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REGIONAL OUTLOOK

Regional economic activity is expected to fall 0.5% in 2002. The economies most affected are Argentina, Uruguay and Venezuela, while the rest have seen Gross Domestic Product (GDP) stagnate. For the second year in a row, per capita GDP growth in Latin America and the Caribbean was negative (-1.9%). The region has already experienced half a decade of low economic growth amidst adverse conditions in the world economy.

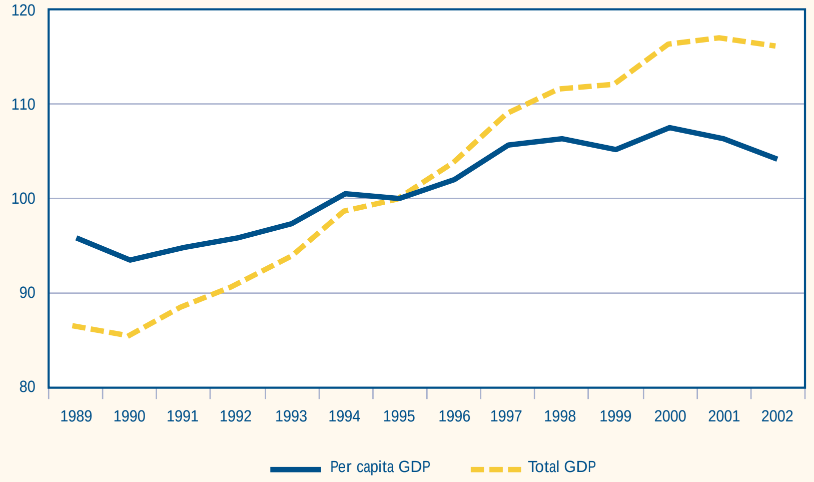
This critical outlook is apparent in the ***Preliminary Overview of the Economies of Latin America and the Caribbean, 2002***, published by the Economic Commission for Latin America and the Caribbean (**ECLAC**). This year, the region transferred net financial resources abroad in an extent not seen since the end of the 1980s, the terms of trade continued to worsen and inflation rose to 12%, double that of 2001, after eight years in decline.

As a result, the living conditions of many Latin Americans worsened and poverty is estimated to have risen by seven million people. The unemployment rate rose from 8.4% of the workforce in 2001 to 9.1%, while real wages fell on average by 1.5%. Among other signs of the weak labour market, informal employment is in the rise.

Despite all this, there is a positive note. As of the second quarter, the region showed signs of recovery, with the GDP for Latin America and the Caribbean expected to rise 2.1% in 2003.

(continued on page 3)

Latin America and the Caribbean: Changes in GDP and Per Capita GDP, 1989-2002
(Index 1995=100, based on figures in 1995 dollars)



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

THE LATIN AMERICAN ECONOMY: A CHANGE IN DIRECTION?

José Antonio Ocampo

One of the most critical years in the history of Latin America's economies has ended. The decline in regional output, estimated at 0.5%, forms part of adverse economic conditions that have lasted now for five years. This "lost half decade", as **ECLAC** has called it, means that this year per capita output will be two percent lower than in 1997. Half of the region's countries have seen their per capita GDP contract in the past five years while the rapid growth once experienced by some individual economies has ground to a halt. In social terms, open unemployment has reached 9.1%, the highest point in Latin American history, and even higher than it was during the "lost decade". During these five years, the poor population has swollen by 20 million Latin Americans.

As has occurred in the past, external factors have hit Latin America hard, but their effect has been multiplied by the weaknesses inherent in the region's own economies. The strongest impact has been observed in the capital account. 2002 marks a point at which interest payments have exceeded net external borrowing for five straight years. This means that US$39 billion, that is, 2.4% of regional GDP, has flowed out of Latin America and into the rest of the world. The drought on capital markets has been notorious this year, as has the magnitude of speculation against some of the region's economies. These factors combine with weak economic recovery in the United States and the steady fall in the terms of trade of non-oil economies.

The region's own weaknesses have to do with the slim margins for manoeuvring that Latin American economies accumulated during times of abundance to deal with future crises. As a result, almost all countries have seen their economic authorities forced to adopt measures on the fiscal and monetary fronts that reinforce external shocks, instead of weakening them. One weakness is the persistent tendency to overvalue our currencies at times when capital is abundant, an approach that leaves these economies defenceless during later periods of drought. The collapse of convertibility in Argentina, moreover, has an important lesson to teach: "automatic pilots" do not work in economics. Economic authorities' "credibility" is not built by tying them to rigid rules, but rather through good management of the discretionary powers available to them.

The past five years have, moreover, demonstrated economies' uneven adjustment to processes of regional integration. The trials and tribulations of Mercosur and the Andean Community over the past five years contrast with the success that one process or another experienced between 1990 and 1997.

> ***"Open unemployment has reached 9.1%, the highest point in Latin America history".***

This is why, as the European Community (now Union) learned several decades ago, the consolidation of integration processes inevitably requires greater macroeconomic policy coordination among members, with the adoption of common currencies perhaps occurring when the process is more advanced.

There has, however, been some good news. The main one is that this year will close on rising growth, unlike 2001, which ended with several of the region's economies amidst deepening recession. The increasingly general use of a floating exchange rate in the region's medium and large economies also represents a step forward, since this will ensure the timely adjustment of the exchange rate during crises and, correctly managed, greater autonomy in the handling of monetary policy. The year's adjustments to exchange rates also demonstrate that these corrections can be made without destabilizing inflation.

This is particularly important, because amidst a scenario involving restricted external resources such as the current one, a competitive exchange rate is an essential part of a good macroeconomic programme. In broader terms, the combination of competitive exchange rates, moderate real interest rates and a sustainable fiscal position is, in today's conditions in Latin America, the best approach to achieve renewed economic growth.

But perhaps the best news is that the economic debate has opened up. The dogmatisms of a decade ago have started to fade. The debate now includes the need for national and international mechanisms to expand the limits on how macroeconomic policies can reduce the vulnerability of developing economies when faced with volatile international capital. Awareness that active policies for productive and technological development are also essential to achieve the full benefits of the opportunities offered by international markets has also increased. There is much greater awareness of the importance of solid public institutions. And, above all, there is growing awareness of the need for integrated policy frameworks in which social objectives really stand at the centre of economic policy.

In branches of knowledge as imprecise as economics, pluralism in debate is essential to evaluate the strengths and weaknesses of different alternatives. The idea, put forward a decade ago by the Washington Consensus that "we already know what to do" turned out to be a mirage. Pluralism in the economic debate and its reflection in political debate are, as a result, enormous opportunities opening before us.

The author is **ECLAC**'s Executive Secretary.

(from page 1)

In 2002, worsening international financial conditions combined with domestic factors meant that Latin America and the Caribbean transferred net financial resources worth about US$39 billion abroad, half of which came from Argentina. Moreover, rising risk premiums on public debt securities more than offset lower international interest rates.

The terms of trade for every Latin American economy worsened from 1998 on, except for those exporting oil (Argentina, Ecuador, Colombia, Mexico and Venezuela). The largest losses in accumulated external relative prices in the past five years affected Peru (-21%), Chile (-19%) and Brazil (-16%). In 2002, the countries hardest hit by worsening terms of trade have been Brazil (-4%), Bolivia and Honduras (around -3%), while Peru posted a recovery of 5% after four years of losses.

With few exceptions, fiscal and monetary policies were contractive and their clearly pro-cyclic content increased the impacts of the adverse external scenario. According to **ECLAC**, this year's events confirmed the perception that authorities had little room left to manoeuvre. This reflected pressure on foreign exchange markets and problems with sustaining public debt.

Most of the region's currencies depreciated against the dollar, clearly demonstrating that sooner or later the real exchange rate ends up lining up with the logic of competitiveness in the real sector of economies, the report concludes.

These devaluations did not touch off inflationary spirals, although inflation did post a significant rise after eight years in decline. In 2002, it averaged 12%, compared to 6% in 2001. But higher inflation does not reflect a situation where wage pressures have exceeded productivity increases.

The economies most affected by economic slowdown were those of South America. Per capita GDP in Argentina will fall 12%, accumulating -22.4% in four years, while Uruguay accumulated a decline of 20% in per capita GDP over four years. In Mercosur, only Brazil will post marginal growth (0.2%) this year. The Andean Community economies have followed different trends, but Venezuela will see its per capita GDP fall by around 9%. Peru will show good economic growth as will Ecuador, but to a lesser degree. Bolivia and Colombia will post positive economic growth, but smaller than the increase in population. Chile also performed less strongly in 2002.

For Mexico, the five economies of the Central American Common Market, Haiti, Panama and the Dominican Republic, the weaker performance of the United States economy during 2001-2002 was significant. Only Costa Rica, El Salvador and the Dominican Republic will post positive per capita GDP growth.

THE EXTERNAL SECTOR

In 2002, Latin America and the Caribbean sent US$39 billion abroad. Although the net inflow of resources had already ceased in 1999, the region had not seen a negative balance of this magnitude since those of the late 1980s. The main reason behind these outflows was the plunge in net inflows of capital.

In this context, the region saw its balance of trade shift noticeably, due mainly to reduced imports. This trend in the balance of payments confirms the reappearance of external restrictions on the region's growth, according to the **ECLAC** report.

The situation described above is associated with the slowdown affecting the world economy, which hurt Latin America and the Caribbean in 2001 and continued to make itself felt in 2002. This year, both the volume of trade and world output performed sluggishly again, with growth rates estimated at from 1% to 2% for both variables.

As a result, the region's countries continued to face weak demand worldwide and low prices for the main export products. This factor, whose influence was general although uneven among countries, combined with the powerful but more geographically focused impact of financial troubles that led to enormous outflows of capital from several countries.

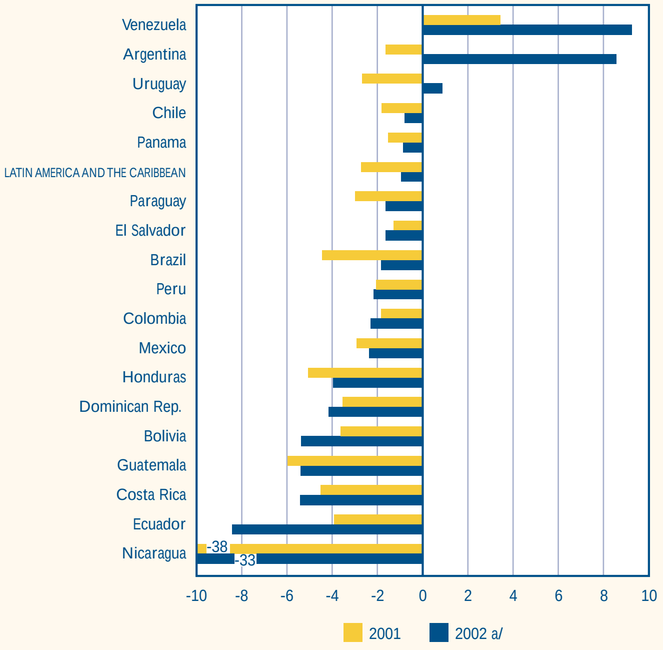
Imports Fall and the Trade Balance Improves

The resulting decline in the economies thus affected, which was reflected in weaker economic activity and significant exchange depreciations, brought with it a new, general and significant decline in imports. Only a small minority of countries from the Andean region and Central America managed to escape from this general pattern.

Similarly, the fall in imports provoked an about turn in the region's trade balance, which went from a US$20.2 billion deficit in 2001 to a US$11.1 billion surplus this year, the first in over a decade. This change was mainly due to high trade surpluses in Argentina, Brazil, Venezuela and, to a lesser degree, Chile, which more than offset the deficits in other countries.

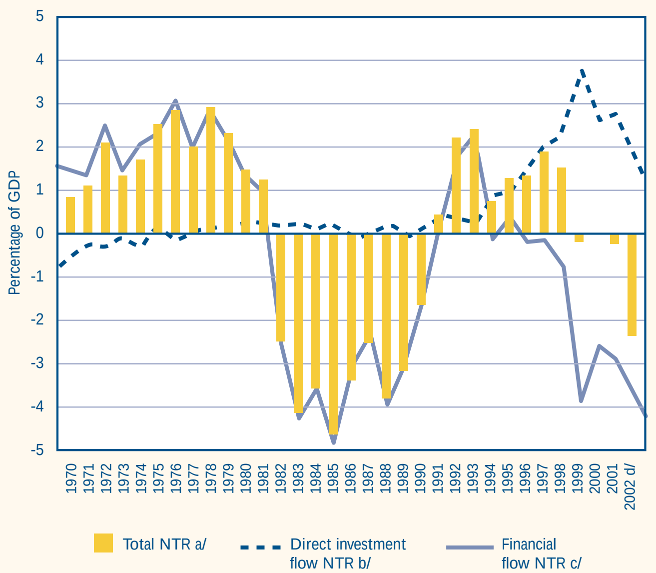
Current transfers, particularly family remittances, contributed to this positive balance. In 2002, current transfers continued the rising trend of previous years, reaching over US$25 billion. The

Latin America and the Caribbean: Current Account Balance
(Percentage of Gross Domestic Product)



Source: **ECLAC**, on the basis of official figures. and the International Monetary Fund.
a/ Preliminary estimates.

Latin America: Net Transfers of Resources (NTR)
(Percentage of Gross Domestic Product)



Source: **ECLAC**, on the basis of official figures and the International Monetary Fund
a/ The net transfer of resources equals net capital inflows (including non-autonomous, errors and omissions), minus the balance in the factor income account (net interest and profits). Negative quantities indicate resources transferred abroad. b/ Net inflows of foreign direct investment (FDI) minus remittance net of profits. c/ Equals net inflows of other capital, other than FDI, minus net interest payments. d/ Preliminary estimates.

Argentine crisis caused a decline in remittances for residents in countries such as Bolivia, Paraguay and Uruguay, whose income due to transfers suffered, along with that of residents of Colombia, Ecuador and Peru. In contrast, almost all the Central American countries and the Dominican Republic received larger amounts, with Brazil, Guatemala and Mexico posting the largest increases.

The financial troubles affecting the region were reflected in the deterioration in the capital and financial accounts of the balance of payments. For the second year in a row, difficulties in obtaining external financing, reduced foreign direct investment and high outflows of short-term capital in Argentina, Brazil, Uruguay and Venezuela pushed net income from autonomous capital way down.

In fact, the region experienced slightly negative outflows of this sort of capital in 2002, something which had not occurred since 1990. Issues on international bond markets in 2002 rose to US$16.2 billion, half the level in 2001. Foreign direct investment (FDI) flows remained positive, but fell to US$39 billion, well below the average of US$67 billion during the five years from 1997 to 2001.

According to the **ECLAC** report, the decline in FDI reaching Latin America and the Caribbean was due to specific situations in each country, such as recession, greater political instability, or uncertainty due to radical changes in the game rules. However, more lasting factors were also at work, among them the exhaustion in many countries of the privatization process or some transnational groups' changing growth strategy.

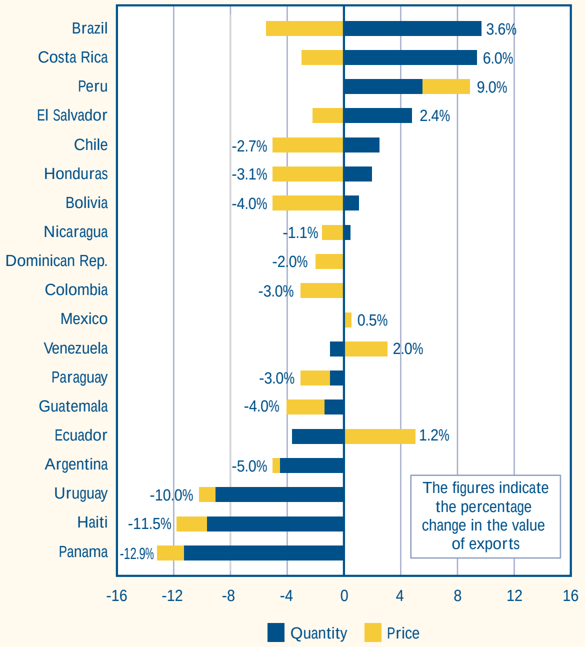
The current account deficit had to be covered by compensatory financing from the IMF and delays in interest payments. The region thus suffered a slight loss of foreign currency reserves.

With reduced access to voluntary financing and several countries facing a balance of payments crisis, IMF financing (or lack thereof) became extremely important. Affected by the Argentine crisis and practically without access to voluntary credits, Brazil and Uruguay obtained significant financing from the IMF. In contrast, Argentina, Ecuador and Paraguay received no new disbursements because they failed to reach agreement on the conditions required by the IMF and some even made net amortizations to this body.

Exports Slump

Except for oil, the commodity price index for goods exported by Latin America and the Caribbean fell 1.5% during the first

Latin America and the Caribbean: Percentage change in exports by unit price and quantity, 2002



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

eleven months over their average in 2001, accumulating a decline of almost 6% for the two years. Minerals, especially copper, tin and zinc, along with coffee, sugar and shrimp, were among the most affected by the lower prices. Among agricultural commodities, the prices of cotton, leather and wood pulp fell.

In short, almost every country saw the average price for its export product basket decline or stagnate. Ecuador and Venezuela were the exceptions, thanks to the considerable importance of oil in their sales abroad, along with Peru, a major producer of fishmeal and gold.

However, the drop in import prices allowed many countries to avoid the deterioration in their terms of trade. Nonetheless, the non-oil exporting countries had to endure a significant decline in their terms of trade: Brazil, Chile, Paraguay, Uruguay and most of the Central American countries saw the accumulated decline for the past five years reach from 15% to 20%.

The other passthrough mechanism by which world economic conditions affected the region in the field of trade was export volume, which rose 2% overall for countries, although many saw their exports slow or decline. This was due to the contraction in intraregional trade, whose fall is estimated at 16%. Most of this affected Mercosur, which reduced its buying by almost 40%, reflecting the collapse of Argentine imports. In contrast, the Central American Common Market saw trade rise 4%.

PROPOSALS FOR RESTRUCTURING FOREIGN DEBT

The frequent financial crises of the 1990s reopened the debate about the best mechanisms for solving them and, particularly, on restructuring foreign debts considered "unsustainable".

A first category of countries involves those that are the least developed. The Paris Club and the *Heavily Indebted Poor Countries (HIPC)* Initiative have established mechanisms for reducing debt with official bilateral and multilateral bodies. Countries benefited include Bolivia, Guyana, Honduras and Nicaragua.

Another category consists of countries considered "emerging markets", which have suffered financial crises resulting from their indebtedness to private creditors. To overcome this, innumerable financing packages have been applied, as part of rescue operations generally led by the International Monetary Fund (IMF).

Since the first case, that of Mexico in 1995, these packages have received fierce criticism based on the conditions they entail, resistance to the use of public resources, and concern about moral hazard deriving from the expectations arising from their existence.

These considerations have given rise to two complementary proposals. One involves incorporating "collective action clauses" in contracts for sovereign debt issues while the other includes a mechanism similar to that of private law so debtors and creditors can negotiate debt reductions before a legal tribunal.

The responsibility of macroeconomic policies in industrialized countries and unstable international markets for debt problems has also been established. This should involve modifications to and reforms of both, along with more prudent financial liberalization processes in emerging markets, including controls on capital inflows, such as those applied in Chile.

Prospects for 2003

The prospects for 2003 make it likely that the regional balance for the current account will not rise much more than this year's. The many corrections to exchange rates should ensure the continuity of improvements to sales abroad posted during the second half. Foreign direct investment should continue to generate positive flows, although within the falling trend of recent years.

However, for Latin American and Caribbean economies to meet their commitments to servicing the debt and remitting profits, renewed access to external financing at normal interest rates is vital. In its absence, the question of restructuring the foreign debt of developing countries will arise for more of the region's countries.

MACROECONOMIC POLICY

Compared to previous years, in 2002 fiscal policy played a reduced role in macroeconomic management. In general, fiscal expenditure was not used as a mechanism to sustain economic activity, in come cases because it had already been used for this purpose and it was becoming risky to maintain this policy and, in others, because the State's ability to manoeuvre had not been reinforced during the years of more growth and this had shrunk even further as the recession deepened and the burden of public debt rose.

In Argentina, Paraguay, Uruguay and Venezuela economic activity plunged as did fiscal expenditure. Meanwhile, in Barbados, Brazil, Chile, Costa Rica, Ecuador, Jamaica and the Dominican Republic fiscal expenditure held steady or even rose.

Income fell in every country affected by recession. The most significant cases were Argentina and Uruguay, where fiscal revenues fell by around 20% in real terms. In half the region's countries, mainly in Central America and the Caribbean, revenues rose. While in Guatemala and the Dominican Republic this was in response to tax reforms applied the previous year (and in Nicaragua to those carried out in 2002), in Ecuador and Brazil revenues rose by more than 10% in real terms, thanks also to improvements to revenue collection and the appearance of new sources.

In 2002, trends in revenues and expenditure translated into a slight increase in the central government deficit of the region's countries from 3.2% of GDP in 2001 to 3.3% in 2002. But there were major differences among countries, given that the fiscal deficit fell in half of them, while it rose in the other half.

The countries with access to external financing included Chile and Mexico, along with several Central American and Caribbean countries, Brazil, Colombia, Jamaica, Peru and Uruguay, the latter all with more restrictions.

In South American countries, the main source of financing for the fiscal deficit was the domestic market and, to a less degree, international financial institutions. Argentina and Brazil, however, among others, had problems capturing resources inside their own borders.

Altogether, these factors indicate that fiscal policy was rather passive in 2002. On one hand, economic authorities' room to manoeuvre had been shrinking for the past five years. On the other, faced with more restrictive external financial conditions, governments were forced to reinforce the credibility of their policies by assuming more austere stances. Only Barbados, Chile, Costa Rica and the Dominican Republic had sufficient freedom to apply compensatory fiscal policies.

The Public Debt Problem Worsened

The decline in economic conditions also affected the sustainability of the public debt. While the fiscal deficit had been growing since the start of the Asian crisis and deficient economic growth had raised public debt as a percentage of output, investors' behaviour also tended to generate and propagate panic and contagion, giving rise to self-fulfilling prophesies.

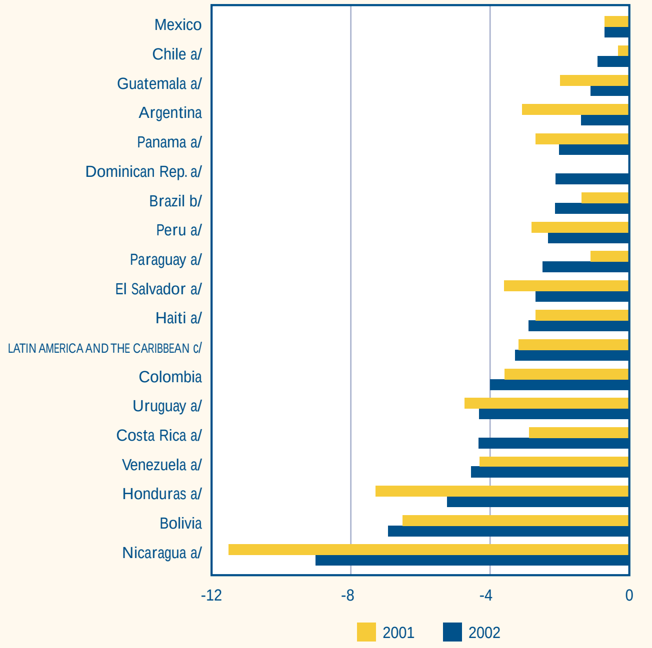
Moreover, the public debt problem also became more complex due to events in monetary and foreign exchange spheres. Monetary policy became austere in response to foreign exchange instability and rising inflation in several countries. This was reflected in rising interest rates, which made paying off domestic debt difficult and tended to worsen the sustainability indicators for public debt.

Altogether these factors ended up causing country risk indicators to rise, making the fiscal situation even more difficult. However, the positive signs observed during the third quarter in the markets of most of the region's countries, headed by Brazil, combined with moderate growth projections for 2003, suggest a less complicated outlook for next year at the fiscal level.

Deteriorating Foreign Exchange Markets

In 2002, the Argentine crisis and financial turbulence in Brazil had a powerful impact on the foreign exchange markets of the region's countries. The events in the Mercosur countries and Venezuela forced changes to the foreign exchange regime, with Argentina, Uruguay and Venezuela adopting a floating exchange rate, and strong real depreciations in all of them. In this sense, the

Latin America and the Caribbean: Public Sector Results
(Percentage of Gross Domestic Product)



Source: **ECLAC**, on the basis of official figures.
a/ Central government. b/ Operating results. c/ Simple average.

Latin America and the Caribbean: Percentage Change in the Real Exchange Rate

(Third quarter 2001- third quarter 2002 a/b/)

	Bilateral exchange rate vs. dollar	Bilateral exchange rate vs. euro	Actual exchange rate vs. world	Actual exchange rate vs. Latin America and the Caribbean
Latin America				
Argentina	168.9	198.3	163.3	135.0
Bolivia	10.2	22.3	-1.6	-15.0
Brazil	15.9	28.5	10.5	-27.0
Chile	5.0	16.4	-1.6	-22.5
Colombia	9.5	21.5	6.1	-7.2
Costa Rica c/	2.4	13.6	2.5	-3.7
Dominican Rep. d/	3.7	15.1	2.2	-9.7
Ecuador	-9.6	0.3	-12.0	-20.9
El Salvador c/	-0.3	10.6	0.3	-0.6
Guatemala c/	-6.6	3.6	-7.6	-11.0
Haiti	7.9	19.7	n/d	n/d
Honduras c/	0.6	11.6	1.1	-0.4
Mexico	3.6	14.9	4.1	-10.4
Nicaragua c/	5.3	16.8	4.1	1.4
Panama	0.4	11.4	0.1	-4.4
Paraguay	29.9	44.1	8.1	-10.0
Peru	3.6	15.0	1.7	-11.2
Uruguay	64.5	82.5	39.5	8.6
Venezuela	54.2	71.0	53.5	43.9
El Caribe				
Barbados	3.4	14.7	5.1	3.7
Jamaica e/	1.7	12.9	3.0	1.9
Trinidad and Tobago	-2.9	7.8	-4.7	-12.7

Source: **ECLAC**, on the basis of official figures and the International Monetary Fund.
a/ This period was used because it provides the clearest view of differences between real bilateral exchange rates against extra-zone currencies (dollar, euro, etc.) and against other currencies within the region. b/ Bilateral exchange rates against the euro and the dollar use January 1999 as their basis; the average actual exchange rate on imports and exports uses January 2000 as the basis. c/ Data from BADECEL was used to calculate the actual exchange rate for Central American countries not included in the maquila. d/ The actual exchange rate was calculated using IMF figures for 2000. e/ The actual exchange rate was calculated using BADECEL figures for 2000.

tendency toward floating regimes in Latin America was reinforced, with governments reserving the right to intervene in the foreign exchange

The rest of Latin America and the Caribbean countries generally experienced moderate depreciations in their real exchange rates, both against the dollar and in "actual" terms, that is, against the currencies of their main trading partners.

The Mercosur countries saw the largest real depreciation in their currencies. The change in the Argentine foreign exchange regime in January 2002 caused a strong, real depreciation in the Argentine peso during the first half of the year. Similarly, the Brazilian real began to depreciate in the second quarter, in part due to the pre-electoral atmosphere and despite Central Bank intervention.

Aside from Mercosur, the currency that most depreciated during this period was Venezuela's. From the third quarter of 2001 to the same quarter of 2002, the bolivar depreciated 55% against the dollar, in real terms. Similarly, the Colombian peso depreciated somewhat less than 10%.

Most of the region's other countries depreciated their currencies in real terms against the dollar and their trading partners by 5% or less, during the period under analysis.

Among the non-dollarized economies, the only ones posting a nominal and real appreciation of their currencies during this period were Guatemala and Trinidad and Tobago, in both cases thanks to generous capital inflows. Two of the region's three dollarized economies, El Salvador and Panama, have managed to keep inflation down, which explains the stability of their actual and bilateral exchange rates against the dollar. Ecuador, in contrast, has been able to steadily reduce inflation, but it remains above international standards, thus causing some loss in foreign exchange competitiveness.

More Restrained Monetary Policy

Monetary policy throughout most of the region was subordinate to trends in foreign exchange parities, which in 2002 meant a more restrained monetary policy stance.

In a context of weak productive activity in most countries, few were able to use monetary policy as a countercyclic instrument.

Four situations were typical. The first affected the group of countries suffering the strongest foreign exchange pressure, which resorted to interest rates to defend their currency. This group includes the economies of Mercosur, whose policies were explicitly contraction-oriented in Brazil, Paraguay and Uruguay, along with Venezuela.

A second group, which includes most of the Central American countries, maintained very contraction-oriented monetary policy.

A third group is composed of those countries that managed to apply countercyclic monetary policies, including Chile, Colombia, Peru (until the third quarter) and Mexico.

Finally, the fourth group includes the dollarized economies, which have no explicit monetary policy and, as a result, saw their monetary conditions determined spontaneously by trends in international markets and shifts in country risk perception. This group includes Ecuador, El Salvador and Panama.

Latin America: Foreign Exchange Regimes, 1996-2002

Regime	1996	1999	2000	2001	2002
Dollarization	Panama	Panama	Panama Ecuador	Panama Ecuador	Panama Ecuador El Salvador
Currency board	Argentina	Argentina	Argentina	Argentina	
Others with fixed parity	El Salvador	El Salvador	El Salvador	El Salvador	
Moving parities	Bolivia Costa Rica Nicaragua	Bolivia Costa Rica Nicaragua	Bolivia Costa Rica Nicaragua	Bolivia Costa Rica Nicaragua	Bolivia Costa Rica Nicaragua
Moving bands	Brasil Colombia Chile Ecuador Honduras Uruguay Venezuela	Colombia Chile Honduras Uruguay Venezuela	Honduras Uruguay Venezuela	Honduras Uruguay Venezuela	Honduras
Floating	Dominican Republic Guatemala Haiti Mexico Paraguay Peru	Brazil Dominican Republic Ecuador Guatemala Haiti Mexico Paraguay Peru	Brazil Chile Colombia Dominican Republic Guatemala Haiti Mexico Paraguay Peru	Brazil Chile Colombia Dominican Republic Guatemala Haiti Mexico Paraguay Peru	Argentina Brazil Chile Colombia Dominican Republic Guatemala Haiti Mexico Paraguay Peru Uruguay Venezuela

Source: For 1996, on the basis of **ECLAC**, *Economic Study of Latin America and the Caribbean 1996-1997*; from 1999 to 2001, adapted from International Financial Statistics, International Monetary Fund. For 2002, own research.

DOMESTIC PERFORMANCE

The economy of Latin America and the Caribbean suffered a contraction in 2002, reflected in the 0.5% decline in GDP. This performance prolongs the economic stagnation affecting the region, whose per capita GDP fell even lower than it did in 1997.

The drop in per capita GDP for the second year running was due in part to the plunging economic activity in Argentina, Uruguay y Venezuela, although virtually all countries posted low growth, mostly under 2%.

Obstacles to Growth

External and domestic factors in each country influenced these results, with performance basically reflecting movements in the capital account, export prices and trade volumes.

These factors combined with domestic conditions, which in several cases were decisive when it came to economic activity. In many countries, domestic factors hampered growth: restrictive monetary policies, stagnant domestic credit, fiscal problems, high public and private indebtedness, speculative pressures that affected interest rates, high unemployment and underemployment and, in several cases, conditions involving political and social conflict. In other countries, adverse weather conditions also took their toll. And, finally, we found cases of positive domestic factors associated with natural resource exploitation, some recovery in domestic demand, and the resolution of some specific problems, such as electric power rationing in Brazil.

The United States' Influence

On this basis, we can distinguish among several groups of countries: the first consists of those very influenced by the situation in the United States, where demand for imports performed poorly; Mexico, Central American and Caribbean countries fall into this category.

The second group includes those affected by trends in their export prices, such as Chile and Peru. In the third group, countries suffer from high levels of domestic and foreign debt, which have made them very vulnerable to the imposition of stricter conditions for access to international financing and speculative attacks. The four Mercosur member countries fall into this category.

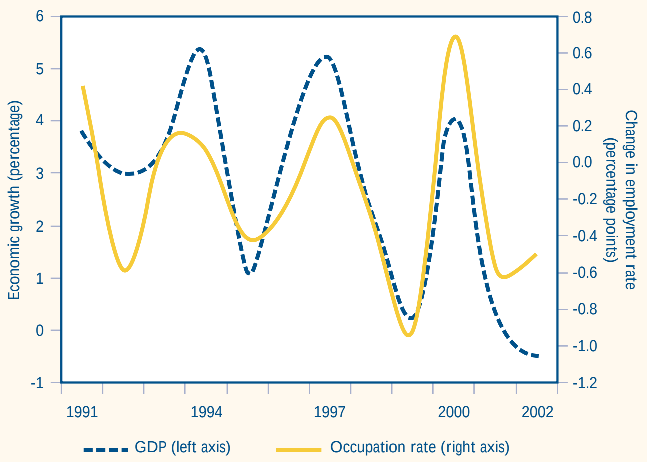
Finally, for some countries domestic factors were very important: Ecuador, Venezuela and to some degree Colombia.

Weak growth in demand in the United States deprived countries in the first group of their driving force. The Mexican economy grew 1.2% in 2002, which brought with it a further decline in per capita output. Central America's sales to the United States gradually recovered as the year advanced, although the amount accumulated during the first nine months was barely 4% higher than in 2001.

The Caribbean countries generally experienced low growth, as tourism did not recover fully from the drop in 2001, and listless external demand affected duty-free zones.

Chile is perhaps the clearest case of a country affected by a persistent drop in the terms of trade, which has translated into an accumulated decline of 20% in five years. In 2002, export prices fell yet again with the plunge in copper and wood pulp prices.

Latin America and the Caribbean: Economic Growth and Employment



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

Vulnerable to Financial Turmoil

Mercosur member countries, the most affected by ebbing capital flows, suffered from high levels of domestic and external borrowing. Moreover, the currency of two of them was very overvalued in early 2002. It is not therefore surprising that the members of this block proved to be terribly vulnerable as access to external financing shut down, financial speculation rose and capital fled the region. All this brought with it steep devaluations, bank stampedes and the falling apart of credit mechanisms in Argentina, Uruguay and to some degree Paraguay. In Argentina and Uruguay, employment fell to unprecedented levels, while domestic demand, already very low, continued to plunge.

In Argentina, the sharp decline in output that began in mid-2001 lasted through the first quarter of 2002. As the second quarter began, the contraction in activity halted, thanks to the high profitability of export sectors, import substitution, and the application of unemployment subsidies. Despite all this, Argentina's GDP is expected to plunge 11% in 2002.

The Argentine crisis hit Uruguay particularly hard. Its output contracted by 10.5%, while Paraguay also suffered (-3%), as the aftershocks reached them by different routes.

Brazil, too, proved vulnerable to financial turbulence due to a heavy burden of public debt (to a large degree, the result of bank restructuring supported by the State in previous years), which to make matters worse is partly indexed in dollars and is short-term. The attack against its currency in foreign exchange markets grew fiercer as the presidential election approached and with the opposition candidate's steady progress in the polls. Investment has still not recovered and output rose just 1.5% in 2002.

Bolivia could also be included in this group. It is the Andean country most affected by the crisis in the Mercosur region.

The Importance of Domestic Factors

Most of the Andean countries are to be found in the fourth group. In their case, domestic elements relegated external conditions to a secondary role as the most influential factors in economic performance. Ecuador continued to recover from the severe crisis experienced in 1999, although per capita output is still lower than in 1998.

Despite relatively favourable external conditions, above all oil prices, Venezuela's output fell by almost 7% in 2002. During the first four months a series of events and policy measures combined to drag the country down into recession. Moreover in December internal political conflicts flared again, in the form of a lengthy strike movement that could depress annual output even further.

Colombia proved unable to make the most of higher oil prices too, because of domestic security problems that have discouraged investment in this sector.

In Peru, the decline in the price of some products (copper and zinc) was offset by the higher prices of fishmeal and gold. This economy has been recovering steadily and growth for 2002 is estimated at 4.5%.

Overall, the regional economy has performed poorly in 2002, to a large degree reproducing the results of the previous year, although by year's end economic activity had begun to recover in most countries, in contrast with the declining tendency suffered in 2001.

Gross Investment Shrinks

Gross fixed investment shrank again, bringing the regional investment rate to barely 18 percentage points of GDP at 1995, below levels during the 1980s and early 1990s. The biggest drops in this indicator occurred in the countries of South America.

The reduction in investment in 2002 was not associated with a decline in domestic saving, but rather the fall in external saving.

This lower investment in fixed capital affects potential growth in the medium term, although it does not seem to be the only obstacle that must be overcome if the region is to resume sustained growth. Income concentration and high levels of unemployment and underemployment not only hamper the recovery of domestic demand for consumption and investment, but also generate a political and social climate that could become very challenging to governments.

Inflation has Risen but Remains Moderate

In 2002, inflation measured by the consumer price index rose again after eight years of steady declines, reaching about 12%, double that registered the previous year. Wholesale prices rose, as would be expected in a context of generalized devaluations, by an annual rate of 29%, compared to just 6% in 2001.

Higher inflation essentially reflected devaluations in several countries, very large ones in some cases. These devaluations brought inflation of about 41% to Argentina, 32% in Venezuela, and 26% in Uruguay.

Despite these shifts, the rise in regional inflation does not seem to reflect a long-term trend, but rather a foreign exchange shock that is gradually being absorbed, without opening the way to lengthy inflationary processes.

Unemployment Soars

Labour performance was weak in a context of regional economic restrictions. The sharp drop in the employment rate, the marked increase in unemployment, the expansion of the informal sector, and the weakness of job creation by small and medium firms were particularly important. Real wages fell 1.5% on average, the result of changes in inflation.

The employment rate hovered around 52.2% while unemployment shot up from 8.4% in 2001 to 9.1%, its highest point every at the regional level since comparable figures have been kept.

In Argentina, Uruguay and Venezuela, the demand for labour plunged despite significant declines in real wages. The sectors most affected were those dependent on domestic demand.

Most of the other countries in the region posted modest economic growth, which also affected their labour performance. In Brazil, Chile, Costa Rica, Ecuador and Mexico, the employment rate fell, although more moderately. The exceptions were Colombia, where a sizeable increase in informal employment offset the weak demand for labour, along with Peru and the Dominican Republic, where higher economic growth favourably influenced employment.

Projections for 2003

In 2003, Latin America and the Caribbean are forecast to grow 2.1%. This rate would make per capita growth slightly positive.

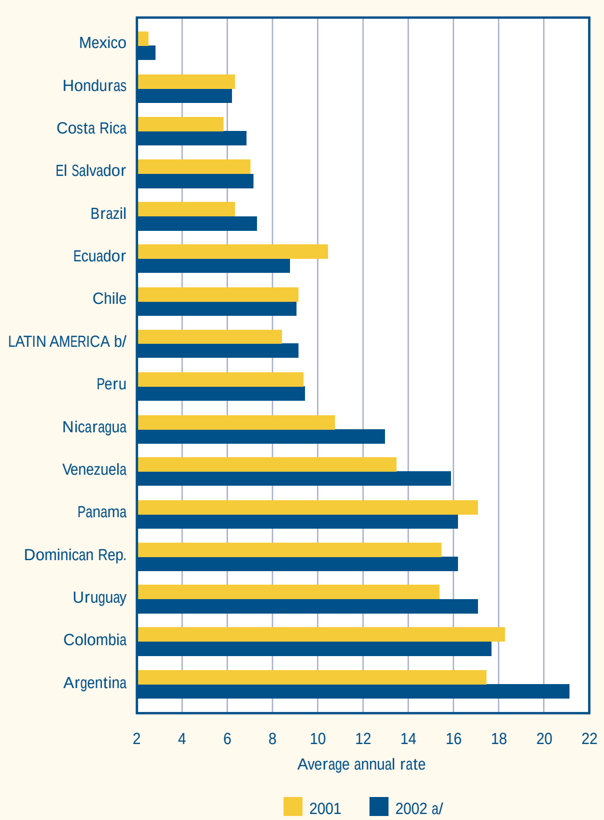
The pattern for growth shows that most countries started to recover in the second quarter of 2002. A slight improvement is also projected for the world economy in 2003. The United States should grow at a similar rate to 2002, around 2%, while Europe and Japan should grow somewhat more than in 2002 (less than 1% and -0.5% respectively). Thanks to vigorous growth in China and India, overall the growth of developing countries as a group should rise.

In the Southern Cone, conditions should change significantly. The strong contraction suffered by Argentina and Uruguay should not repeat itself in 2003 and Chile should grow more than in 2002, mainly due to better external conditions derived from the signing of free trade agreements with the European Union and the United States. Argentina should grow about 2%, while in Uruguay the negative burden of 2002 will make growth difficult, although exports could rise.

Growth for the Andean Community should rise by about 1.6%, an improvement over its stagnation in 2002. The complex situation in Venezuela has provoked a strong contraction and lower oil production could affect exports and prevent positive growth in 2003. For Colombia, growth should reach about 2% and for Ecuador, 1%. Peru should remain in first place along with Chile at 3.5%.

In Brazil, growth should reach about 1.8%, provided the current external and domestic macroeconomic conditions can be maintained: particularly, the favourable foreign exchange rate and high interest rates. In Mexico, growth is projected to reach 3%. For Central American countries and the Dominican Republic this should reach 2.6%, very similar to 2002.

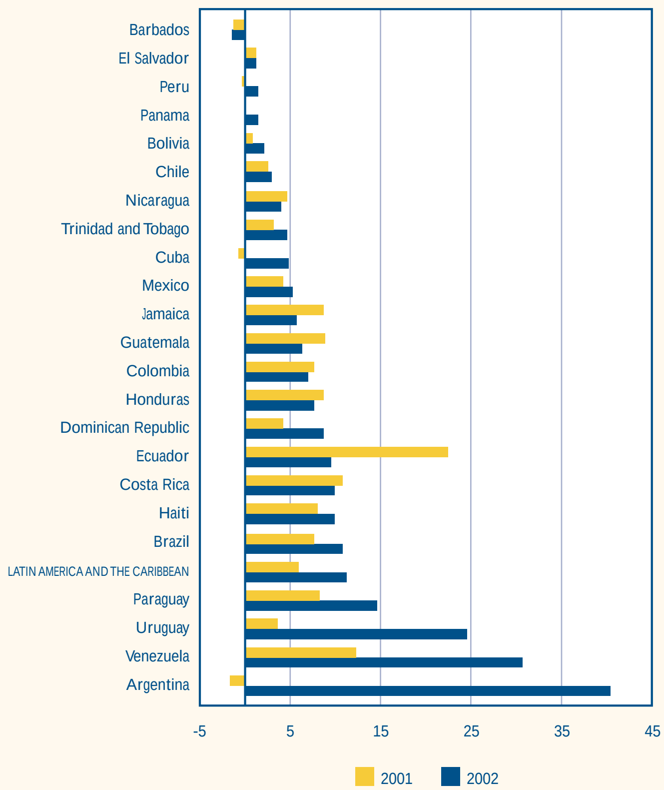
Latin America and the Caribbean: Urban Unemployment



Source: **ECLAC**, on the basis of official figures.
a/ Preliminary figures. b/ Weighted average.

Latin America and the Caribbean: Consumer Prices

(12-month change) a/



Source: See Statistical Appendix.
a/ Last period available

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The symbols used in this newsletter represent the various indigenous cultures of the Americas and some of the milestones in the region's history. The symbols are engraved on the outside of the conference rooms at ECLAC headquarters in Santiago, Chile.

Astronomic Observatory | **Kukulcan Temple** | **Santiago del Nuevo extremo** | **A Mongolfiera** | **Mining and Trade** | **Corn**

Latin America and the Caribbean: Total and Per-Capita Gross Domestic Product.

(In percentage, based on values in constant 1995 dollars)

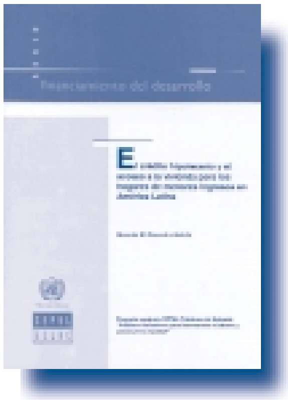
	Annual growth rates						Annual average rate	
	2000		2001		2002 a/		1998 - 2002	
	GDP	GDP/capita	GDP	GDP/capita	GDP	GDP/capita	GDP	GDP/capita
Latin America and Caribbean	**3.8**	**2.2**	**0.3**	**-1.2**	**-0.5**	**-1.9**	**1.3**	**-0.3**
Subtotal (20 countries)	**3.8**	**2.2**	**0.3**	**-1.2**	**-0.5**	**-2.0**	**1.2**	**-0.3**
Argentina	-0.8	-2.0	-4.4	-5.6	-11.0	-12.1	-3.3	-4.5
Bolivia	2.3	0.1	1.3	-0.9	2.0	-0.2	2.2	-0.1
Brazil	4.0	2.6	1.5	0.2	1.5	0.2	1.6	0.3
Chile	4.4	3.1	2.8	1.6	1.8	0.6	2.3	1.0
Colombia	2.2	0.4	1.4	-0.4	1.6	-0.1	0.4	-1.4
Costa Rica	2.2	-0.1	1.0	-1.2	2.8	0.7	4.4	2.0
Cuba	5.3	4.9	2.5	2.1	1.4	1.1	3.4	3.0
Dominican Republic	7.3	5.5	2.7	1.0	4.0	2.3	5.8	4.1
Ecuador	2.3	0.4	6.0	4.1	3.4	1.6	0.8	-1.0
El Salvador	2.1	0.1	1.9	0.0	2.3	0.4	2.7	0.7
Guatemala	3.4	0.7	2.4	-0.3	1.9	-0.7	3.3	0.6
Haiti	1.9	0.1	-0.7	-2.5	-1.5	-3.3	1.1	-0.7
Honduras	4.8	2.1	2.7	0.1	2.0	-0.6	2.2	-0.4
Mexico	6.8	5.2	-0.4	-1.9	1.2	-0.3	3.2	1.7
Nicaragua	6.4	3.6	3.0	0.3	0.5	-2.1	4.3	1.5
Panama	2.6	1.0	0.4	-1.1	0.4	-1.1	2.3	0.7
Paraguay	-0.6	-3.1	2.4	-0.1	-3.0	-5.4	-0.4	-2.9
Peru	3.0	1.4	0.2	-1.4	4.5	2.9	1.6	0.0
Uruguay	-1.9	-2.6	-3.4	-4.1	-10.5	-11.1	-3.1	-3.8
Venezuela	3.8	1.8	2.9	1.0	-7.0	-8.7	-1.2	-3.1
Subtotal Caribbean	**4.7**	**4.0**	**2.2**	**1.5**	**1.9**	**1.2**	**3.1**	**2.4**
Antigua y Barbuda	2.6	2.2	4.3	4.0	0.0	-0.3	3.3	3.0
Barbados	3.1	2.8	-2.2	-2.6	-0.4	-0.7	1.5	1.1
Belice	10.5	8.1	4.7	2.6	3.7	1.7	5.3	3.1
Dominica	0.7	0.8	-5.2	-5.2	-6.0	-5.9	-1.3	-1.2
Granada	6.5	6.2	-3.3	-3.6	3.0	2.7	4.2	3.9
Guyana	-2.3	-2.7	2.3	1.9	2.0	1.7	0.9	0.5
Jamaica	1.0	0.1	1.8	0.9	2.0	1.1	0.9	0.1
Saint Kitts and Nevis	5.0	5.8	2.0	2.7	-2.5	-1.8	1.8	2.5
San Vicente and the Granadinas	1.8	1.2	0.3	-0.3	4.0	3.4	3.1	2.4
Santa Lucia	0.3	-0.8	-5.0	-6.1	1.0	-0.1	0.4	-0.7
Suriname	-1.2	-1.7	_	_	_	_	-0.4	-0.6
Trinidad and Tobago	9.2	8.7	4.3	3.8	2.7	2.2	5.8	5.4

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

Note: Totals and subtotals do not include those countries for which no information is given,
a/ Preliminary estimate.

RECENT TITLES

1 ***El Crédito Hipotecario y el Acceso a la Vivienda para los Hogares de Menores Ingresos en América Latina*** (*Mortgage credits and low income household access to housing in Latin America*), by Gerardo González Arrieta. Financiamiento del Desarrollo series No. 122, September 2002 (LC/L.1779-P, Spanish). This report analyses credit instruments available for housing in eight countries: Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Peru and the Dominican Republic. WWW



2 ***Gasto, Inversión y Financiamiento para el Desarrollo Sostenible en Argentina y Costa Rica*** (*Expenditure, investment and financing for sustainable development in Argentina and Costa Rica*), several authors. Medio Ambiente y Desarrollo series Nos. 52 and 53, October 2002 (LC/L.1758-P and LC/L.1760-P, Spanish). These two documents form part of the joint **ECLAC**/ UNDP project on Financing for Environmentally Sustainable Development in Latin America and the Caribbean, carried out as part of the World Summit on Sustainable Development, Johannesburg, 2002. The Argentine report indicates that public expenditure on the environment currently stands at almost 0.67% of GDP, while for Costa Rica it stands at almost 0.64%. WWW

3 **Expenditures, Investment and Financing for Sustainable Development in Trinidad and Tobago and Brazil**, by several authors. Medio Ambiente y Desarrollo series Nos. 56 and 58, November 2002 (LC/L.1795-P and LC/L.1797-P, English). Both studies form part of the same joint **ECLAC**/UNDP project mentioned above. WWW

4 **Science and Technology for Sustainable Development. A Latin American and Caribbean Perspective**, by Gilberto Gallopín. Medio Ambiente y Desarrollo series No. 62, October 2002 (LC/L.1802-P, Spanish and English). This study includes the results of the Latin American and Caribbean regional workshop on science and technology for sustainable development, held at **ECLAC** in March 2002.

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CALENDAR

MONTH	EVENT	VENUE
JANUARY		
8 - 9	Seminar - workshop “Social capital, a tool for programmes to overcome urban and rural poverty”. **ECLAC**	**ECLAC** Headquarters, Santiago, Chile
23	Presentation: Summary of Latin America and the Caribbean in the World Economy 2001-2002. **ECLAC**.	**ECLAC**
23 - 24	Seminar “*Institutional Requirements for Market-Led Economies*”. German Technical Cooperation in Chile GTZ/ **ECLAC**	**ECLAC**
27 - 30	Fourteenth Regional Seminar on Fiscal Policy. Latin American and Caribbean Social and Economic Planning Institute (ILPES) /**ECLAC**.	**ECLAC**
29	First meeting of budget directors. ILPES/ **ECLAC**/ Sponsored by the Public Management Service of the Organization for Economic Cooperation and Development (PUMA-OECD)/ Supported by the Chilean Ministry of Finance.	**ECLAC**
29 - 31	Regional Preparatory Ministerial Conference of Latin America and the Caribbean for the World Summit on the Information Society.	Bávaro, Punta Cana, Dominican Republic
30	Workshop “Fiscal policy and instruments for environmental management in the countries of Latin America and the Caribbean”. Sponsored by the Interagency Technical Committee of the Forum of Environmental Ministers of Latin America and the Caribbean, formed by **ECLAC**, the United Nations Development Programme (UNDP), the United Nations Environment Programme (UNEP), the Inter-American Development Bank (IDB) and the World Bank.	**ECLAC**
APRIL		
22 - 23	Conference “Renewed growth for Latin America: from crisis to prosperity”. **ECLAC**.	**ECLAC**

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