bailout in 2014.

Figure I.5

Europe (selected countries): five-year credit default swaps, second half 2009-first half 2013

(Basis points)



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

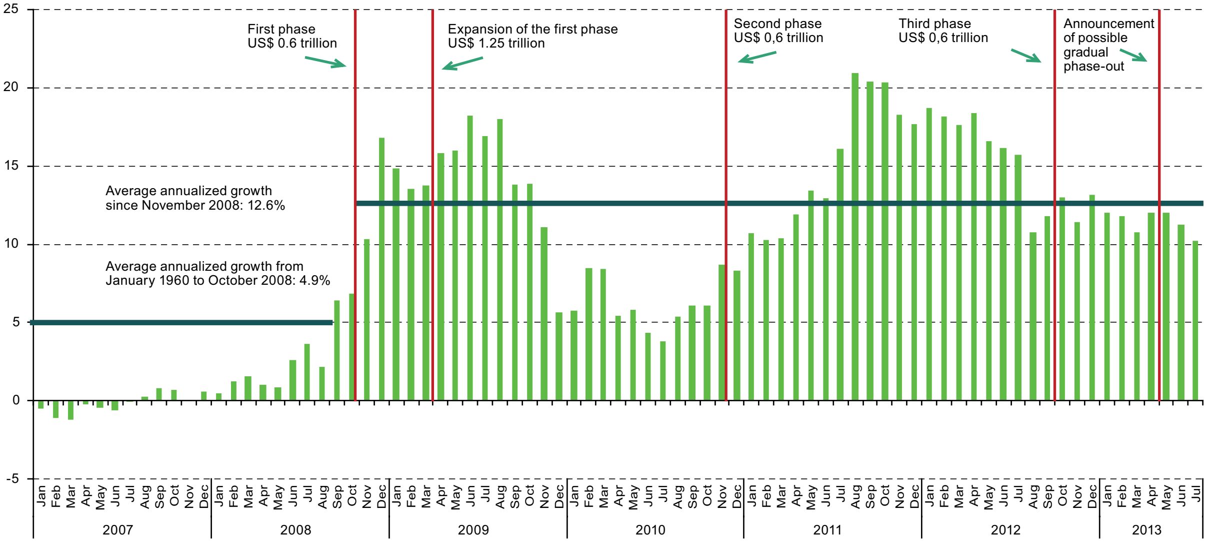
6. The beginning and ending of United States monetary stimulus: repercussions

- The purchase by the United States Federal Reserve of private sector financial and non-financial assets in exchange for liquidity in the framework of its monetary stimulus scheme has expanded monetary aggregates, including M1, with some lagged effects. Other economies, including Japan and the United Kingdom, have adopted similar policies to fuel credit recovery and aggregate domestic demand.
- Among other effects, the increased international liquidity resulting from quantitative easing boosted capital flows to emerging markets, including those of Latin America, as expectations of greater yield spreads were fired by prospects of higher rates of interest and economic growth in these markets.
- At the same time, greater demand for emerging market assets exerted upward pressure on the value of these countries' currencies, especially those whose economies are most integrated with international financial markets and those specializing in commodities, which international agents also viewed as a good investment prospect.
- In May 2013, the Chairman of the Federal Reserve announced that the asset purchase programme under way could be wound up, depending on developments in economic activity and employment in particular. This fuelled short-term volatility owing to uncertainty regarding: (i) when the stimulus would be withdrawn; (ii) how the "tapering off" would take place; and (iii) the effects it would have on the United States economy and the economies which had been receiving these flows.
- Expectations of tighter liquidity in international markets have already led to nominal currency depreciation in several emerging markets and commodity-exporting countries in general, and some of these economies have slowed.
- The announcement of monetary stimulus withdrawal could shrink demand for emerging-market financial assets, leading to lower prices for these assets, a decline in the issue of new emerging-market instruments and negative impacts on the real economy.
- Lower growth in China's economy could have moderate effects on commodity prices.

■ **Figure I.6** ■

United States: growth of M1 during quantitative easing, 2007-first half of 2013

(Yearly variation in percentages)



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

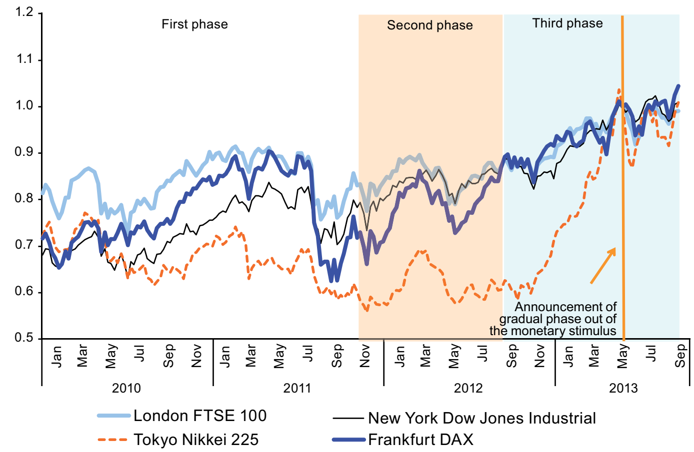
7. Monetary stimulus in the United States has affected the main stock markets

- The first stage of quantitative easing (QE1) boosted asset prices in the world's main stock markets.
- The European crisis, during which steps were taken to address the problems faced by Greece, coincided with larger fluctuations in the main stock markets.
- During later monetary stimulus periods, stock market performance improved in several developed countries.
- Lastly, the announcement of possible monetary stimulus withdrawal in the United States has fuelled uncertainty and may be increasing stock market volatility.

■ **Figure I.7** ■

Europe (selected countries), Japan and United States: stock market performance, 2007-2013

(Yearly variation in percentages)



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

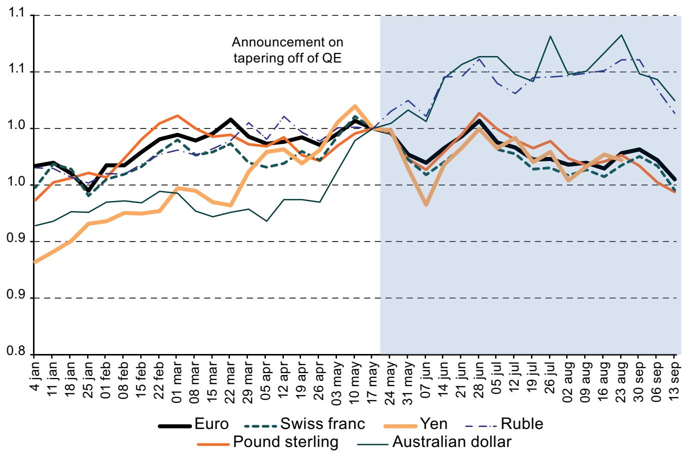
8. Financial volatility: quantitative easing in the United States has affected exchange rates

- The announcement of the tapering off of monetary stimulus led to a dip in currency values, including the Russian ruble and the Australian dollar, partly weakened by expectations of lower prices for the two countries' export raw materials.

■ Figure I.8 ■

United States dollar against the euro, the yen and the pound sterling, Swiss franc, Australian dollar and ruble

(Index: 22 May 2013=100)



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

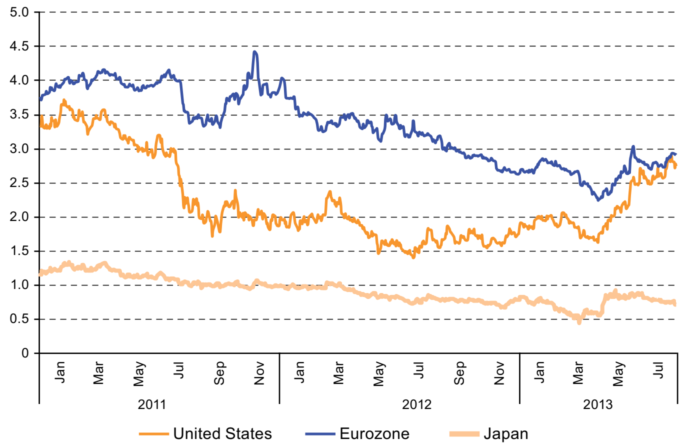
9. The possible end of monetary stimulus in the United States has pushed up yields on Treasury bonds (and interest rates)

- Yields on developed country sovereign bonds had been falling steadily owing to the unprecedented liquidity programmes in the United States and the shift in European Central Bank policy since mid-2012.
- In May 2013, this trend was reversed by expectations of: (a) recovery of the United States economy, (b) higher returns on United States financial assets, and (c) reduced liquidity injections by the Federal Reserve.

Figure I.9

Eurozone, Japan and United States: yields on 10-year sovereign bonds, January 2011-July 2013

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the Statistical Office of the European Communities (EUROSTAT) and Datastream.

Chapter II

Repercussions in Latin America and the Caribbean

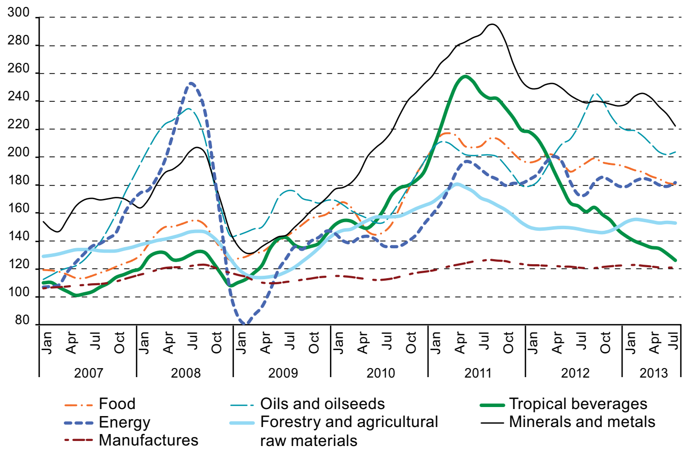
1. Current international economic conditions have led to a slight fall in the prices of the region's export commodities

- Throughout 2013 prices for the region's export commodities have fallen across the board, although with some differences.
- Nevertheless, prices are still relatively high compared with the levels seen before the global financial crisis. Among the largest prices falls are those of tropical beverages.
- The downtrend is attributable mainly to China's slowing economic growth.

■ **Figure II.1** ■

Latin America: price indices for export commodities and manufactured goods, three-month moving average, January 2007-July 2013 [a]

(Index, 2005=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the United Nations Conference on Trade and Development (UNCTAD) and the Netherlands Bureau of Economic Policy Analysis (CPB).

[a] The groups of export commodities are weighted by their share in Latin America's export basket.

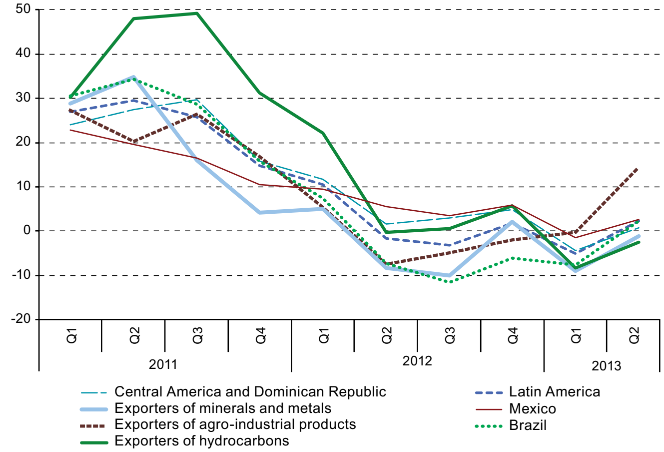
2. However, the downturn in the region's total exports and in exports to its main trading partners seems to have bottomed out

- Year-on-year, the value of exports picked up in the second quarter of the year (up 1.7%) compared with the sharp first-quarter fall (4.9%). Even so, this upturn in the second quarter was too small to offset the first-quarter figure, so in the first half-year export values were down by 1.6% year-on-year. This result is mainly a reflection of falls in the prices of several of the region's primary goods exports.
- Recession in the eurozone and still-weak growth in the United States lie behind the decline in the region's exports to those two markets thus far in 2013. The region's exports to China posted modest but positive growth in the second quarter after heavy falls in the three preceding quarters.
- Although exports to Asia (up 6.5%) were the main drivers of the modest year-on-year growth in total exports in the second quarter, growth in the region's exports to countries outside the large economic blocs (up 18.2% year-on-year) also played an important part. Most of these destination markets are in Africa.
- Exports have picked up more strongly in agro-industrial exporting countries (Argentina, Paraguay and Uruguay) than in exporters of hydrocarbons (Bolivarian Republic of Venezuela, Colombia, Ecuador and Plurinational State of Bolivia), pointing to the importance of raw materials in determining export values.

Figure II.2

Latin America: year-on-year variation in export values, by origin, January 2011–June 2013

(Percentages)

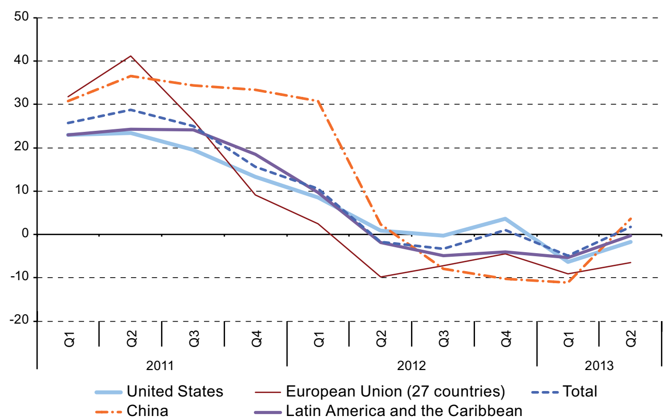


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure II.3

Latin America: year-on-year variation in export values, by destination, January 2011-June 2013

(Percentages)



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

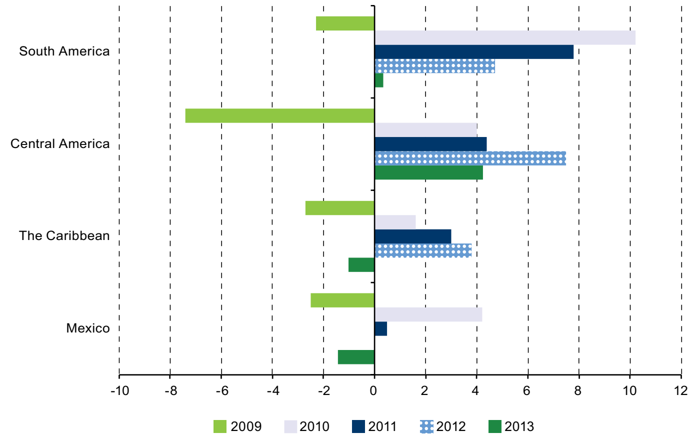
3. Tourism has picked up somewhat in Central America and, to a lesser extent, in South America, and has declined in Mexico and the Caribbean

- In the first few months of 2013 foreign tourist arrivals were down by 1% in Caribbean destinations and by 1.4% in Mexico.
- In the Caribbean, the downturn is attributable to the still difficult economic situation in the European countries, which are a major source of tourists for the subregion.
- Sluggish tourism flows into South America is mainly a result of slowing economic activity in the region itself, which affects intraregional tourism and business travel flows.
- The upturn (4.2%) in tourist arrivals into Central America mainly reflects the —albeit still slow— economic recovery in the United States, which is the main source of tourists for these countries.

Figure II.4

Latin America and the Caribbean: year-on-year variation in tourist arrivals, 2009-2013 [a]

(Percentages)



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

[a] The figures for 2013 refer to January-April and, in the case of Mexico, to January-May.

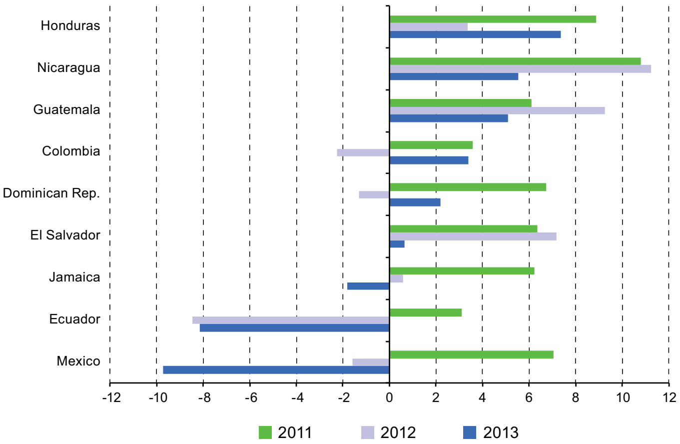
4. A mixed picture with regard to remittances: up in Central America but down in Ecuador and Mexico

- Thus far in 2013, remittances into Central America have risen, on the back of the upturn, albeit a slow one, in the United States economy.
- Remittance inflows have grown only slowly in Colombia and fallen sharply in Ecuador, reflecting the difficult labour situation in some of the main destination countries for emigrant workers: Plurinational State of Bolivia and Spain in the case of Colombia and Italy and Spain in the case of Ecuador.
- The drop in remittances into Mexico appears to reflect the fact that emigrants to the United States work mainly in sectors that suffered both during and after the global economic and financial crisis (construction, manufacturing and commerce), and that Mexico immigration into the United States is slowing and even going into decline to some extent.

■ Figure II.5 ■

Latin America and the Caribbean (selected countries): year-on-year variation in income from emigrant remittances, 2011-2013 [a]

(Percentages)



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

[a] The figures for 2013 refer to the first quarter for the Dominican Republic and Ecuador; January-April for Jamaica; January-May for Colombia and Honduras; January-June for Mexico and Nicaragua; and January-July for El Salvador and Guatemala.

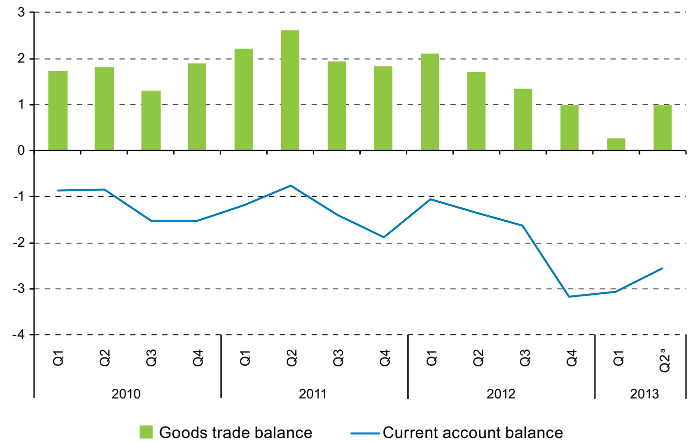
5. The current account continues to deteriorate

- Although the current account deficit was smaller in second-quarter 2013 than in the two preceding quarters, the region's balance-of-payments flows have deteriorated steadily over the past few years.
- The widening current account deficit is explained chiefly by the deterioration in the goods trade balance, as imports have increased faster than exports in the past few years and eroded the existing trade surplus. Furthermore, the sluggish performance of the inbound tourism market has worsened the services trade deficit.
- The surplus on the transfers balance has declined, as well, basically because of smaller remittances to Mexico, while the deficit on the income balance has held fairly steady during the past few years.

Figure II.6

Latin America (14 countries): current account and goods trade balance, January 2010-June 2013

(Percentages of GDP)



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

ª Preliminary figures.

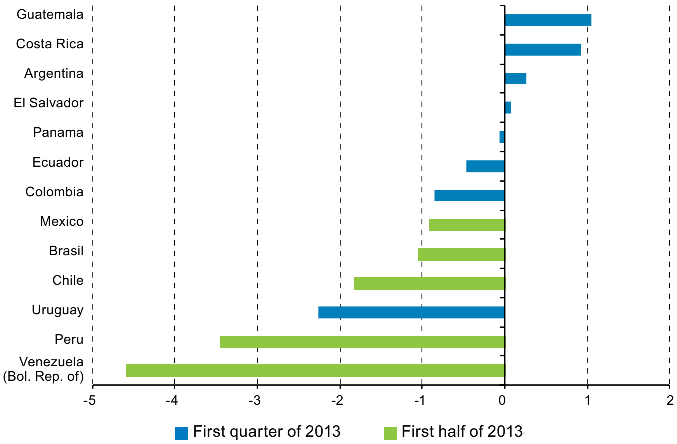
6. The current account has deteriorated in most of the countries in the region

- The current account has deteriorated in most of the countries in the region, especially in those most reliant on exports of minerals and metals (Chile and Peru) and hydrocarbons (Bolivarian Republic of Venezuela, Colombia and Ecuador), although more diversified economies (Brazil and Mexico) have experienced a similar trend. The Central American countries appear to be less affected.

Figure II.7

Latin America (selected countries): year-on-year variation in current account balance as a percentage of GDP, moving average, 2013

(Percentages of GDP)



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

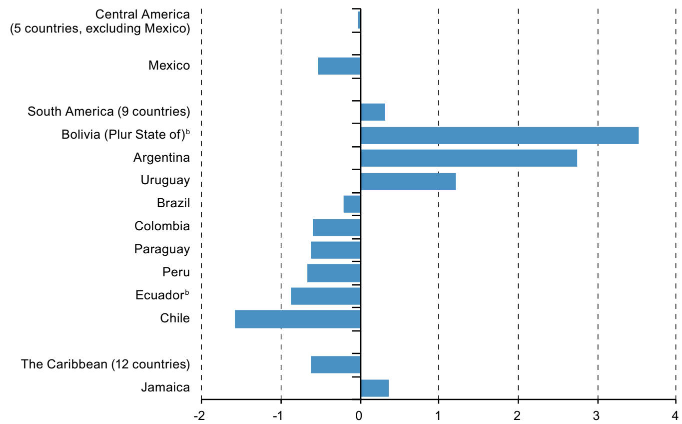
7. The picture is mixed with regard to fiscal revenues, depending on exports of metals and hydrocarbons, and the tourism industry

- The economic slowdown, the fall in some export commodity prices and the drop in tourism in the Caribbean have hit fiscal income in several of the region's countries.
- South America registered a rise in income on average, owing to jumps in revenues in Argentina, the Plurinational State of Bolivia and Uruguay. Conversely, tax revenues from copper export firms slumped in Chile and Peru, and income from hydrocarbons fell in Ecuador. Colombia, Paraguay and Brazil saw modest falls in total revenues.
- Income in the Caribbean has fallen by almost half a GDP percentage point, with the downturn across the board for exporters of services (tourism) and commodities (hydrocarbons and metals and minerals). Jamaica is showing a slight upturn after several years of declining income.
- Central America has experienced modest but fairly steady growth in income in the past few quarters and this, combined with recent tax measures, has made for some stability in total income. Mexico has seen a sharp fall in income from exports of hydrocarbons, partially offset by a rise in the income tax take.

■ **Figure II.8** ■

Latin America and the Caribbean (selected countries): year-on-year variation in total income as a percentage of GDP, June 2013 [a]

(Percentages of GDP)



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

[a] Compares the sum of income in the four quarters ending in June 2013 with the sum of income in the four quarters ending in June 2012.

[b] Non-financial public sector.

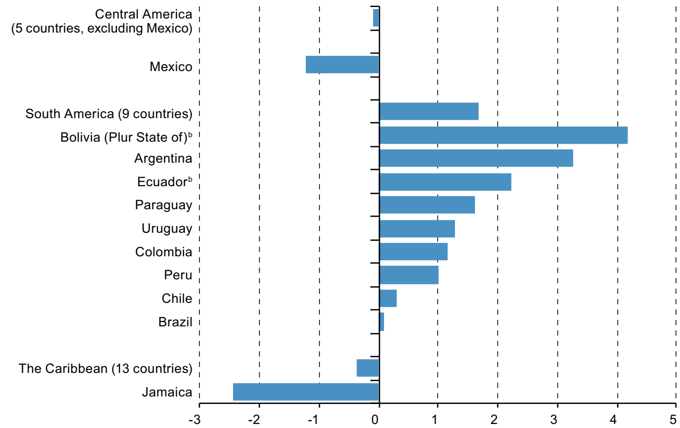
8. Public spending has trended upwards, especially in South America, in some cases as part of efforts to invigorate domestic demand in response to the downturn in the external sector

- Within South America, spending rose sharply in Argentina and the Plurinational State of Bolivia, in step in income trends, and in Paraguay and Ecuador, despite the cyclical drop in income. Expenditure rose at above-GDP rates in Peru, Chile, Colombia and Uruguay, as well. Conversely, in Brazil spending edged up as a percentage of GDP, owing in part to a substantial drop in interest payments in the past few quarters.
- The latest data available for Central America show a slight fall in public spending in relation to GDP. Mexico also started the year with very modest public spending, but is likely to up the pace during the rest of the year following the recent announcement of intentions to bring forward budget execution and broaden deficit targets for 2013 and 2014.
- The Caribbean countries have continued to adjust their public spending as part of efforts to narrow their deficits and ease the burden of public debt on their economies, amid slack growth that persisted for several years now.

Figure II.9

Latin America and the Caribbean (selected countries): year-on-year variation in total spending as a percentage of GDP, June 2013 [a]

(Percentages of GDP)



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

[a] Compares the sum of income in the four quarters ending in June 2013 with the sum of income in the four quarters ending in June 2012.

[b] Non-financial public sector.

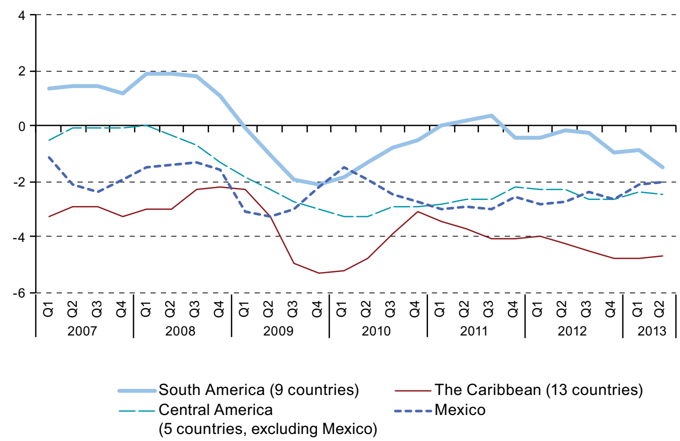
9. The fiscal deficit widened in the Caribbean and in South America

- The overall central government balance is reflecting a fresh downturn in the fiscal situation in the last few quarters in the Caribbean, a fairly persistent deficit of around two percentage points in Mexico and Central America, and a slight deterioration in South America.

■ **Figure II.10** ■

Latin America and the Caribbean (selected countries): overall balance, January 2007-June 2013 [a]

(Percentages of GDP)



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

[a] Sum of the overall balance of the last four quarters, divided by the moving average for GDP.

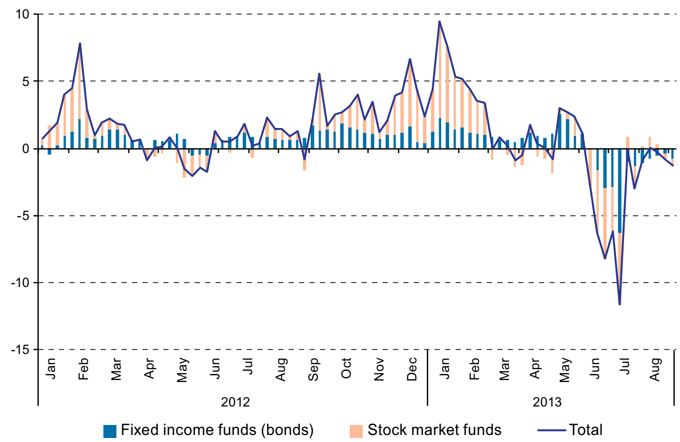
10. International financial volatility has led to a short-term adjustment in capital flows to emerging economies

- Financial investors have begun to rebalance their portfolios, withdrawing from funds involving emerging economy instruments.
- Now that United States asset yield expectations have risen and risk ratings for developed countries are more stable, their instruments are becoming more attractive compared with those of emerging economies.
- As a result, although foreign direct investment and portfolio investment have continued to flow into the region, the more volatile components of external financing are showing net outflows and reserve accumulation has slowed with respect to the preceding periods.
- The withdrawal of monetary stimulus in the United States is expected push up global interest rates, including the cost of external financing for Latin America and the Caribbean.

Figure II.11

Emerging economies: investment fund net inflows and outflows, January 2012-August 2013

(Billions of dollars)



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

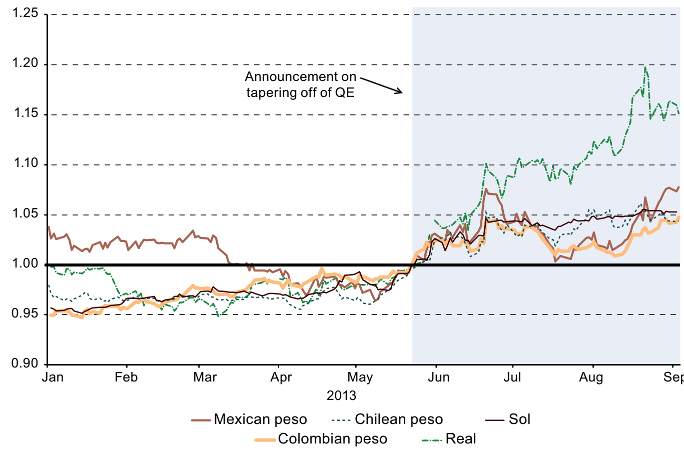
11. After the announcement that monetary stimulus could be phased out in the United States, exchange-rate instability increased in the economies most integrated into international financial markets

- For the economies of Latin America and the Caribbean, volatility in the international financial markets in the various phases of quantitative easing, combined with the macro developments, led to currency appreciation in those countries whose economies are most integrating into the financial markets.
- The recent announcements by the United States Federal Reserve, together with slowing growth in these economies, have strongly reversed the trend towards currency appreciation in the region. The currency depreciation following the Federal Reserve's announcements has been as much as 15% in some cases, including Brazil.

Figure II.12

Movement of the Brazilian real, Mexican peso, Colombian peso, Chilean peso and Peruvian sol against the United States dollar, January-September 2013

(Index: 22 May 2013=1.00)



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

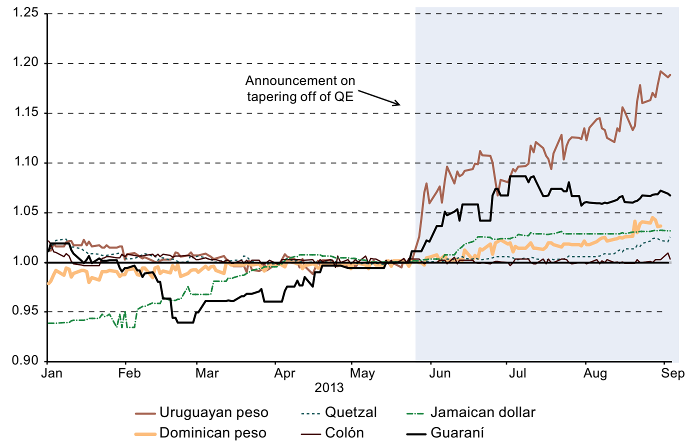
12. Exchange rate instability has increased in other countries in the region, as well

- The effects have not been confined to the currencies of the economies most integrated into the international financial markets. Other currencies, including the Uruguayan peso and the guaraní have depreciated by 18% and 5%, respectively.

Figure II.13

Movement of the Uruguayan peso, Dominican peso, quetzal, colón, Jamaican dollar and guaraní against the United States dollar, January-September 2013

(Index: 22 May 2013=1.00)



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

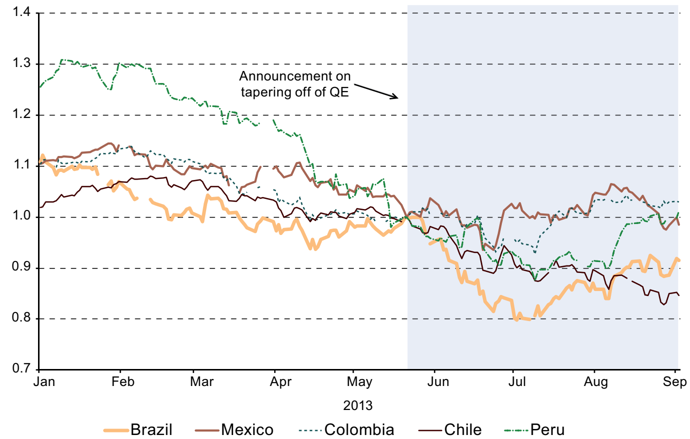
13. Financial instability has affected stock markets in Latin America

- The region's main stock markets have been highly volatile following the announcement of the tapering off of quantitative easing. Overall, stock markets have fallen in Brazil, Chile, Mexico and Peru, and slightly in Colombia.

■ **Figure II.14** ■

Latin America (selected countries): stock market values

(Index: 22 May 2013=1.00)



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

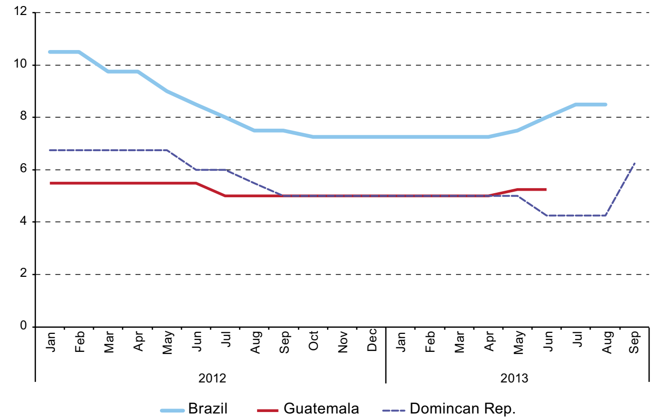
14. A range of monetary policies have been adopted in response to financial instability, both in inflation-targeting countries and countries with other monetary policy regimes

- Amid highly volatile external conditions, reflected by sharp nominal exchange-rate depreciations, the region's central banks again used a variety of instruments (interest rates, growth of monetary aggregates, management of international reserves and macroprudential policies) to pursue their policy objectives.
- In economies with inflation-targeting regimes, which therefore use the monetary policy rate as one of the main tools (or the main tool) of monetary policy, the following measures were taken in 2013:
  - Brazil, Guatemala and the Dominican Republic raised their monetary policy rates.
  - Colombia and Mexico reduced their policy rates.
  - In Chile and Peru, the central banks kept their policy rates unchanged.
- These trends reflect concerns about growing inflationary pressures in the countries that raised their interest rates and, in countries that reduced or maintained their rates, the view that within-target inflation gave central banks the policy space to boost aggregate domestic demand through the channel of monetary conditions. Some authorities (particularly those of Mexico), stated that the rate cuts also sought to counteract the effects of the growing volatility caused by monetary stimulus in advanced economies.

Figure II.15

Inflation-targeting countries that increased their monetary policy rates: interest rates, January 2012-September 2013

(Percentages)

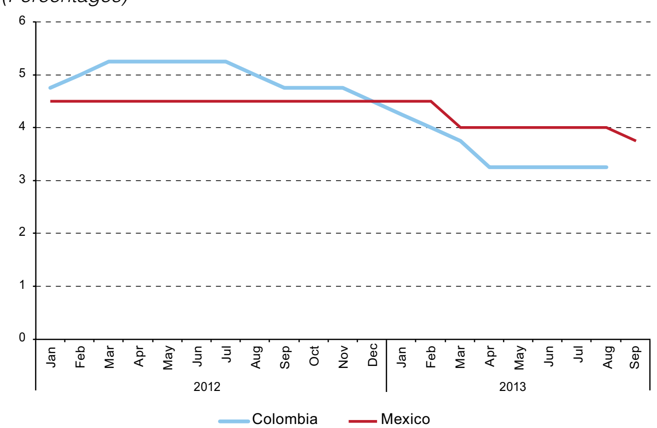


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure II.16

Inflation-targeting countries that reduced their monetary policy rates: interest rates, January 2012-September 2013

(Percentages)



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

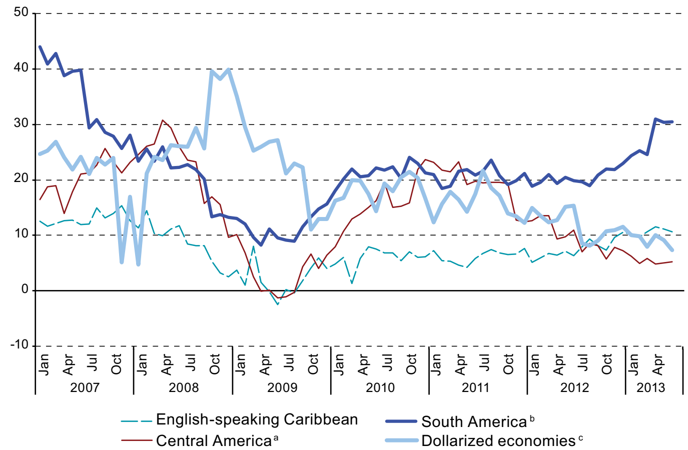
- In non-inflation-targeting countries, monetary aggregates are the main indicator of the type of monetary policy. These aggregates have sustained high growth in some of the region's countries, such as Argentina and the Bolivarian Republic of Venezuela. This explains why South American economies in this group (Argentina, the Bolivarian Republic of Venezuela, Paraguay, the Plurinational State of Bolivia and Uruguay) posted the region's highest average growth for M1, with rates close to 30%.

  In Uruguay, the monetary authorities decided in June 2013 to switch policy instruments and adopted a policy based on monitoring the growth of monetary aggregates, rather than managing rates.
- Within the non-inflation-targeting economies, the South American group differed from those of Central America, whose M1 monetary aggregates posted an average growth rate of less than 10%. Likewise, the monetary aggregates of the region's three dollarized economies grew at about 10%, and the economies of the English-speaking Caribbean showed M1 growth rates of slightly over 10%.

Figure II.17

Non-inflation-targeting countries: differentiated growth of monetary aggregates

(Year-on-year variation in M1, percentages)



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

[a] Includes Costa Rica, Haiti, Honduras and Nicaragua.

[b] Includes Argentina, the Bolivarian Republic of Venezuela, Paraguay, the Plurinational State of Bolivia and Uruguay.

[c] Ecuador, El Salvador and Panama.

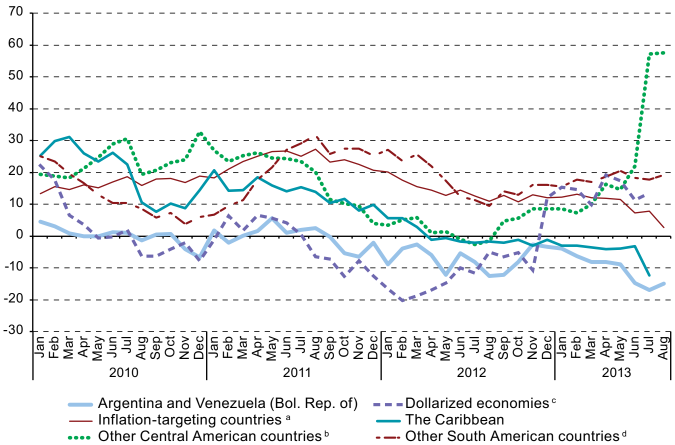
15. Several countries in the region reported slower growth in international reserves

- International reserves declined or expanded more slowly in the economies of the region that are more fully integrated into the international financial markets.
  - In Brazil and Chile, reserves fell slightly between December 2012 and July 2013.
  - International reserves rose in Colombia, Mexico and Peru over the same period.
  - International reserves dipped in Mexico and Brazil following the announcement by the United States Federal Reserve that monetary stimulus could be tapered off.
- There were gains in international reserves in certain other economies in the region, especially non-inflation-targeting Central American countries (notably Costa Rica) and Haiti, while international reserves declined in Argentina, the Bolivarian Republic of Venezuela and several Caribbean countries (the Bahamas, Barbados, Jamaica, Suriname and Guyana), where in some cases they fell by more than 10%.
- The management of international reserves was complemented by other measures to reduce exchange-rate volatility, including the introduction of repo mechanisms for United States dollars to protect against exchange-rate fluctuations, and guarantees of adequate access to foreign exchange liquidity to help the economy function normally (Brazil), monetary arrangements to meet demand for foreign exchange in order to facilitate bilateral trade (Brazil and Chile), the active use of reserve requirements and regulations on foreign-currency lending to encourage lending in the local currency (Peru), and interventions (purchases of dollars) on foreign exchange markets (Costa Rica and Colombia).

■ **Figure II.18** ■

Year-on-year variation in international reserves, 2010-2013

(Percentages)



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

[a] Includes Brazil, Chile, Colombia, the Dominican Republic, Guatemala, Mexico and Peru.

[b] Includes Costa Rica, Haiti, Honduras and Nicaragua.

[c] Ecuador, El Salvador and Panama.

[d] Includes Paraguay, the Plurinational State of Bolivia and Uruguay.

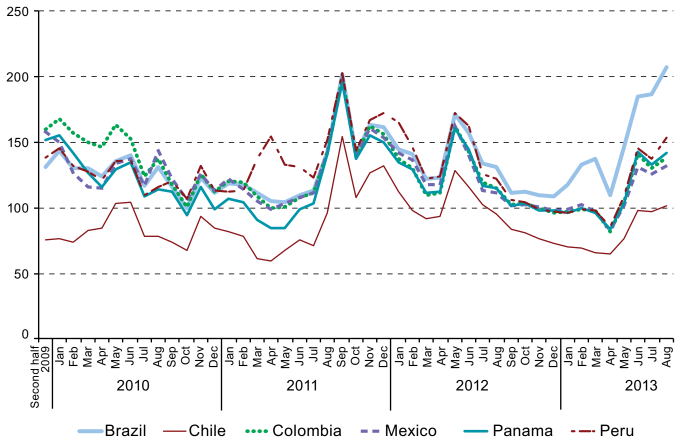
16. Global financial volatility has led to higher sovereign risk in several Latin American and Caribbean countries

- The evolution of the region's risk premiums has been determined largely by events in the global financial markets. In 2011, risk premiums rose amid uncertainty surrounding the crisis in the eurozone countries, until the announcement of a new policy by the European Central Bank. After the announcement, risk premiums followed a downward trend, which was broken following the United States Federal Reserve's announcement on the possible withdrawal of monetary stimulus.
- Most emerging country risk premiums, including those of Latin America and the Caribbean, have risen sharply since May 2013. This reflects expectations that external financing will become more costly, and therefore has a greater impact on countries that rely more heavily on this source of financing.

■ **Figure II.19** ■

Risk indicators in the region: five-year credit default swaps, second half of 2009 to August 2013

(Premiums indexes)



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

Chapter III

The challenges for Latin America and the Caribbean in the current international conditions

1. The challenge of controlling inflation

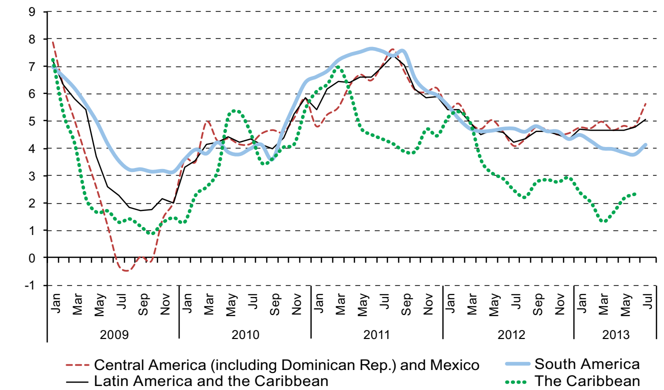
Despite financial volatility, inflationary pressure tended to ease (with some exceptions), although monetary policy dilemmas have worsened in some countries.

- In the second half of 2013, the median inflation rate was slightly up on the preceding months, although with substantial differences between countries.
- Inflation trended upwards more strongly in Central America and Mexico than in South America.
- Argentina and the Bolivarian Republic of Venezuela are still the two economies in the region with double-digit inflation.
- The steepening of median inflation rates in the past few months has been driven mainly by food prices, resulting from specific local supply factors, and higher international prices for some products.
- In the latter category are maize, wheat and soybean flour, whose prices, although lower than in the second half of 2012, are still higher than in the first half of that year.
- The recent rise in inflation is evident in the simple average for the region, as well, which reflects its behaviour in a limited number of countries. In the past year Brazil's 12-month inflation rate inflation rose more steeply than in the rest of South America, but has recently stabilized and begun to fall.
- The steep rise in inflation in the rest of South America in the past few months reflects a spike in the rate in the Bolivarian Republic of Venezuela.
- Monetary policy dilemmas have worsened in some countries as a result of rising inflation amid slowing economic growth and increased exchange-rate volatility (in particular, currency depreciation).

Figure III.1

Latin America and the Caribbean: median 12-month inflation rate, January 2009-July 2013

(Percentages)

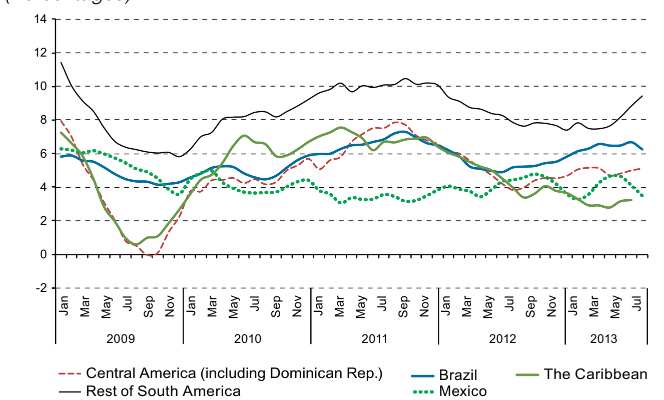


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure III.2

Latin America and the Caribbean: 12-month rates of inflation (simple average), January 2009-July 2013

(Percentages)



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

2. The challenges of regaining a path of sustained growth

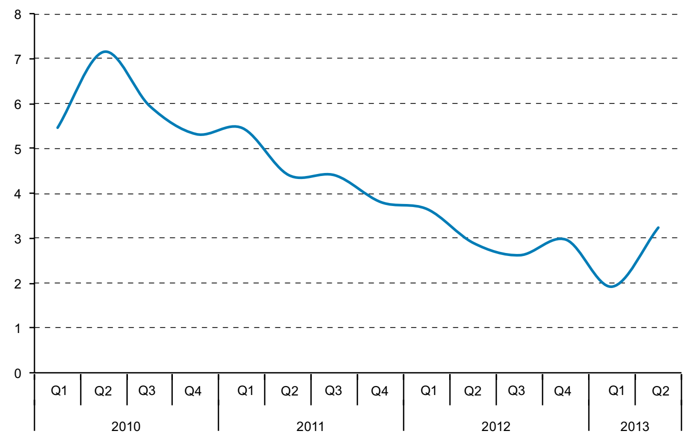
Growth was showing a partial upturn by the second quarter of 2013.

- In the first half of 2013 the Latin American and Caribbean economy expanded at a rate of almost 2.5% over the year-earlier period.
- After an overall gradual slowing of the region's economies, second-quarter 2013 brought an upturn at the regional level, compared with the first-quarter results.
- This uptick was driven by investment growth, chiefly in the construction sector, and a partial recovery in volumes of goods and services exports in several countries.

■ **Figure III.3** ■

Latin America and the Caribbean: quarterly GDP growth, 2010-second quarter of 2013

(Year-on-year variation in percentages, on the basis of dollars at constant 2005 prices)



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

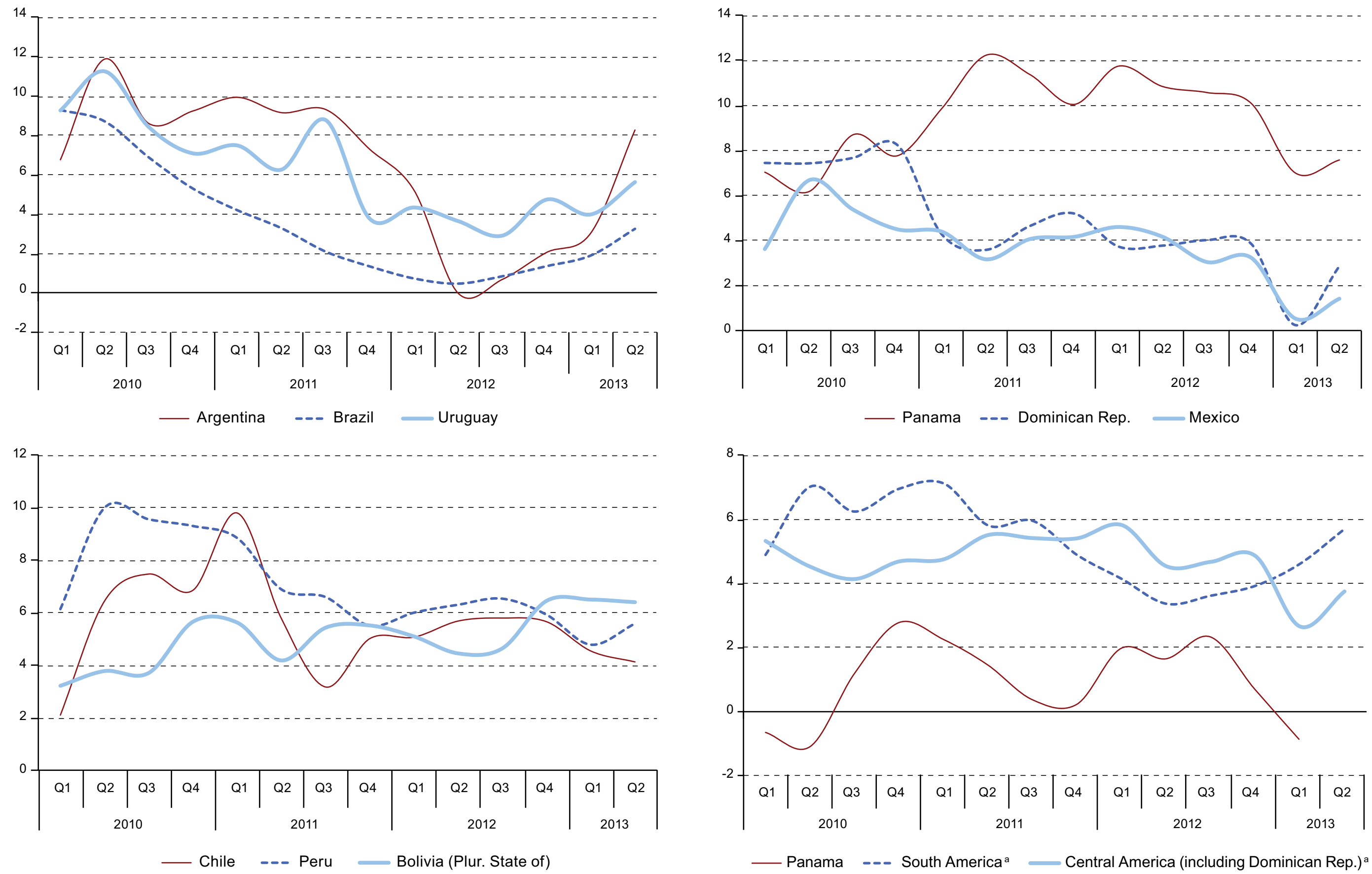
But the recovery in growth has been uneven.

- Despite the growth uptick in the second quarter of 2013, in several countries average growth in the first half of the year was still below the rates seen throughout 2012.
- This occurred in some of the Central American economies, Chile, Mexico and Peru.
- Conversely, Brazil and the South American agricultural exporters posted higher growth than in 2012.

Figure III.4

Latin America and the Caribbean: quarterly GDP growth, 2010-second quarter of 2013

(Year-on-year variation in percentages, on the basis of national currencies at constant prices)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Estimate. Corresponds to the simple average of the rates of GDP variation in the countries included in each subregion.

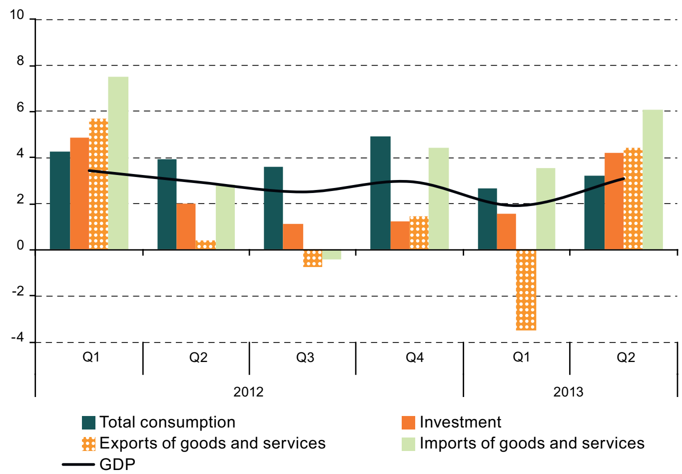
This partial upturn has been driven by both goods and services exports and investment (as well as consumption), while the performance of the manufacturing sector has been mixed.

- The higher rate of GDP growth rate the regional level reflected the upturn in goods and services export volumes (which had fallen in the first quarter of 2013) and a rise in investment.
- Total consumption, the fastest-growing demand component between first-quarter 2012 and first-quarter 2013, grew slightly less in the second quarter.
- The region's industrial output indices were mixed in the first half of 2013.
- The sector continued to render a positive performance in several countries in the second quarter of the year, although at slowing rates in some cases.
- In other countries, the manufacturing sector recovered from downturns seen throughout 2012 and into the first quarter of 2013. Finally, there were other economies in which the sector showed a downturn or very sluggish growth.

Figure III.5

Latin America: gross domestic product and breakdown of aggregate demand, 2012-second quarter of 2013

(Quarterly variation in percentages, on the basis of dollars at constant 2005 prices)



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

Table III.1

Latin America (selected countries): industrial output index, 2012-second quarter of 2013

(Year-on-year variation in percentages)

	2012				2013	
	Q1	Q2	Q3	Q4	Q1	Q2
Argentina	2.3	-3.3	-2.5	-0.9	-1.3	3.6
Bolivia (Plurinational State of)	5.3	5.8	4.4	3.8	4.6	6.8
Brazil	-3.4	-4.7	-2.4	-0.4	0.0	5.1
Chile	4.3	4.1	1.4	4.2	0.5	-1.0
Colombia	1.5	0.4	0.1	-2.0	-6.2	0.1
Costa Rica	14.2	12.0	-0.3	2.7	-4.7	3.3
El Salvador	1.8	1.7	1.5	1.1	0.6	0.4
Honduras	15.5	8.2	6.1	3.7	3.4	1.8
Mexico	4.7	3.6	3.8	2.5	-1.4	1.6
Nicaragua	6.7	0.7	1.7	2.2	-2.3	5.2
Peru	-0.7	0.2	3.6	2.7	-0.1	3.1
Uruguay	-4.5	4.3	8.8	15.5	8.8	2.8
Venezuela (Bolivarian Republic of)	2.2	1.8	2.5	0.9	-4.1	7.2

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

3. The challenge of preventing employment from slackening and unemployment from rising

- In the first half of 2013 job creation continued to slow, and in the second quarter the employment rate was similar to the year-earlier period.
- The impact of cooling job creation on unemployment was softened by the simultaneous fall in the numbers of previously inactive people joining the labour market, and the unemployment rate actually fell slightly in the second quarter. For the first half-year overall, unemployment eased down from 6.7% in 2012 to 6.6% in 2013.
- The standstill in the employment rate reflects weakening labour demand, since the generation of wage employment, specifically formal wage employment, slowed. Nevertheless, in most of the countries wage employment continues to expand more rapidly than the other categories, indicating that there is no labour oversupply in the region as yet. This observation is borne out by the fact that the unemployment rate is not (yet) rising.
- This situation is thanks to cumulative progress made in the past decade in terms of creating large number of formal jobs.

■ **Figure III.6** ■

Latin America (10 countries): employment and unemployment, first quarter of 2008-second quarter of 2013

(Year-on-year variation in percentage points)

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

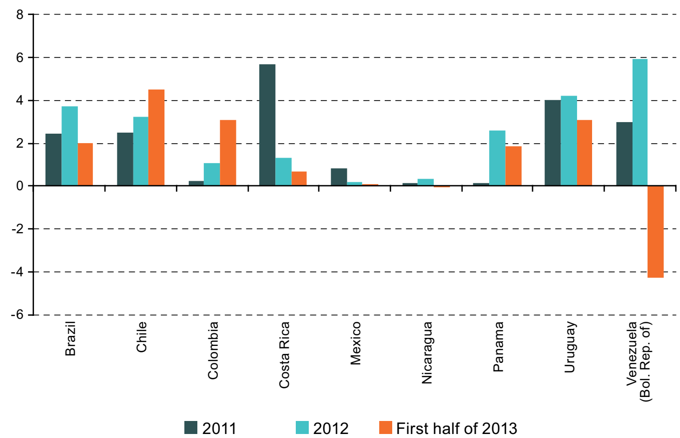
4. The challenge of expanding the wage bill alongside growing employment and productivity

- This dual feature of the labour markets —slowing of employment creation, but without significant supply-side pressures— is also reflected in wage trends. Generally speaking, in the first half of 2013 nominal average wages rose at similar rates to those of 2012.
- Real average wages rose by much less than in the previous year in several countries, however, owing in most cases (Brazil, Costa Rica, Panama and Uruguay) to an uptick in inflation. The most extreme case was the Bolivarian Republic of Venezuela, where real average wages had surged in 2012, but slumped in the first half of 2013 as inflation rose.
- In other countries (Mexico and Nicaragua), the year-on-year variation in real average wages was similar to 2012, but low.
- The exceptions to these patterns were Chile and Colombia, where lower consumer inflation contributed to a larger gain in the purchasing power of wages.
- With both job creation and wages rising slightly less than in 2012 for the region overall, expansion of the wage bill —a driver of domestic demand and, therefore, growth— would appear to be slackening.

■ **Figure III.7** ■

Latin America (selected countries): real average wages in formal employment, 2011 - first half of 2013

(Year-on-year variation in percentages)



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

5. The challenge of driving growth with equality: three dimensions of social covenants for investment (and productivity)

a) Institutional framework:

- Consolidate or create coordination bodies to integrate the array of policies aimed at driving investment and promoting conflict prevention and resolution.

b) Short-term policies:

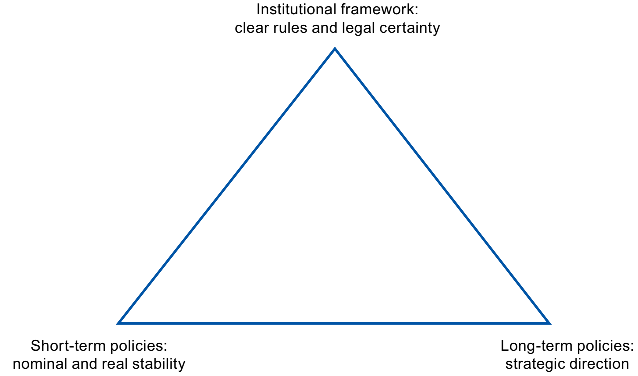
- Avoid idle capacity, build up countercyclical capacities to respond to shocks in a timely manner and prevent domestic crises leading to recession, by maintaining a sustainable internal and external equilibrium.

c) Long-term policies for structural change:

- Promote investment in diversifying tradable sectors.
- Promote investment in infrastructure.
- Train workers to facilitate structural change.
- Strengthen micro-, small and medium enterprises to increase their productivity and help them integrate into value chains competitively.
- Coordinate with other policies (on industry, innovation and the environment) to ensure that investment will contribute to structural change.

■ Diagram III.1 ■

Three dimensions of a social covenant for investment aimed at promoting growth with equality



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

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