THE INTERNATIONAL FINANCIAL CRISIS AND ITS IMPLICATIONS FOR LATIN AMERICA AND THE CARIBBEAN

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ECLAC

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Foreword

Nearly four years after the collapse of Lehman Brothers marked the start of the financial crisis of 2008 and 2009, the global economy once again faces a complex situation originating in the industrialized world. This time the epicentre is the euro zone, where several economies are in a deep recession and their governments are hard-pressed to reconcile the need to resume growth with the urgency of reducing their high deficits and debt burdens. The resulting global economic uncertainty and turmoil are sapping a global recovery that was already the weakest in 40 years.

On the occasion of the thirty-fourth session of the Economic Commission for Latin America and the Caribbean (ECLAC), to be held in San Salvador from 27 to 31 August 2012, the Commission considered it timely to provide the governments and other economic actors in the region with this brief report on the complex international scenario and its potential consequences for the region. The report has two parts. The first examines the current international situation and the outlook for the global economy, focusing on more structural, medium-term issues. The second part assesses the potential impacts for the region in the short run and gauges the available space for deploying countercyclical policies.

Turmoil in the euro zone is, so far, being transmitted to Latin America and the Caribbean primarily through the channel of international trade, in the form of falling demand for the region's exports of goods and services. The region's exports to the European Union were already down by 5% in the first half of 2012. Add to this a downtick in commodity prices, the ebbing flow of remittances from Europe and a certain degree of financial volatility associated with heightened perceived risk. Nevertheless, this scenario has not hampered the region's access to international capital markets nor triggered a significant drop in inward direct investment.

The United States is performing better than the euro zone, but its recovery is still fragile. Its economy is threatened by a set of tax increases and spending cuts equal to 4.7% of GDP that will automatically take effect on 1 January 2013 unless Congress reaches a political agreement for postponing part of these measures. Absent an agreement, the United States economy could slide back into recession in the first quarter of 2013.

Over the next few years the developing countries, in particular China and the other emerging economies of Asia, will continue to be the main engine of the global economy and trade; the industrialized countries will likely see slow, volatile growth. The latter need to make strides in household and public debt reduction. This process, which could take three to five more years, would involve continued

financial constraints, stringent fiscal and public debt consolidation requirements, short and uneven recoveries, high unemployment and substantial public sector intervention in the financial sector and the economy.

Overall —and with the marked exception of the Caribbean— the countries of the region have space for implementing countercyclical monetary and fiscal policies enabling them to face temporary external shocks originating in the industrialized economies. But a prolonged global economic slowdown would limit the scope of those countercyclical policy measures.

The issues set out in this report will be examined in greater detail in two flagship ECLAC publications that are soon to be released: *Economic Survey of Latin America and the Caribbean* and *Latin America and the Caribbean in the World Economy.*

Alicia Bárcena
Executive Secretary
Economic Commission for Latin America and the Caribbean (ECLAC)

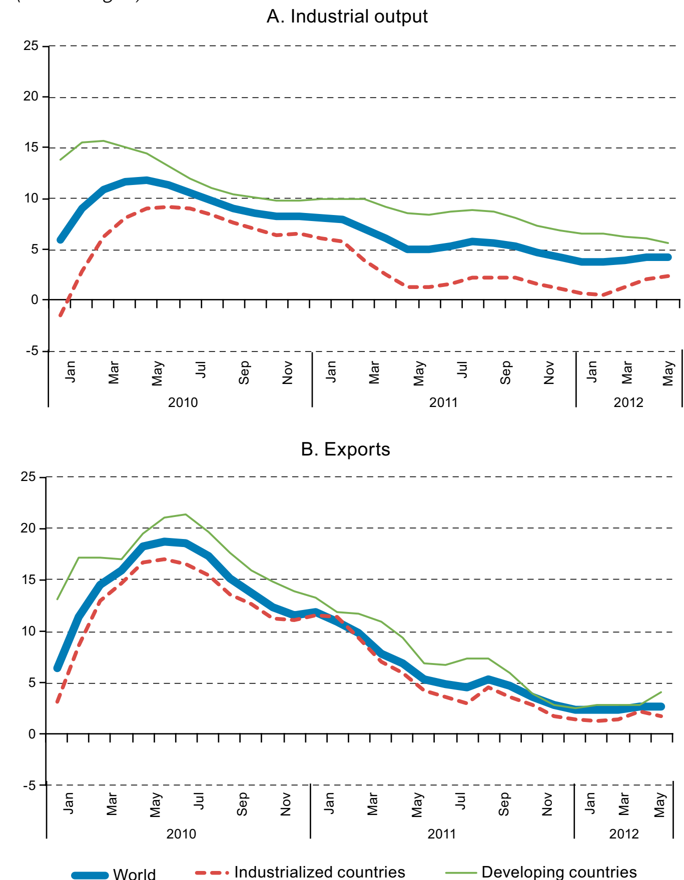
1. The main engines of the global economy are slowing while more storm clouds gather

- **The international economic scenario is growing more complicated.** Economic growth projections were revised downwards in mid-2012. Compared with projections from early in the year, they point to euro zone stagnation giving way to recession in the second half of the year, while the recovery in the United States falters and the slowdown in China steepens. In July 2012, the United Nations projected 2.5% growth for 2012, down slightly from 2.8% in 2011. But this projection is based on a rather optimistic set of assumptions.[1]
- **After recovering in 2010, world trade growth is cooling.** On the heels of the strong post-crisis rally in 2010, when trade volume climbed by nearly 14%, expansion slowed to 5% in 2011 (WTO, 2012). For 2012, the World Trade Organization expects that world trade volume will increase by only 3.7%, below the 5.1% average for the past two decades.
- **There are more clouds on the horizon.** Tensions in the Middle East and the Persian Gulf area are threatening oil price stability. A price spike for non-economic reasons would make a global recession more likely. The 6% jump in world food prices in July —the largest since 2009— is additional cause for concern. The drought in the United States, production setbacks in the Russian Federation and unseasonable rainfall in Brazil have pushed these prices steeply up, particularly in the case of grains, which have risen 17%.

Figure 1

World and main regions: annual growth of industrial output and exports, 2010-2012

(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of CPB Netherlands Bureau of Economic Policy Analysis, *World Trade Monitor*, and Organisation for Economic Cooperation and Development (OECD), OECDStat" [online database] http://stats.oecd.org/Index.aspx [date of reference: 6 July 2012].

[1] The main assumptions are: there will be no financial disruption in the euro zone; a political agreement will be reached in the United States for postponing some of the fiscal cutbacks and raising the public debt ceiling; and countercyclical policies in the emerging economies will revive the economy in the second half of the year. The likelihood of all three happening is low.

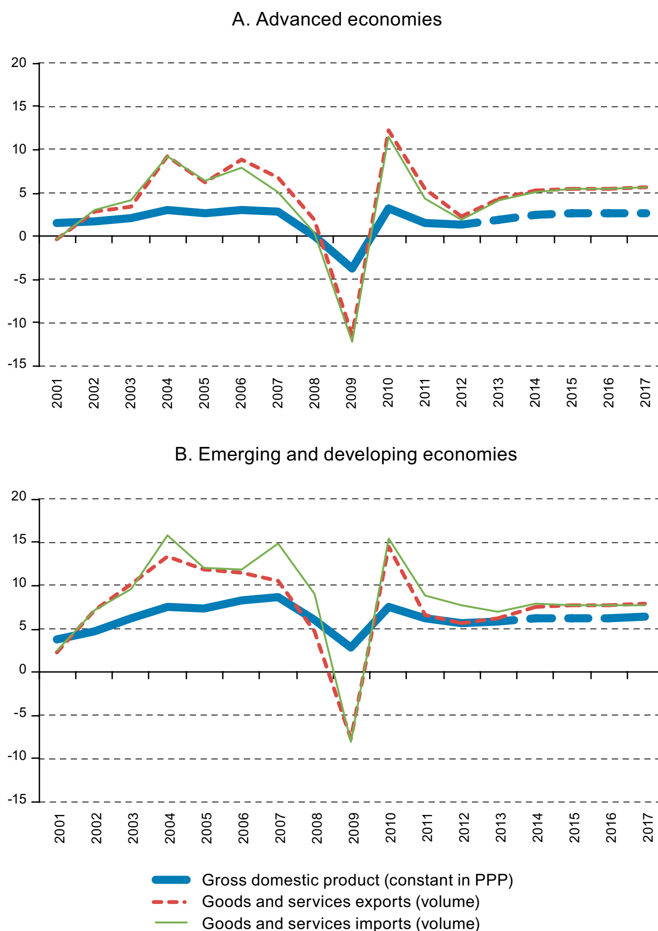
2. For the South, the decline in 2009 was less sharp, the recovery has been faster, and growth through 2017 is projected to be more than twice the pace in the North

- After the crisis that shook the global economy in 2009, the developing economies (the "South") have posted a stronger recovery than the advanced economies (the "North"). But the difficulties facing the industrialized economies have spilled over into the South in 2012. The South, led by China, has differed from the North in that the crisis has not been as deep, the recovery has been faster and GDP and trade have grown more briskly. This performance helped the countries of the South regain pre-crisis trade levels in 29 months while the countries of the North have not yet fully recovered, 55 months after the subprime crisis broke out. As the demand for imports falls and financial conditions in the North worsen, the developing economies are seeing a slowdown in 2012. Nevertheless, projections show that over the coming five years the pace of growth in the countries of the South will be at least double that of the countries of the North.
- In any event, the general differences between the economies of the North and the South mask considerable heterogeneity within each group. In the North, the greatest heterogeneity is in Europe, where Germany is in the best position. While it is being affected by the depressed context in the region, German exports outside Europe are benefiting from the euro's falling value against the dollar and the yuan. Austria, Denmark, Finland, the Netherlands and Sweden are in a similar position. On the other hand, countries like Greece, Ireland, Italy, Portugal and Spain are in a deep recession exacerbated by sweeping fiscal austerity measures. As for the South, there are marked differences between the BRICs (Brazil, Russian Federation, India and China): economic expansion is moderating in China and India whereas economic activity in Brazil cooled markedly and then resumed growth in the second half of 2012.

Figure 2

Selected groups: gross domestic product, exports and imports of goods and services, 2001-2017

(Constant growth rate)



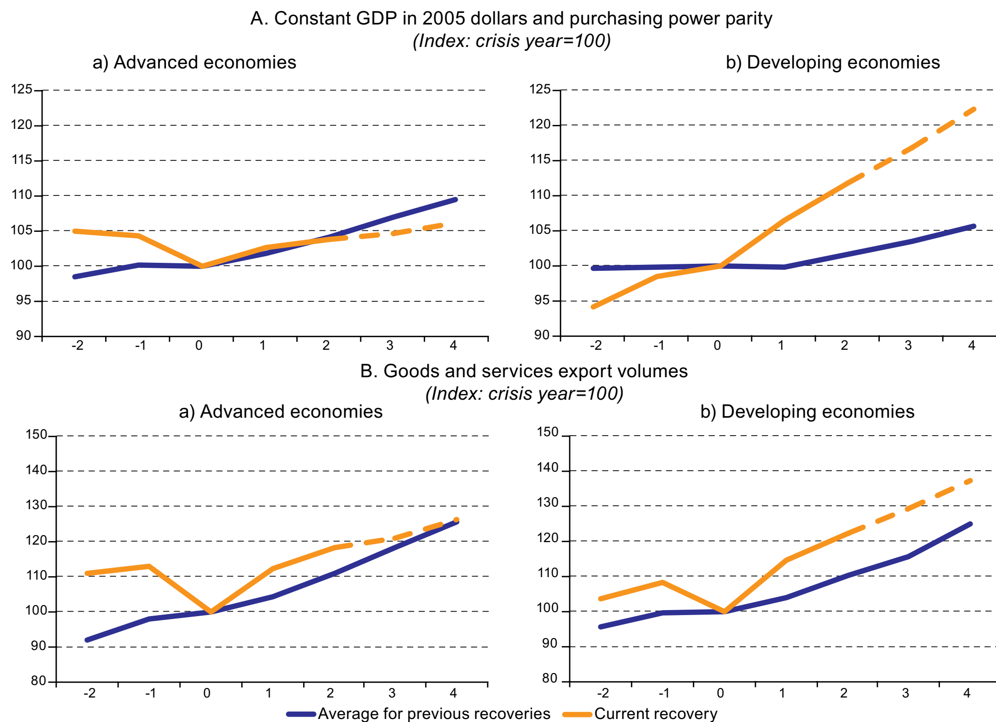
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook*, April 2012, and July 2012 update.
Note: the dashed lines refer to IMF projections.

3. Compared with previous recoveries, patterns are markedly different in the North and the South

- **The current post-crisis period is different, not only because the pace of recovery varies between advanced countries and developing ones but also because it stands in contrast to recoveries from earlier crises such as those that broke out in 1982 and 1991.** In 2010, the global economy recovered from the worst, most synchronous crisis since the Second World War at a pace similar to the two preceding recoveries. But the pattern in industrialized countries has differed sharply from the one seen in developing countries. In the advanced economies, GDP and exports have tended to recover at the same pace or more slowly than in previous recoveries; recovery for both in the developing economies has been far faster than in the past. This good performance by the developing economies, plus the fact that the advanced economies are posting one of the weakest recoveries of the post-war period, helps reinforce the perception that the developing economies are becoming the drivers of global growth.

■ Figure 3 ■

Advanced and emerging economies: recovery after the 2009 crisis compared with 1982 and 1991



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World dataBank, International Monetary Fund, *World Economic Outlook*, 2012 and Ayan M. Kose, Prakash Loungani and Marco E. Terrones (2012), “Tras la pista de la recuperación mundial”, *Finanzas y Desarrollo*, June, pages 10 to 13.

Note: 0 is the crisis year; the scale shows years before and after the crisis. The average for earlier recoveries includes the 1982 crises and the 1991 crisis. Dashed lines denote IMF projections.

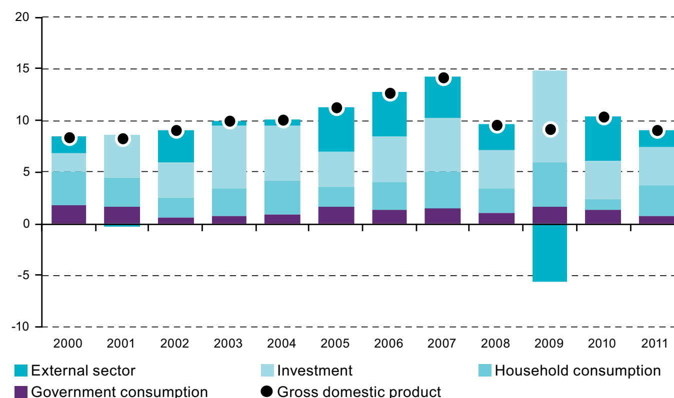
4. China's economy is slowing as key economic reforms are implemented

- China's twelfth five-year development plan 2011-2015 highlighted the need to bring vertiginous double-digit growth down to a more sustainable 7% while shifting the focus from investment and exports to domestic consumption. But the unfavourable international economic environment is triggering sudden slowdowns in exports and industrial activity, to a point that could even endanger the 7.5% growth target for 2012.
- Rising net exports helped widen the trade surplus to 8% of GDP in 2007. But lower post-crisis demand in the industrialized countries, currency appreciation and the soaring price of raw materials (of which China is a net importer) helped push the surplus, as a percentage of GDP, down to below 2% in 2012.
- Export growth continues to slow (as the graph for components of final demand and GDP shows). The real engine of economic growth in China in recent years has been investment, while household consumption accounted for only one third of GDP in 2011.
- Data as of July 2012 show an annualized increase in exports of just 1%, a 16% drop in exports to Europe and a 0.6% increase in exports to the United States. A sharp drop in inflation (from 6.5% in July 2011 to 1.8% in July 2012) provides scope for new monetary and credit expansion measures in the second half of the year, paired with ongoing stimulus measures promoting investment at the local government level and supporting private investment with tax incentives. The impact of these measures is expected to be felt starting late in the third quarter, with growth by year-end very close to the target set by the authorities in early 2012.

Figure 4

China: contribution to GDP growth by component of final demand, 2000-2011

(Percentages)

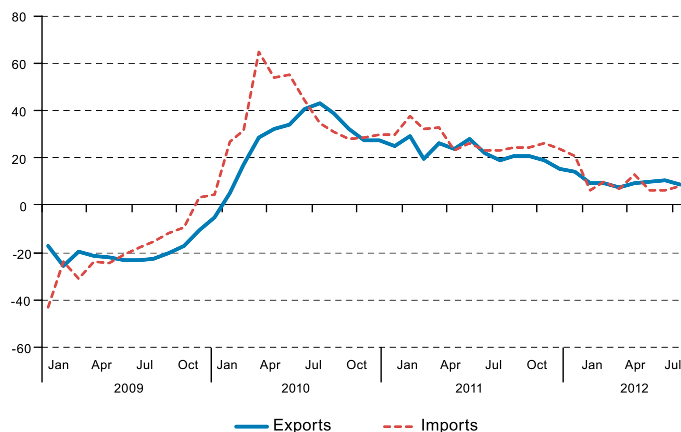


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators, and information provided by the Ministry of Commerce (MOFCOM) and the Customs Office of China.

Figure 5

China: growth of export and import values, 2008-2012

(Percentages over year-earlier quarter)



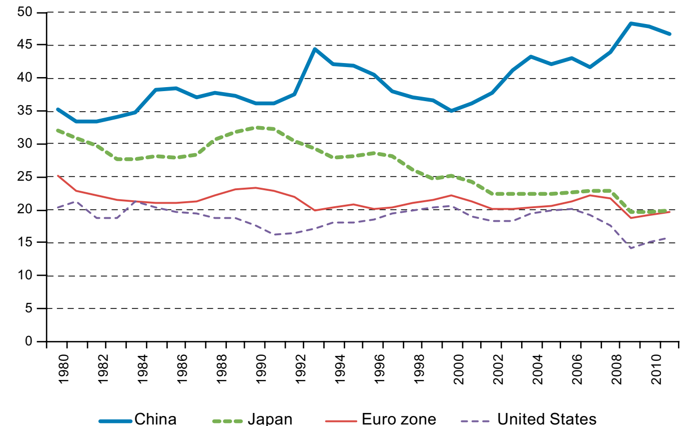
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World dataBank, and information provided by the Ministry of Commerce (MOFCOM) and the Customs Office of China.

5. A major challenge for China is to shift its sources of growth from net exports and investments to private consumption

- The debate in China is whether the sharp slowdown in exports and industrial output will lead to a new countercyclical programme of a magnitude similar to that implemented in 2008 (US$ 628 billion) to keep growth at around 7%-8%. There seems to be enough fiscal and monetary space, but the structural conditions do not seem appropriate for repeating such an ambitious programme. Although the programme was successful in that it enabled the Chinese economy to expand by 9.1% in 2009 in the middle of the global crisis, it was so big that it impaired bank portfolio quality, increased local government debt and encouraged excess capacity in a number of key industries (steel, automobiles, cement and construction materials). The flood of liquidity exacerbated inflationary pressures and created property bubbles in the major cities.
- The directives of the twelfth five-year development plan 2011-2015 placed high priority on boosting domestic consumption and mapping out a more sustainable growth pattern. One of the key indicators that the plan seeks to change is the overly-high investment rate (which hovered in the area of 40% of GDP before the 2008-2009 crisis), by correlatively increasing consumption. But the features of the stimulus programme deployed in 2008 and 2009 skewed that support towards major investments in infrastructure and capital-intensive industries and pushed the investment rate up to nearly 50% of GDP. The current strategic debate in China is, then: (i) whether a new growth stimulus programme is needed; (ii) if so, how it can be structured so as to avoid overly encouraging investment and its flip side: decreasing the share of wages in national income.

■ Figure 6 ■

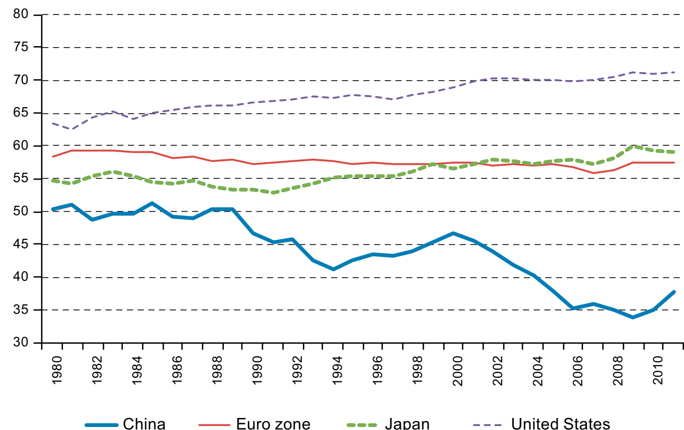
Selected countries: gross fixed capital formation as a percentage of GDP, 1980-2011



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators.

■ Figure 7 ■

Selected countries: private consumption as a percentage of GDP, 1980-2011



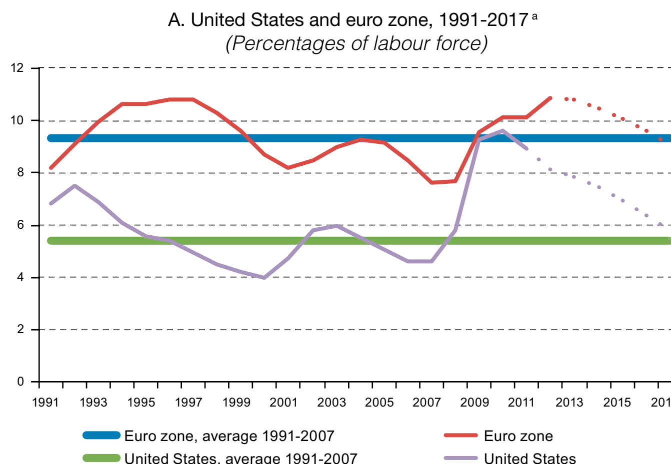
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World dataBank.

6. The complex economic situation is hampering job recovery in the industrialized economies

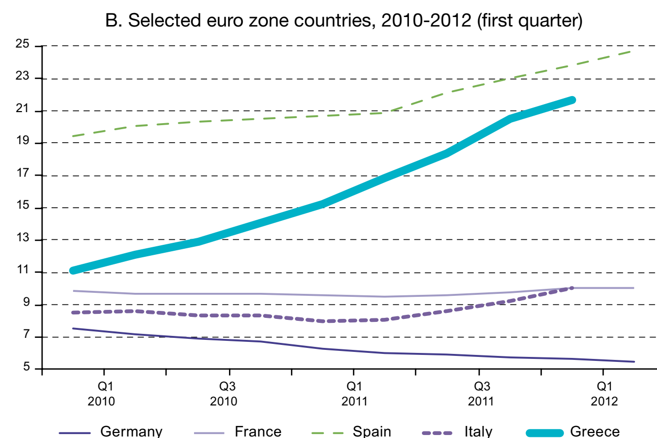
- **One of the biggest challenges in the current situation is job recovery, especially in the industrialized countries.** Many countries saw employment rates improve as the economy recovered in 2010, but the 2011 slowdown halted forward progress. In all of the major economies, the employment-to-population ratio remains below 2007 levels except in Germany, Brazil and China. This is also reflected in persistently high unemployment rates, especially in the advanced countries. Through June 2012, unemployment in the United States remained above 8%, exceeding pre-crisis levels.
- **In June 2012 unemployment in the euro zone was the highest in its history** (11.2% of the labour force, or 17.8 million people). In almost all of the euro zone countries, unemployment at year-end 2011 was higher than in 2007, except for Germany. The most heavily indebted countries posted the largest unemployment increases and rates in June 2012, owing in part to drastic fiscal cuts: Spain (24.8%), Greece (22.5%), Portugal (15.4%) and Ireland (14.8%) (Eurostat, 2012). Euro zone unemployment is expected to continue to rise and might not stabilize until sometime in 2013.
- **Overall, the Organisation for Economic Cooperation and Development countries would need to create 14 million jobs in order to return to pre-crisis levels of employment** (OECD, 2012b). Other worrisome trends are the increase in long-term unemployment (35% of total euro zone unemployment) and the rate of joblessness among the young (United Nations, 2012).
- In the industrialized economies, private consumption is the largest component of final demand (between 70% and 75%). Slow job creation, high unemployment and depressed real wages herald serious difficulties for returning to pre-crisis rates of growth. And credit expansion will not be a substitute for an increase in real wages, as it was in the 2000s. A credit-driven revival of private consumption cannot be expected until private deleveraging is completed.

Figure 8

Unemployment rates, 1991-2017



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund, World Economic Outlook, April 2012 Update.
[a] IMF projections for 2012-2017.



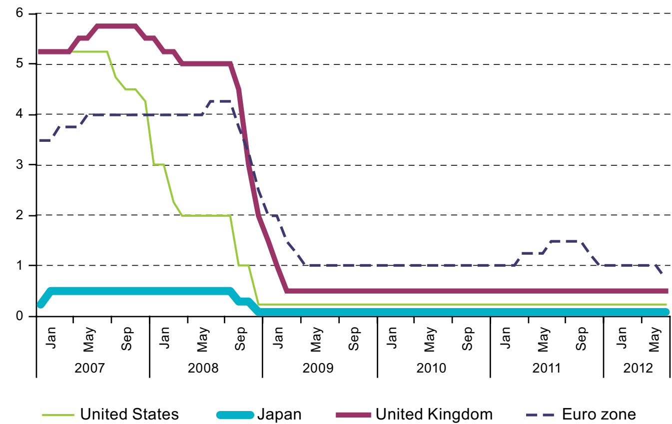
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Cooperation and Development (OECD), *OECD Economic Outlook*, May 2012 and IMF, World Economic Outlook, April 2012.

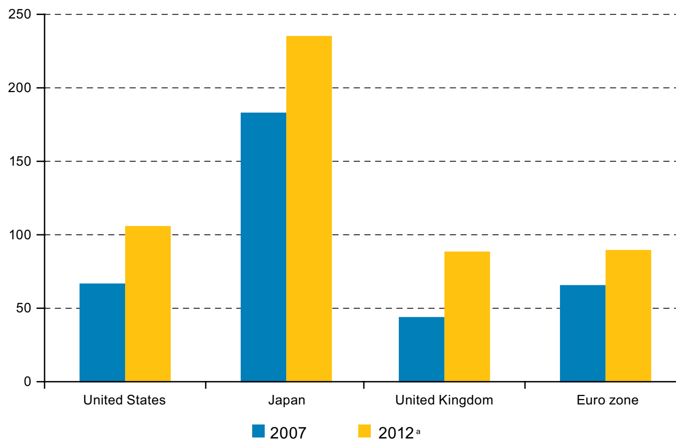
7. The industrialized countries have less space for countercyclical policy than in 2009

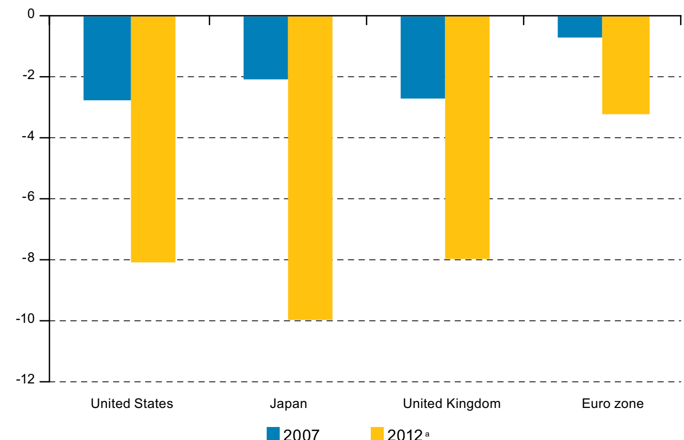
- The industrialized economies have very little scope for addressing a new crisis, for a number of reasons. On the monetary stimulus front, interest rates in the United States and the euro zone are approaching zero and there have been several rounds of quantitative easing. Public debt and fiscal deficits are at unsustainable levels in most OECD economies. And private debt reduction will take a few more years; this, in addition to curbing domestic demand, makes monetary policy less effective as a reactivation tool.
- The emerging countries also have less scope for deploying countercyclical measures than in 2009, because earlier countercyclical recovery programmes were so successful. Some were so big that they fuelled credit booms or inflationary pressures and even threatened to create property bubbles. Another limiting factor has been emerging throughout 2012: worsening terms of trade and falling export values are taking a particularly heavy toll on the fiscal balance of minerals-, metal- and energy-exporting economies.

■ Figure 9 ■

Selected countries and groups, 2007-2012







Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bloomberg and International Monetary Fund, *World Economic Outlook*, April 2012.

[a] Data for 2012 are projections.

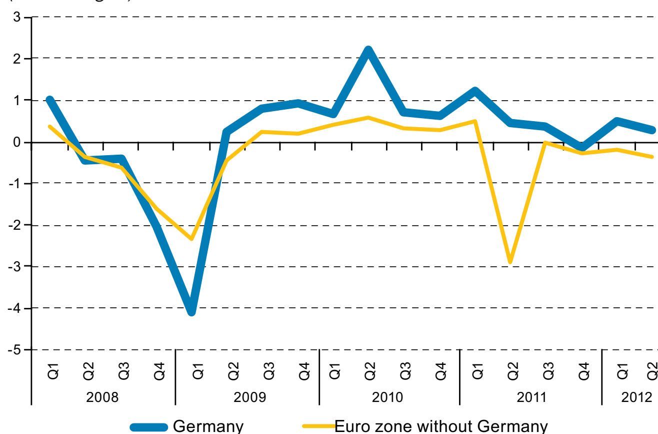
8. Despite enormous efforts, the euro zone crisis continues and could deepen

- **The euro zone approached recession in the second quarter of 2012, amid the looming threat of a W-shaped recovery or double-dip recession.** Technically speaking, the euro zone has avoided a recession because economic activity was stagnant in the first quarter of 2012. In practical terms, though, the euro zone (without Germany) has been practically flat since the first quarter of 2008.
- **Despite major agreements, the crisis has not yet been defused.** The euro-zone summit in late June agreed on direct recapitalization of banks without going through governments, and on a 120-billion-euro growth stimulus programme. Recapitalization would be paired with a single banking supervisory mechanism that could take several years to become operational. Such a delay would mean higher public deficits in the meantime. And the complicated details of how to mesh national and European Community regulators remain to be fleshed out. Likewise, the resources agreed for stimulating growth (1% of the euro zone's GDP) seem too limited in the face of financial uncertainty and widespread fiscal austerity.
- **The euro is still under threat.** Volatility and financial uncertainty are affecting cross-border and interbank credit lines in Europe, with the most indebted economies taking the hardest hit. Regulators in the more solvent economies are pressuring local banks to increase their capital and liquidity at the cost of limiting their exposure in the Mediterranean countries. Because of the large share of intra-European trade, this affects exports throughout the euro zone. The major banks and multinational companies are already drafting contingency plans for a potential rearrangement of the euro zone, as can be seen in the marked scale-back of their exposure to the hardest-hit economies, the gradual shift of part of their euro assets to dollars and the transfer of accounts in euros to economies regarded as safer. These processes, which are already being felt in the world's major financial centres, are putting further pressure on indebted economies.

Figure 10

Germany and euro zone without Germany: quarterly GDP growth, 2008-2012

(Percentages)

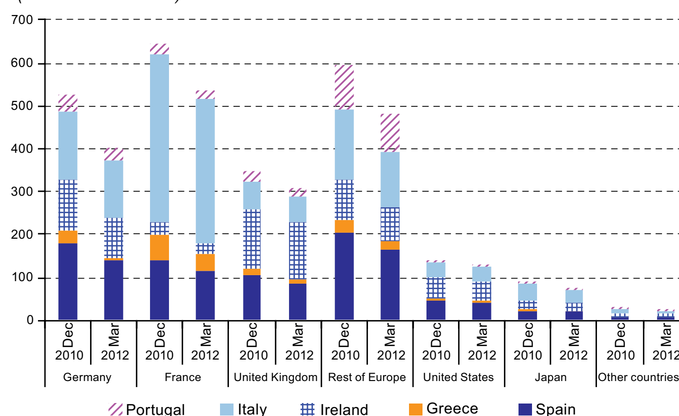


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Eurostat "National Accounts, Main Tables" [online] http://epp.eurostat.ec.europa.eu/portal/page/portal/national_accounts/data/main_tables [date of reference: 17 August 2012].

Figure 11

Banks in selected countries or groups: loan exposure to selected euro zone countries, 2010 and 2012

(Billions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Bank of International Settlements, "Consolidated banking statistics", table 9E, Foreign exposures on selected individual countries, ultimate risk basis [online] http://www.bis.org/statistics/consstats.htm# [date of reference: 14 August 2012].

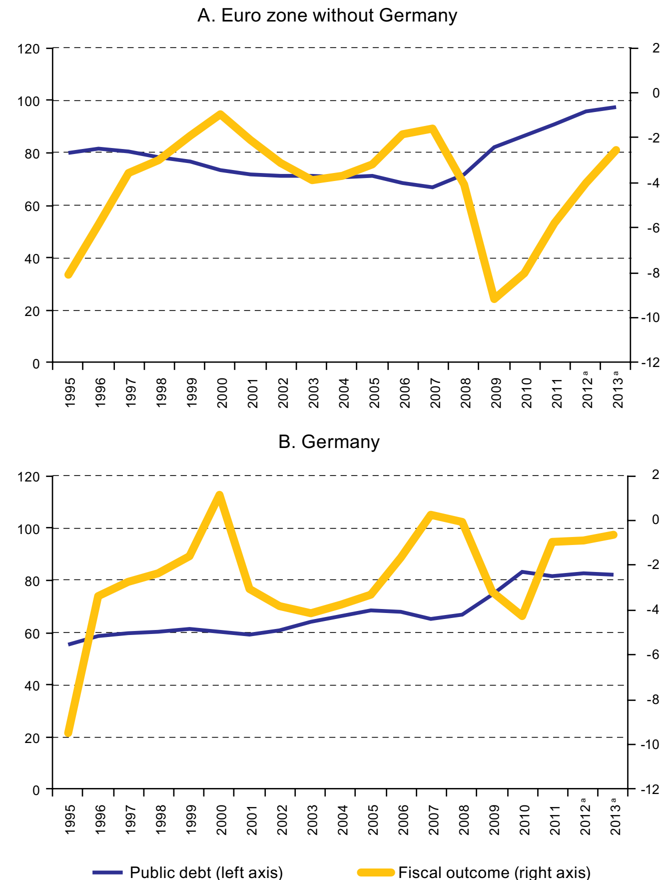
9. Fiscal deficits and public debt in the euro zone pose economic policy dilemmas

- A number of euro zone economies are confronted with a thorny economic policy dilemma: fiscal cutbacks versus growth. On the one hand, high fiscal deficits and public debt in a recession lead investors and analysts to question fiscal account sustainability, especially in countries like Spain and Italy. These concerns are expressed in higher sovereign bond risk premiums for these countries, making funding more expensive for them. To mitigate this high perceived risk, these countries are undergoing severe fiscal consolidation that is dealing a heavy blow to their already weakened economies. This upsets investors, whose behaviour swings wildly as they press for fiscal consolidation while fearing the slower growth it brings (Blanchard, 2012). On the other hand, sweeping austerity measures in the euro zone could constitute a fallacy of composition: fiscal consolidation might make sense for a single economy but could turn into an adverse scenario if all of the euro zone economies were to implement the same policy, especially since nearly two thirds of European Union exports go to the European market.
- There is a growing perception that the crisis must be faced with a more appropriate mix of austerity and growth if a double-dip euro-zone recession is to be warded off. The dilemma lies in the fact that, in the short run, fiscal consolidation and slower growth drive sovereign debt risk premiums up, but, without robust public investment (in infrastructure, for example), growth is unlikely to return to levels that ensure a stable public debt path.

■ **Figure 12** ■

Euro zone and Germany: public debt and fiscal balance, 1995-2013

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the Organisation for Economic Cooperation and Development and International Monetary Fund, *World Economic Outlook*, April 2012.

[a] IFM projections.

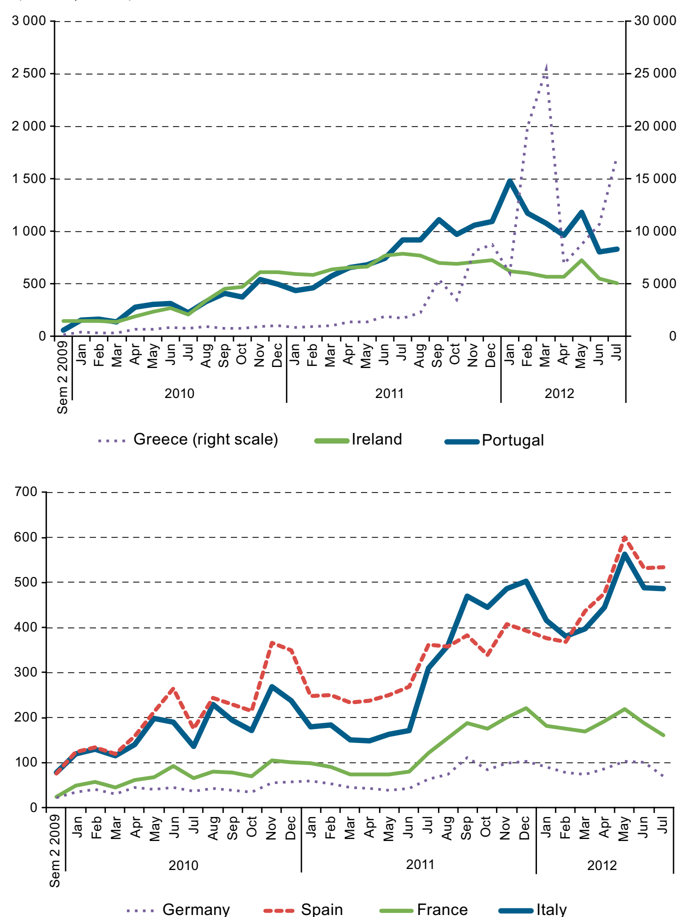
10. Patterns differ among euro zone members

- **The difficult overall context in Europe masks substantial heterogeneity among individual countries.** Germany is in the best position: while it is being affected by the depressed context in the region, its exports outside Europe are benefiting from the euro's falling value against the dollar and the yuan. And the crisis is helping Germany's public accounts because the mounting credit risk of a number of euro zone countries boosts demand for German bonds and pushes their real yields into negative territory. This is helping bring down Germany's deficit, which is likely to balance out in 2013.[2] Other countries, such as Austria, Denmark, Finland, the Netherlands and Sweden, are in a similar position.
- On the other hand, countries like Greece, Ireland, Italy, Portugal and Spain are in a deep recession exacerbated by stringent fiscal austerity measures. As a result, risk premiums for Greece, Italy and Spain are spiralling up to unprecedented, unsustainable levels.
- In short, widespread fiscal austerity has impacts ranging from positive financial externalities for Germany and the countries of the North to a worsening economic scenario in the South. This is one of the economic and political divides between Northern Europe and Southern Europe that make it hard to reach agreements leading to an orderly exit from the crisis.

■ Figure 13 ■

Europe (selected euro zone countries): credit default swap risk premiums, second quarter 2009-July 2012

(Base points)



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

[2] Spiegel Online, "Eurocrisis Will Help Germany Balance its Budget" [online] http://www.spiegel.de/international/europe/euro-crisis-helps-germany-by-lowering-borrowing-costs-a-838880.html [date of reference: 21 July 2012].

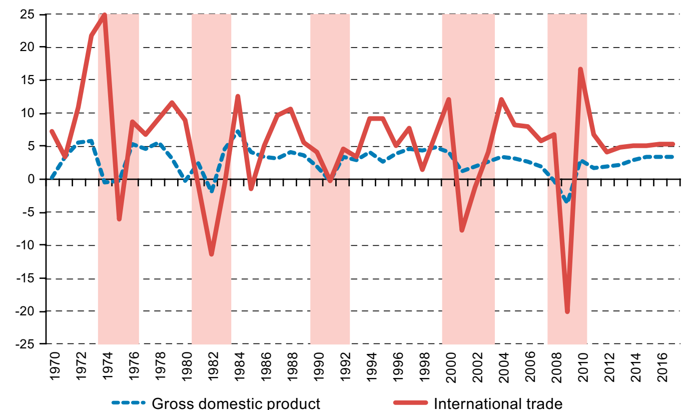
11. In the United States, recovery from the subprime crisis is the slowest and most vulnerable of all recoveries since the 1970s

- Economic growth in the United States slowed to a modest 1.5% in the second quarter of 2012. Job creation has slackened, from 250,000 jobs between December 2011 and February 2012 to 100,000 between March and June and only 80,000 in June 2012. At this pace of job recovery, pre-crisis employment levels will not be regained until 2025 (Stiglitz, 2012).
- These figures show that the United States is in a period of slow, vulnerable growth five years after the outbreak of the subprime crisis. Despite forceful revitalization programmes, this recovery is proving to be the slowest since the 1970s.
- Annual growth during the recovery (between mid-2009 and 2012) is averaging 2.4%, which is low in view of the magnitude of the stimulus measures implemented. This shows that the fiscal deficit accounts for the bulk of economic activity in times of sharp private debt reduction. Indeed, the financial balance of the private sector turned from a deficit equal to 2.4% of GDP in the third quarter of 2007 to a surplus of 8.2% of GDP in early 2012. This massive shift, of more than 10 percentage points of GDP, would have triggered a severe depression were it not for increased fiscal spending (Wolf, 2012).

■ Figure 14 ■

United States: gross domestic product and international trade, 1970-2017

(Rates of variation)

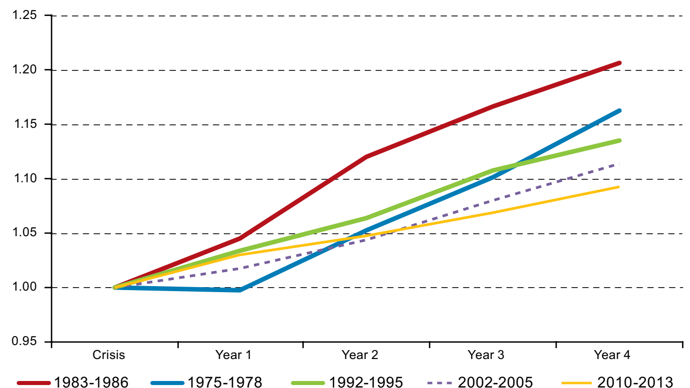


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators; International Monetary Fund (IMF), *World Economic Outlook*, April 2012 update and July 2012 update.
Note: Data from 2012 onwards are IMF projections.

■ Figure 15 ■

United States: cumulative growth in the four years after the crisis

(Index: crisis year=1)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World dataBank; International Monetary Fund (IMF), *World Economic Outlook*, April 2012 update and July 2012 update.
Note: Starting in 2011, total trade refers only to exports of goods and services.

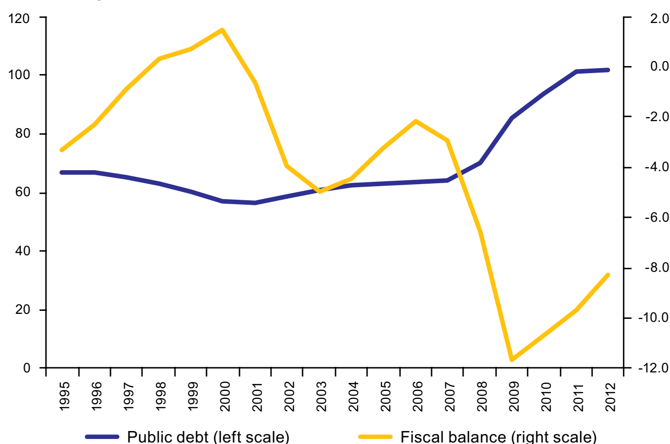
12. Late this year the United States will face a fiscal cliff with significant implications for growth potential in 2013

- **There is a real threat of another United States recession in 2013**. Automatic tax hikes and spending cuts totalling US$ 560 billion (4.7% of GDP) will be triggered in January 2013 unless Congress reaches an agreement for postponing some of the measures.
- If all of the measures were to take effect the economy would slow dramatically, with growth projected at just 0.5% for 2013 and the economy expected to contract during the first half of the year (Congressional Budget Office, CBO, 2012). The International Monetary Fund (2012b) projects that the economy will stall in 2013 if there is no legislative agreement and all of these fiscal measures take effect.
- The United States economy will start 2013 with growth in the area of 1.5%; fiscal matters in need of Congressional agreement equal some 4.7% of GDP. There is little likelihood of legislative agreement on the entire amount, so even in the most optimistic of scenarios with partial legislative agreements the most likely outcome would be modest growth in 2013 (Roubini, 2012). The most recent International Monetary Fund projection suggests 2.3% growth for 2013, but this forecast hinges on best-case assumptions concerning this fiscal debate as well as the response to the euro crisis. This last point is a relevant one, because the slowdown in Europe is starting to dampen exports from the United States.

Figure 16

United States: fiscal balance and public debt

(Percentages of GDP)



Source: Congressional Budget Office (CBO), "Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013", May 2012.

Table 1

United States: expected fiscal cuts in 2013

(Billions of dollars and percentages of GDP)

	Billions of dollars	Percentages of GDP
Deficit in 2012	1 171	...
Deficit in 2013	612	...
Consolidation	559	...
Expiring tax cuts	399	3.3
Effect of automatic cuts in federal spending	65	0.5
Unemployment benefit cuts	26	0.2
Medicare reduction [a]	11	0.1
Other adjustments	105	0.9
Economic feedback effect [b]	-47	-0.4
Total	560	4.7

Source: Congressional Budget Office (CBO), "Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013", May 2012.

[a] Medicare is a health insurance programme for those aged over 65.

[b] The economic feedback effect is the effect that slower growth in 2013 has on tax revenue and fiscal spending. http://www.cbo.gov/sites/default/files/cbofiles/attachments/FiscalRestraint_0.pdf [date of reference: 6 August 2012].

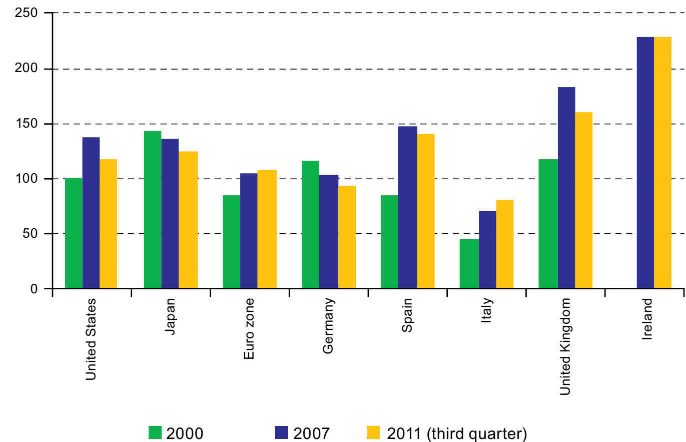
13. The complex process of household debt reduction in the industrialized countries is constraining economic growth

- **The difficult recovery in the industrialized countries is the expected outcome of a crisis whose primary causes included an unsustainable increase in gross household debt.** During the five-year run-up to the outbreak of the 2008 crisis, average gross household debt rose by 39 percentage points to reach 138% of income. In a number of European countries it topped 200% (IMF, 2012a). When the 2008 crisis drove home values down, many households saw their equity fall in relation to what they owed. Moreover, falling income and rising unemployment made it increasingly hard to make mortgage payments.
- Debt reduction is concentrated in lower-income households that spend a high percentage of their income; this inevitably has a substantial negative macroeconomic impact. In order to reduce their debt burden, households have to cut back on consumption and increase savings as they discover that their homes were overvalued, access to credit is constrained and future income expectations are dampened. Consumption is also impacted by heightened economic uncertainty, which encourages preventive saving (IMF, 2012a).

■ **Figure 17** ■

Selected industrialized countries: household debt, 2000, 2007 and 2011

(Percentages of gross disposable income)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Cooperation and Development (OECD), OECD *World Economic Outlook*, May 2012.

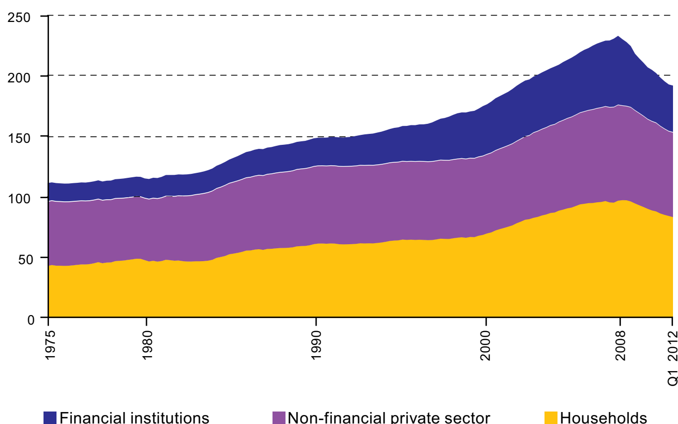
14. Recessions triggered by financial crises due to overindebtedness are especially costly and complex to address

- Recessions triggered by overindebtedness tend to set off sharper drops in GDP, private consumption and employment than those caused by other factors, and they depress economic activity for at least five years (Reinhart and Rogoff, 2010; McKinsey, 2012). Recoveries from crises caused by overindebtedness are also long because of subsequent government interventions to rescue financial institutions and support families. They leave a legacy of high fiscal deficits and public debt that take years to bring down. Moreover, in a context of private debt reduction, monetary and financial stimulus measures are of limited effectiveness, because the funds provided by the financial system to stimulate aggregate demand tend to return to the financial system through debt paydowns.
- To exit the current crisis, families in many countries need to go through forced debt settlement or bankruptcy. The country that has made the most progress in deleveraging is the United States, where bankruptcies accounted for two thirds of debt reduction between 2008 and 2011 (McKinsey, 2012). It is estimated that by late 2013 the private sector in the United States will be returning to its medium-term debt trend, which would also allow a return to faster growth. By contrast, Ireland, Spain and the United Kingdom still have high private debt payments that are a severe drag on private consumption and its contribution to growth.

Figure 18

United States: private debt by category, 1975-2012 [a]

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the United States Federal Reserve System.

[a] Does not include asset-backed securities, to avoid double counting of underlying loans.

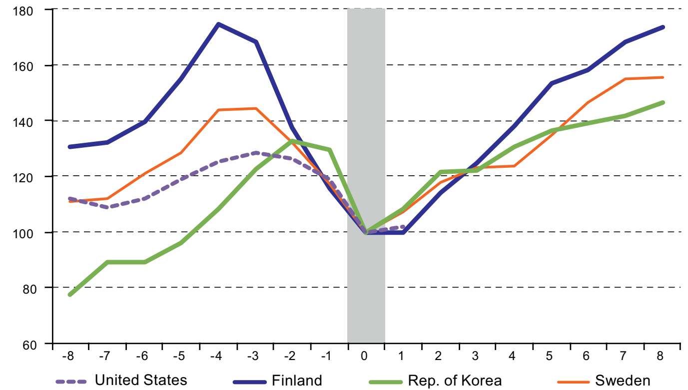
15. Successful deleveraging processes have some things in common

- Finland, Sweden and the Republic of Korea are examples of countries that successfully deleveraged after a deep financial crisis (McKinsey Global Institute, 2012). Some of the similarities in these cases are: (i) rapid resolution of bad loans; (ii) robust export performance supported by significant devaluation; (iii) rapid expansion of private investment; (iv) structural reforms to promote productivity and competition (in the Nordic countries, entry into the European Union and retail sector deregulation; in the Republic of Korea, restructuring corporate conglomerates and further opening the economy to foreign direct investment); and (v) stabilization of real estate market prices and resumption of new home sales. Another similarity is that fiscal deleveraging took place only after growth had resumed, driven by exports and private investment. In other words, fiscal deleveraging came in the final years of private debt reduction. In the countries examined, the process took between five and seven years. This suggests that the United States is only just beginning the process, as the figures suggest.

■ **Figure 19** ■

Selected countries: gross fixed capital formation eight years before and after the crisis

(Index: crisis year=100)

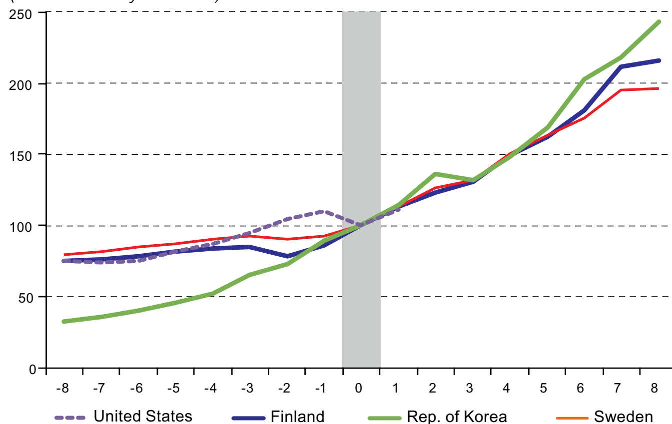


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators [online database].
Note: Year 0 is the crisis year —1994 for Finland and Sweden, 1999 for the Republic of Korea and 2009 for the United States.

■ **Figure 20** ■

Selected countries: exports eight years before and after the crisis

(Index: crisis year=100)

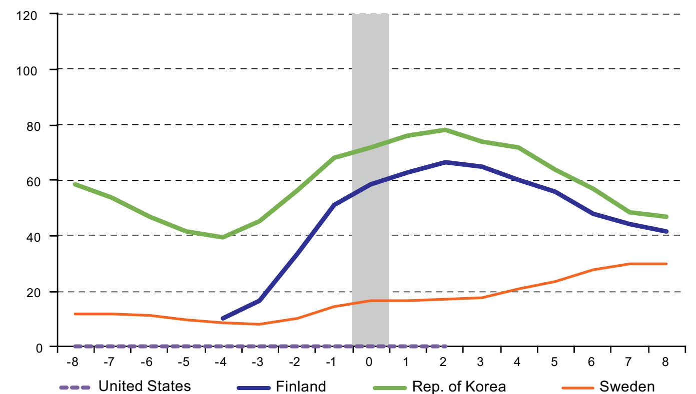


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World dataBank [online database].
Note: Year 0 is the crisis year —1994 for Finland and Sweden, 1999 for the Republic of Korea and 2009 for the United States.

■ **Figure 21** ■

Selected countries: public debt eight years before and after the crisis

(Percentages of GDP)



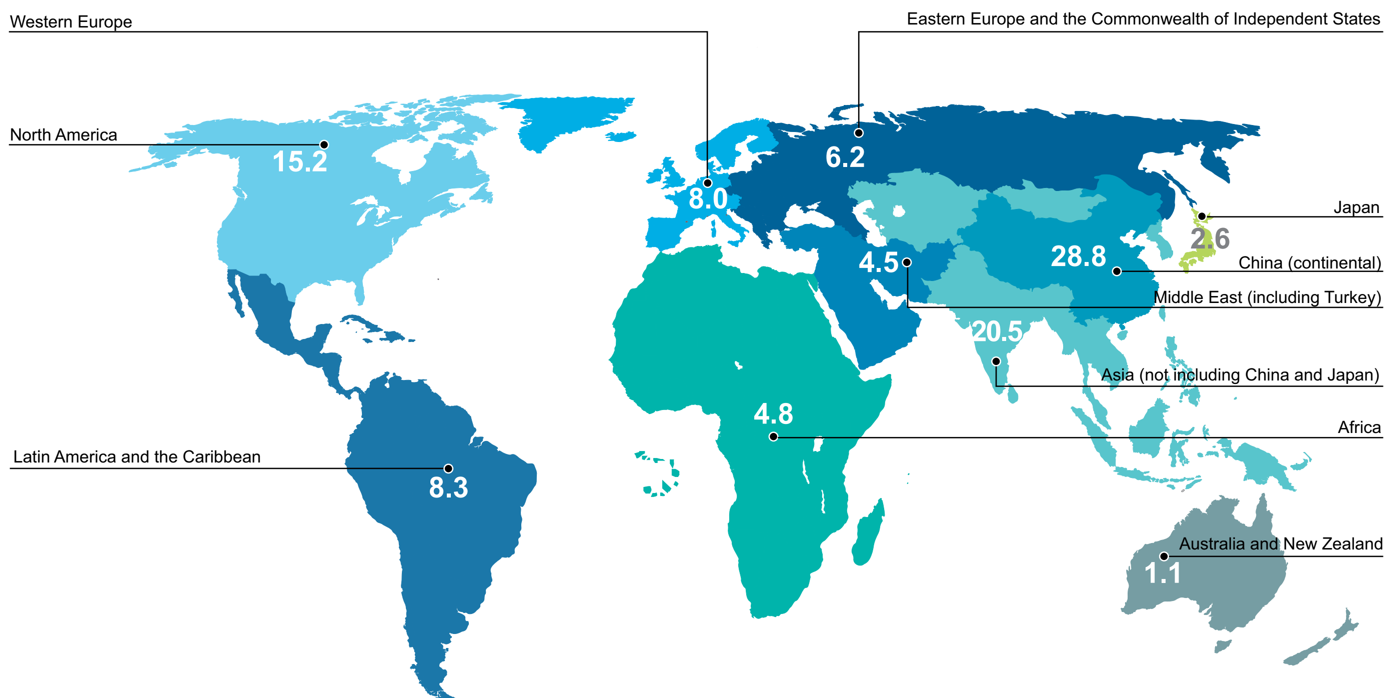
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, World Development Indicators [online database].
Note: Year 0 is the crisis year —1994 for Finland and Sweden, 1999 for the Republic of Korea and 2009 for the United States.

16. 2013-2020 will be a cycle of slow growth in the industrialized economies and higher growth in the emerging economies

■ Map ■

Contribution to projected global growth, 2011-2017

(Percentage points)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook Database*, April 2012.

- **For 2012-2017, many analysts forecast continued slow growth in the industrialized countries (the "North") and just a slight cooldown in the developing countries (the "South")**. The United Nations (2012) projects annual average growth of 2.5% for the countries of the North and 5.6% for the countries of the South between 2013 and 2020. The International Monetary Fund (IMF, 2012a) and the Organisation for Economic Cooperation and Development (OECD, 2012) project even faster growth for the South. According to all of these organizations, the United States is likely to perform the best among countries of the North. In the South, between 2013 and 2017 China is expected to continue to post the fastest expansion, at a projected annual rate of nearly 8%. Africa and Latin America and the Caribbean should grow by 4%-5%, slower than the pace forecast for developing Asia.
- In 2011-2017, developing Asia is expected to account for nearly half of global economic growth. Latin America and the Caribbean are forecast to contribute more than 8.3%, slightly more than Eastern Europe but nearly twice the contribution made by Africa. The industrialized countries together are forecast to account for less than a third.

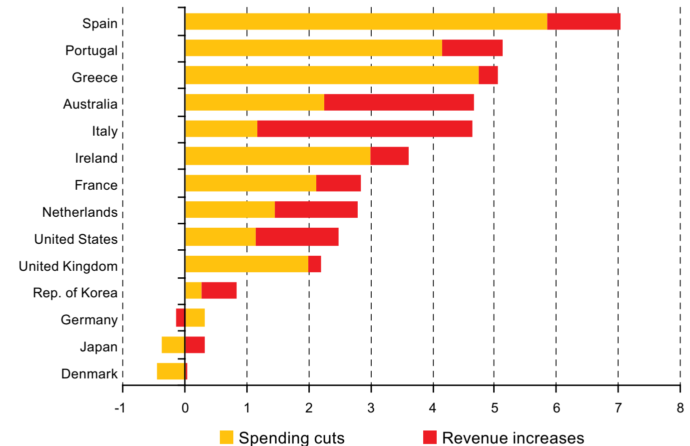
17. Fiscal consolidation and population ageing will be another drag on growth in the industrialized economies

- A number of industrialized countries (not just European ones, but Australia and the United States as well) need to rein in their public debt. To do so, the governments are reducing the primary balance (before interest payments). The fiscal cutback is expected to exceed 4% of potential GDP in Spain, Portugal, Greece, Australia and Italy between 2011 and 2013, according to estimates from the Organisation for Economic Cooperation and Development (2012). Most of the adjustment in these five countries will be in the form of spending cuts. The exception is Italy, where the bulk will be from tax increases.
- Fiscal consolidation slows growth. The Organisation for Economic Cooperation and Development (2012) estimates that reducing the primary balance as a percentage of GDP by 1 percentage point would reduce GDP growth by approximately 0.5%. In the five countries with cutbacks in excess of 4% of potential GDP, GDP growth would therefore be some 2% lower in 2011-2013.
- The future costs associated with population ageing in terms of higher spending on public health and on pensions pose another challenge for the fiscal consolidation required in the industrialized countries. Higher spending on health might be desirable, but funding it could be difficult. The Organisation for Economic Cooperation and Development (2012) anticipates that increased health spending and the spending associated with long-term care for older persons would increase the annual fiscal cost by an average of 1.5% of GDP. The additional cost is for pensions and varies widely among countries.

Figure 22

Selected industrialized countries: fiscal consolidation as projected by change in the primary fiscal balance, 2011-2013

(Percentage of potential GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Cooperation and Development (OECD), *OECD Economic Outlook*, May 2012.

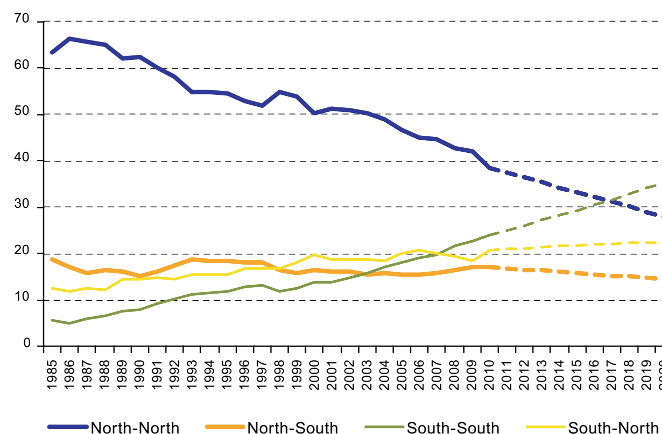
18. Burgeoning South-South trade is a structural trend that the features of the crisis are reinforcing

- Faster growth in the developing countries than in the industrialized ones over the past few decades has rearranged international trade flows. Since the mid-1980s the developing countries' share of world exports has soared; exports between developing countries now exceed their exports to developed countries. Asia's booming trade, both intraregional and with other developing regions, accounts for much of this shift.
- The flip side is the plummeting share of trade among developed countries as a percentage of the world total: from more than 60% in 1985 to less than 40% in 2010.
- If trade flows follow this same trend over the next few years, by around 2017 trade among developing countries could account for a larger proportion of global trade value than trade among developed countries.

Figure 23

Developed and developing country exports, 1985-2020 [a]

(Percentages of world total)



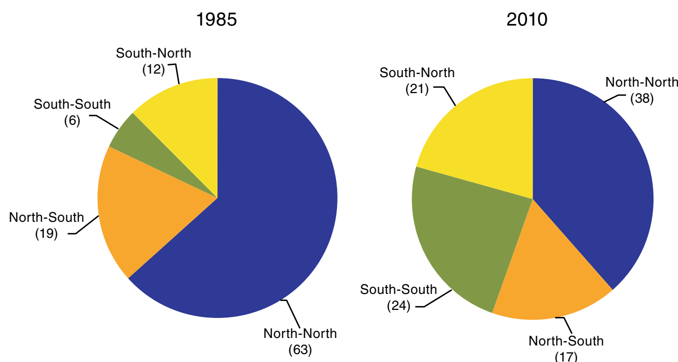
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations commodity trade database (COMTRADE).

[a] Figures for 2011 onwards are ECLAC projections.

Figure 24

World: distribution of exports, 1985 and 2010

(Percentages of world trade)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations commodity trade database (COMTRADE).

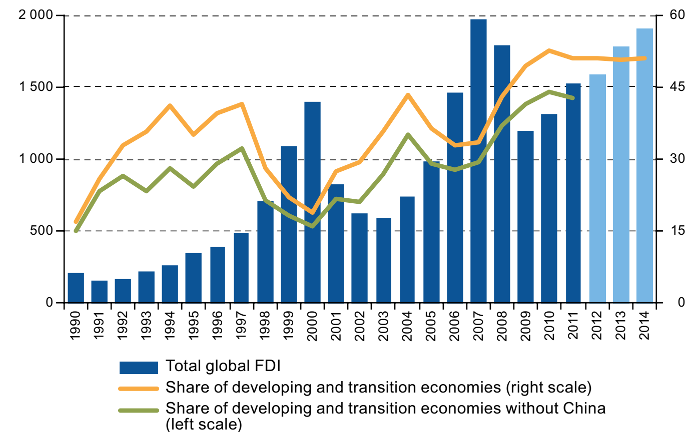
19. The developing countries are also raising their profile as receivers and senders of global foreign direct investment

- **Foreign direct investment (FDI) flows continued to recover in 2011; low growth is expected in 2012 (UNCTAD, 2012). Developing countries and transition economies combined received slightly more than half of inward FDI flows in 2011 and are expected to maintain this share through 2014**. The two developing regions topping the list of FDI recipients are Asia and Oceania (led by China and Hong Kong Special Administrative Region of China) and Latin America and the Caribbean (where Brazil is the main recipient, as well as the fifth worldwide in 2011).
- **The developing countries' share of outward foreign investment**, which surged during the past decade, dropped to 23% in 2011 after reaching an all-time high of 28% in 2010.
- These trends towards a higher share of developing countries in global FDI flows in both directions still hold if China is not included in this category of countries.

Figure 25

Developing and transition economies: share of foreign direct investment inflows, 1990-2014 [a]

(Billions of dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations Conference on Trade and Development, UNCTADSTAT database and *World Investment Report 2012: Towards a New Generation of Investment Policies* (UNCTAD/WIR/2012), Geneva, July 2012.

[a] Figures for 2012 to 2014 are projections.

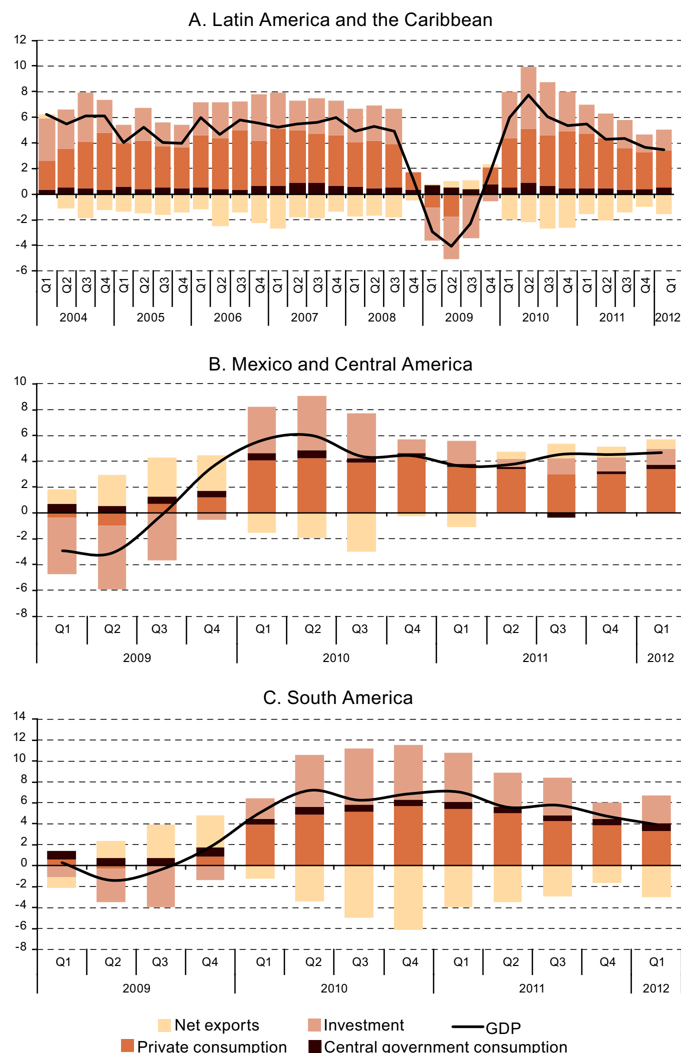
20. The stagnant external environment is cooling economic growth in Latin America and the Caribbean

- In aggregate terms, the complex international situation and developments in individual countries weighed on the region's economic activity throughout 2011. The slowdown halted in the first quarter of 2012 but resumed to a certain degree in the second quarter, signalling a potential scenario in which growth could be slower than in the past for a prolonged period. It is therefore estimated that, at 3.2%, the region's economy will expand less than in 2011.
- The contribution that the components of aggregate demand make to the region's GDP has varied widely among the countries, but there are some factors in common. The contribution of private consumption fell steadily in 2011 but stabilized in the first quarter of 2012 albeit at a lower level than in prior years. The contribution of public consumption rose slightly, as did investment.
- There are some differences among subregions. Average growth was relatively stable in Mexico and Central America between the third quarter of 2011 and the first quarter of 2012; the contribution by private and public consumption was positive and growing, and the contribution by net exports was positive. South America saw a slowing GDP growth trend that sharpened in the third quarter despite a growing contribution by investment and public consumption. Rising imports reflected the increase in investment, whereas export volume slackened. As a result, the negative contribution of net exports to GDP growth increased in the first quarter of 2012.

■ **Figure 26** ■

Selected regions: GDP variation and contribution to growth of the components of aggregate demand

(Percentages, weighted average, dollars at constant 2005 prices)



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

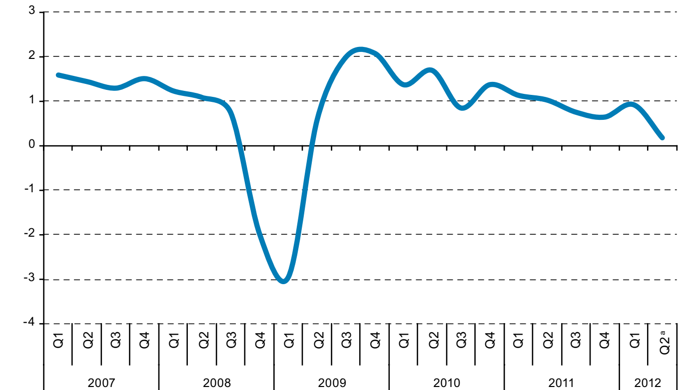
21. Growth in the region slowed in the second quarter of 2012

- Preliminary data for the second quarter of the year show that economic activity resumed the slowdown that had seemed to halt in the first quarter. GDP growth (over the previous quarter[3]) is estimated at just under 0.5% —markedly below the rates posted since the second quarter of 2009. This cooling is also seen in the indicators of sectoral activity available for the second quarter of the year, especially in the industrial activity trend.

Figure 27

Latin America and the Caribbean: gross domestic product, 2007-2012

(Percentages, constant 2005 dollars, variation from year-earlier quarter, seasonally adjusted series)



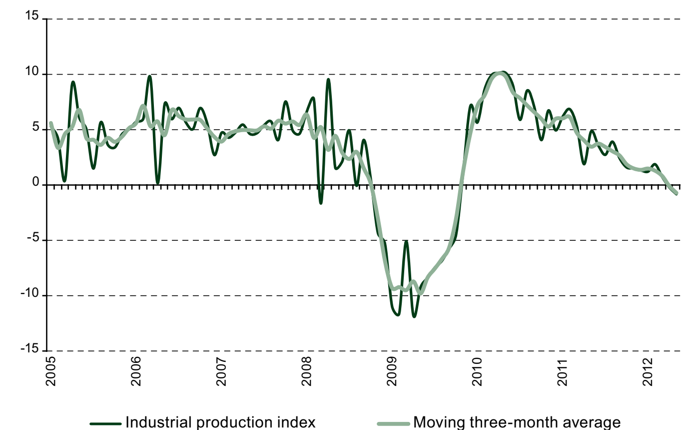
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Estimate.

Figure 28

Latin America: twelve-month changes in industrial production index, January 2005 to May 2012

(Percentages)



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

[3] Seasonally adjusted series.

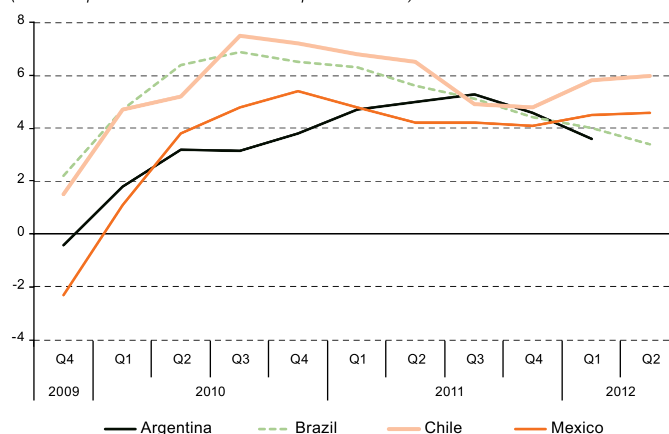
22. The labour markets continue to improve

- **As of mid-2012, on a regional aggregate basis employment was rising steadily and the unemployment rate was falling**. The predominant pattern was moderately rising real wages, making the labour markets one of the drivers of growing domestic demand. Information available for 2012 to date indicates that job generation was led by an increase in wage employment, showing that business expectations were still relatively optimistic. Nonetheless, in a number of countries slower growth and gloomier expectations led to greater caution in new hiring and, as a result, slower formal job generation.
- An examination of year-on-year employment rate variation also reveals differences. The rate has slowed sharply in Argentina, Chile, Peru and Uruguay after climbing in 2009-2010; in Colombia and Mexico employment rose at rates similar to or even higher than in preceding years. In Brazil, the increase in employment was the same as the average for 2011 but lower than in 2010.
- In an environment of contained inflation, average wages continued to post modest real gains. However, international price patterns for some food items could push up their price for consumers and impact the purchasing power of lower-income segments of the population. An external context of slow economic growth in the region's main trading partners over the next few years would decrease business labour demand. This would, above all, curb wage job generation and shift a larger share of job creation to low-productivity activities as pressure from material household needs increased the labour supply. The recent steady downtrend in the unemployment rate would also slow.

Figure 29

Latin America (selected countries): year-on-year growth in employment covered by social security

(Fourth quarter 2009 to second quarter 2012)

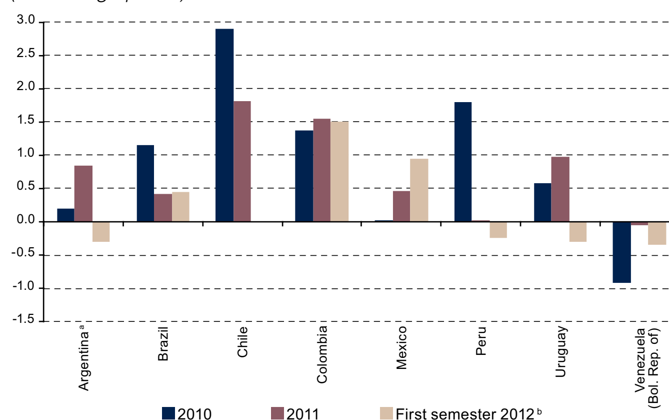


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure 30

Latin America (selected countries): year-on-year variation in employment rate, 2010-first quarter 2012

(Percentage points)



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

[a] The bar for the first half of 2012 is for the first quarter of 2012.

[b] Preliminary data.

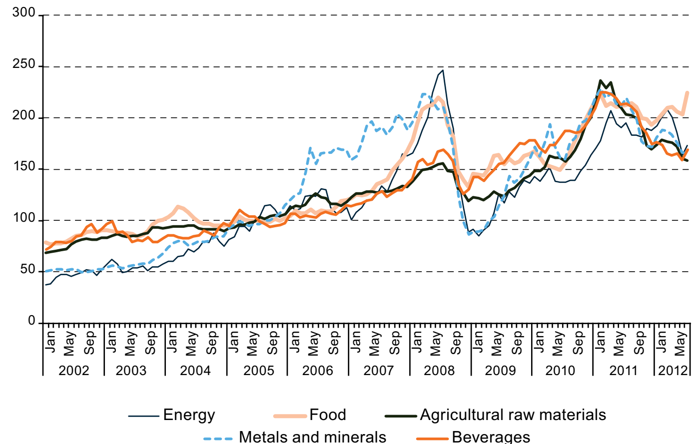
23. Except for some food items, raw materials prices are falling

- **So far in 2012, commodity prices are below the average for 2011**. Food prices are the exception, especially in the case of grains (soybeans, rice and maize): the downtrend through January 2012 reversed in February because of specific supply situations. Commodity price patterns affect the economies of Latin America and the Caribbean in different ways. The terms of trade have worsened for those countries of the region most specialized in commodity exports (chiefly, the countries of South America); net hydrocarbon importing countries benefited more from falling energy prices. And while the countries of Central America benefited from falling fuel prices, they have been negatively impacted by the rising price of food.
- Although international commodity prices have declined (especially for metals, minerals and energy), they are still well above the levels posted before 2003, when they began their steady climb.

■ Figure 31 ■

Commodity prices

(Index: 2005=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, “Pink Sheet”, August 2012.

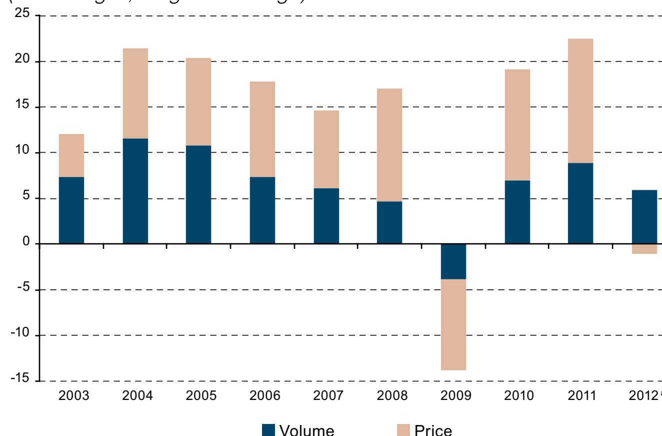
24. The region's exports will grow far more slowly in 2012 than in 2011

- **Growth of the region's goods exports is expected to slow from 23% in 2011 to about 5% in 2012**. Declining external demand has cooled the growth of exports from the region, but the most important factor has been an unfavourable price trend for the principal export commodities.
- The global economic slowdown is also reflected in the region's exports according to destination. Export value to the United States has held relatively steady since the third quarter of 2011, thanks to slow growth in the United States and the fact that manufactured products account for the largest share. On the other hand, the economic crisis in the European Union has pushed its external demand down and fed a downtrend in export value from Latin America and the Caribbean since mid- 2011.
- The situation is similar for the region's exports to Asia, although in this case the impact has come more from declining prices because the region's exports to Asia are, largely, commodities.

Figure 32

Latin America: year-on-year variation in export volume and prices, 2003-2012

(Percentages, weighted average)



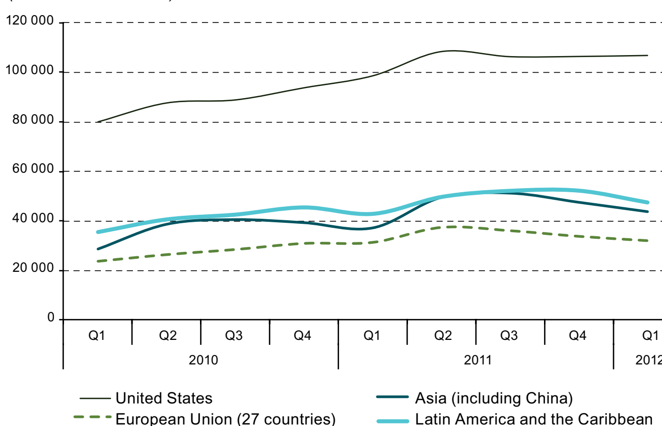
Source: Economic Commission for Latin America and the Caribbean (ECLAC), "Boletín estadístico de comercio exterior de bienes en América Latina y el Caribe. Segundo trimestre de 2012", No. 7, Santiago, Chile, 2012.

[a] Projection.

Figure 33

Latin America: export value by destination, 2010-2012

(Millions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), "Boletín estadístico de comercio exterior de bienes en América Latina y el Caribe. Segundo trimestre de 2012", No. 7, Santiago, Chile, 2012.

25. The heaviest slowdown in the region's exports and remittance income has been vis-à-vis the European Union

- While exports from Latin America to all destinations are slackening overall, the cooldown has been sharper in the case of exports to the European Union: in the second quarter of 2012 export value was down by nearly 11% over the same period in 2011.
- The region's exports to the United States and Asia, as well as its intraregional exports, also grew at a slower pace in the first quarter of 2012, with rises of 8.3%, 17.7% and 10.6% respectively, versus increases of 23.9%, 30% and 20.5%, respectively, in the first quarter of 2011.
- Migrant remittances are another channel through which the European Union crisis is transmitted to the region. An examination of remittance patterns during the first quarter of 2012 for a set of countries in the region shows that in two of the three countries posting declines (Ecuador and Colombia) the principal migrant destination is Spain.

■ Table 2 ■

European Union: variation in value of imports from selected countries, 2009-2012

(Year-on-year variation, percentages)

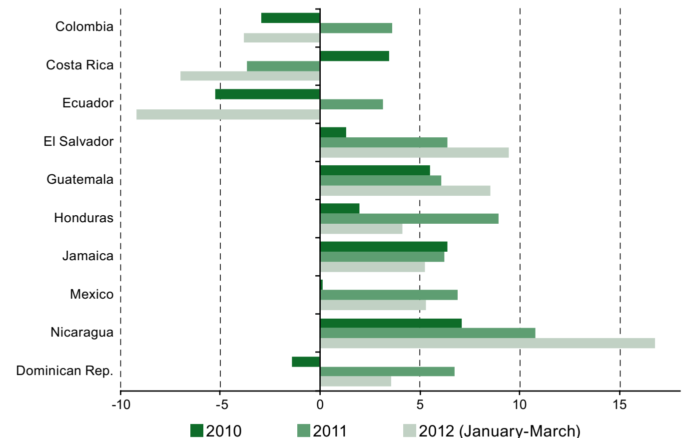
	Value				Volume			
	2009	2010	2011	Jan-Apr 2012	2009	2010	2011	Jan-Apr 2012
Brazil	-27.7%	28.2%	16.6%	-1.0%	-40.0%	28.5%	1.4%	-11.9%
Chile	-33.5%	25.9%	14.8%	-14.5%	-9.2%	11.7%	23.0%	-34.3%
Honduras	7.4%	17.9%	44.8%	16.4%	9.9%	1.2%	-5.4%	-6.3%
Argentina	-22.8%	13.4%	14.2%	-2.3%	-27.1%	4.5%	4.8%	4.6%
Uruguay	-20.0%	44.7%	1.7%	-9.1%	-21.7%	79.2%	-8.7%	-13.9%
Costa Rica	-12.4%	100.1%	7.5%	38.2%	-9.8%	5.7%	3.2%	3.4%
Peru	-17.0%	61.4%	22.8%	9.5%	-8.2%	30.2%	27.3%	35.5%

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

■ Figure 34 ■

Latin America and the Caribbean (10 countries): variation in income from migrant remittances, 2010-2012

(Percentages)



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

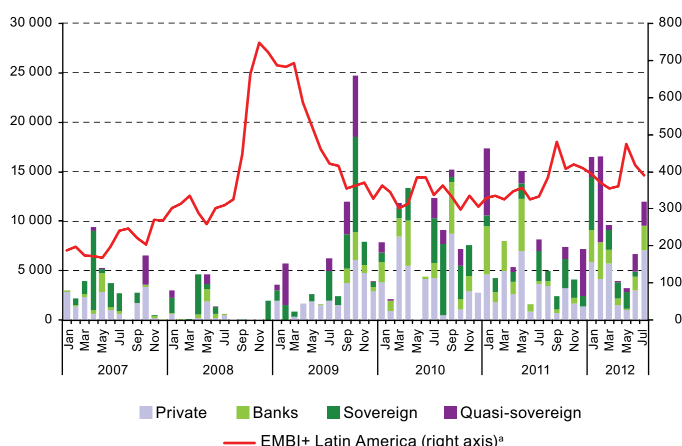
26. Despite global financial turmoil the region has, overall, maintained its access to the international financial markets

- **For Latin America and the Caribbean, turmoil in the international financial markets has meant steadily increasing perceived sovereign risk**. The sharp decline after the outbreak of the 2008-2009 global crisis was followed by a gradual rise beginning in 2011. Current risk levels are substantially below those at the peak of the global crisis, although they are higher than pre-crisis levels. At the same time, measures of risk that are comparable with those of the euro zone countries show that in a number of cases the region continues to have lower risk levels. In this environment, the region has maintained fluid access to the international financial markets, where its bond issues have gone from a monthly average of US$ 7.660 billion in 2011 to US$ 9.779 billion so far in 2012 and have grown across the board (sovereign, quasi-sovereign, corporate and bank bonds).
- These factors combined enabled the region to continue to strengthen its external position during the first half of 2012 as, with certain exceptions, it continued to build up international reserves. In April 2012 gross reserves stood at a new record high of more than US$ 800 billion.

Figure 35

Latin America: bond issues on international markets

(Millions of dollars and basis points)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from LatinFinance (bonds database), JP Morgan and Merrill Lynch.

[a] *Emerging Markets Bonds Index*.

Table 3

Latin America and the Caribbean: country risk (EMBIG)

(Basis points)

	Annual average					2012						
	2007	2008	2009	2010	2011	January	February	March	April	May	June	July
Argentina	327	871	1 174	696	701	840	843	880	962	1 236	1 088	1 087
Belize	484	827	1 421	818	1 011	1 466	1 836	1 665	1 732	1 694	1 691	1 765
Brazil	182	293	300	209	195	225	197	177	188	244	208	183
Chile	103	216	206	131	140	162	160	148	156	191	167	154
Colombia	163	301	320	194	166	200	171	141	152	207	158	140
Ecuador	661	1 398	2 016	954	819	818	788	824	792	948	892	852
El Salvador	164	419	488	322	383	485	473	453	470	508	480	471
Jamaica	373	545	845	492	485	669	625	579	610	653	640	662
Mexico	129	251	298	191	188	229	209	185	187	249	202	176
Panama	157	299	304	181	172	212	180	153	158	218	187	169
Peru	141	276	282	179	194	221	195	157	166	216	174	145
Dominican Republic	212	680		373	453	557	543	506	513	532	488	481
Trinidad and Tobago	166	378	868									
Uruguay	200	417	412	219	200	222	206	173	190	251	197	172
Venezuela (Bolivarian Republic of)	352	877	1 254	1 107	1 213	1 155	916	939	926	1 209	1 129	1 099
Latin America and the Caribbean (15 countries)	254	537	728	433	451	533	524	499	514	597	550	540

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of JP Morgan Emerging Markets Bond Index Global (EMBI Global).

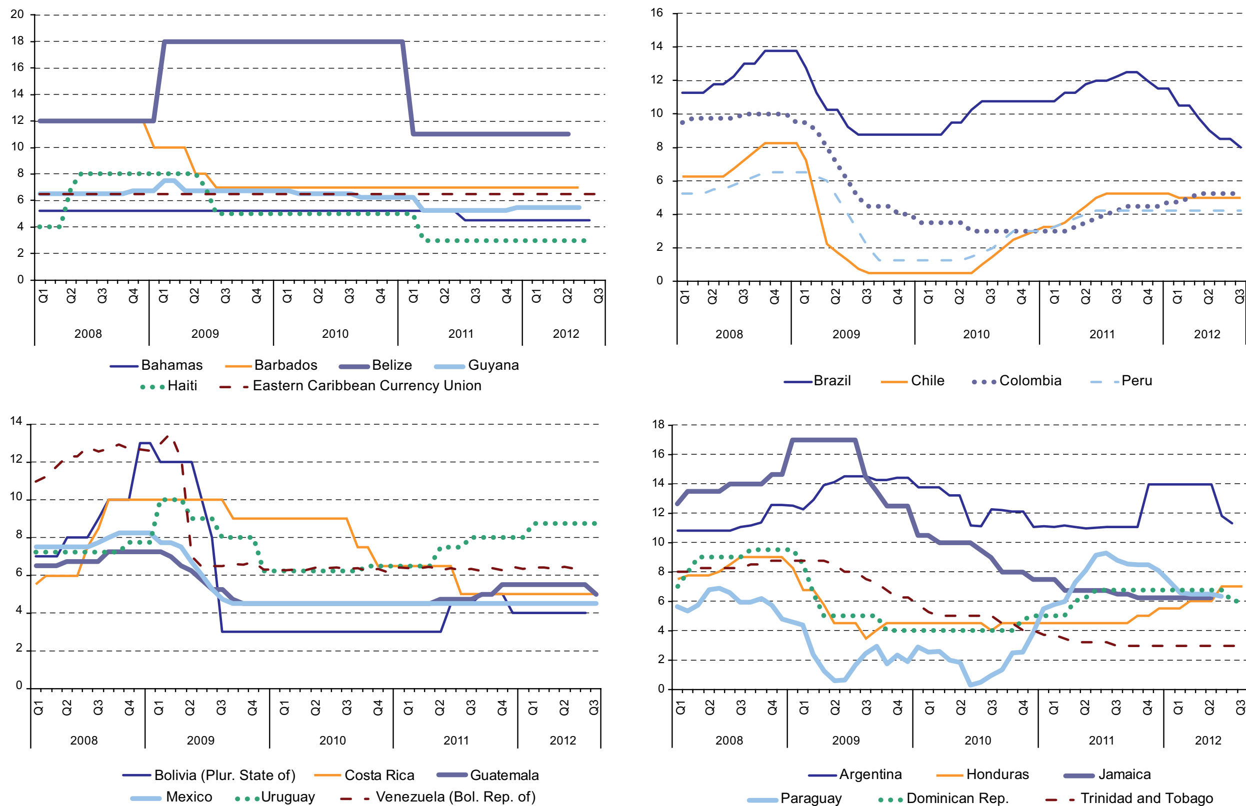
27. Marked prudence has guided monetary policy reference rate management in the region

- **In an external environment marked by high uncertainty, caution has guided monetary policy management, particularly in the face of high perceived volatility in the global financial market**. Most central bank boards kept their policy rates steady; any changes have tended to be downward.
- Argentina, Paraguay, Brazil, Guatemala and the Dominican Republic lowered their rates in the second quarter of 2012. But if aggregate external demand slows further and spìlls over into components of domestic demand, there are likely to be larger downward movements to avoid a further cooling of aggregate domestic demand and thus of economic activity.
- For several of the countries of the region, current policy rate levels are, on average, 74% of the level recorded in October 2008. This, along with potential inflationary pressures from rising food prices, could be interpreted as narrowing the space for rate cuts to spur aggregate demand.

■ **Figure 36** ■

Selected countries: monetary policy rates

(Annualized percentages)



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

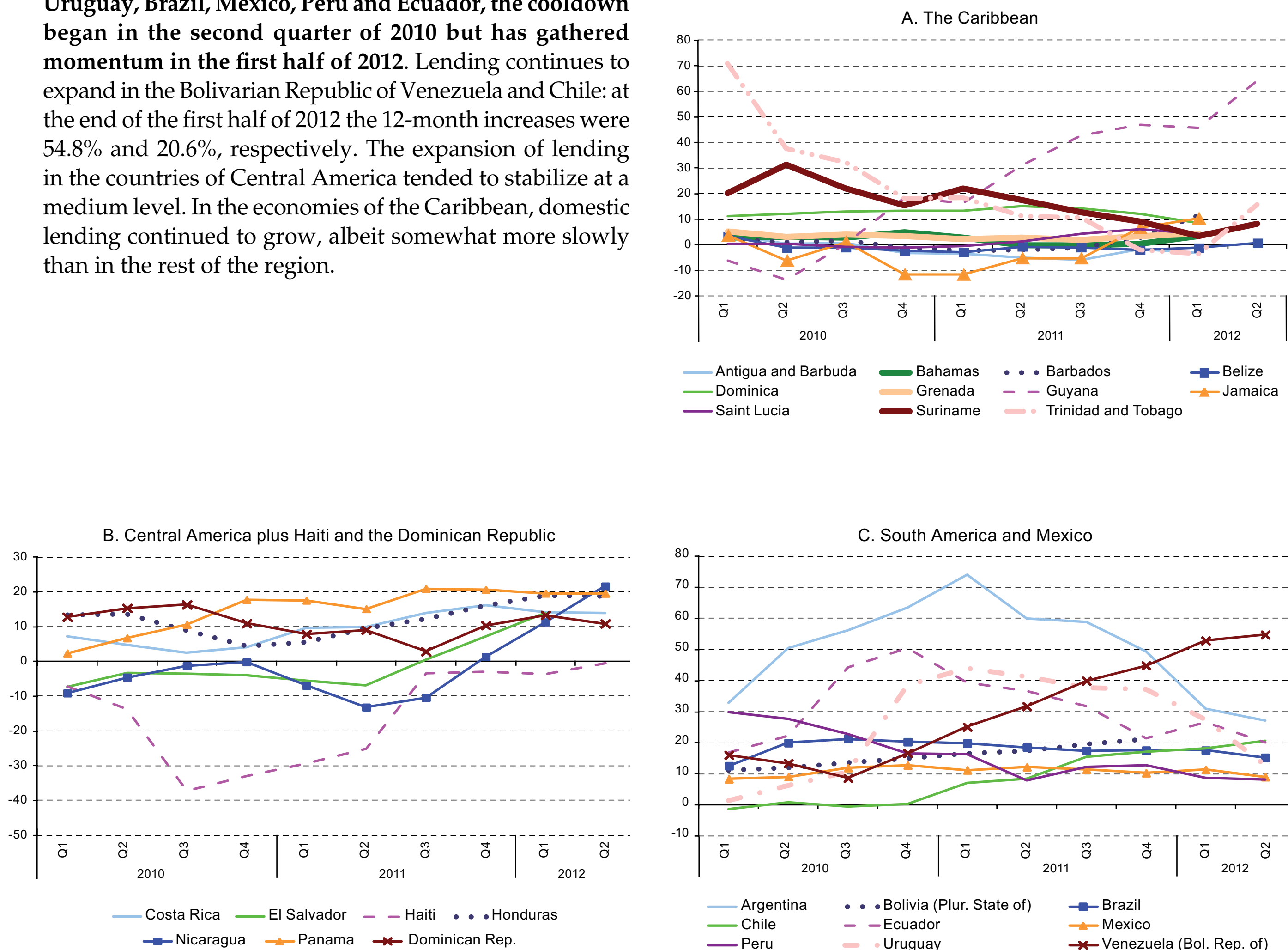
28. Domestic lending continues to surge

- **Domestic lending continues to surge in most of the region, although this growth has been tending to slow in a number of countries in the first two quarters of 2012. In Argentina, Uruguay, Brazil, Mexico, Peru and Ecuador, the cooldown began in the second quarter of 2010 but has gathered momentum in the first half of 2012**. Lending continues to expand in the Bolivarian Republic of Venezuela and Chile: at the end of the first half of 2012 the 12-month increases were 54.8% and 20.6%, respectively. The expansion of lending in the countries of Central America tended to stabilize at a medium level. In the economies of the Caribbean, domestic lending continued to grow, albeit somewhat more slowly than in the rest of the region.

■ Figure 37 ■

Latin America and the Caribbean (selected subregions): year-on-year variation in total lending, quarterly averages

(Percentages)



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

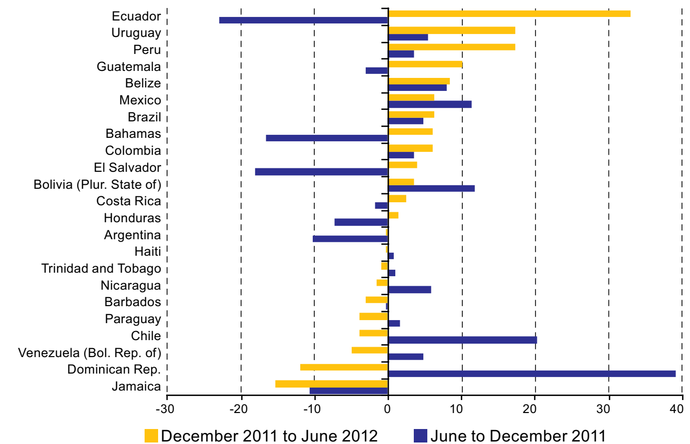
29. Trends have been uneven as regards international reserve accumulation

- **In the first half of 2012, international reserves swelled considerably in some countries but contracted in others**. With the exception of the Bolivarian Republic of Venezuela, Chile and Paraguay, the South American countries built up international reserves significantly in the first semester. Reserves rose over end-2011 levels by 32.9% in Ecuador, 17.4% in Peru and 17.2% in Uruguay. Conversely, in the Caribbean, reserves posted a first semester decline of 15.4% in Jamaica and 12.0% in the Dominican Republic.
- International reserves have played a key role in the region in alleviating the impacts of sudden stops in international financial flows, by helping to finance international trade and providing central banks with liquidity to inject into the system through foreign-exchange market interventions. Thus far in 2012, international reserves are much higher than they were in the run-up to the 2008-2009 crisis. Import growth makes the reserves-to-imports ratio similar for the two periods, however.

Figure 38

Latin America and the Caribbean: variation in international reserves, June 2011-June 2012

(Percentage)

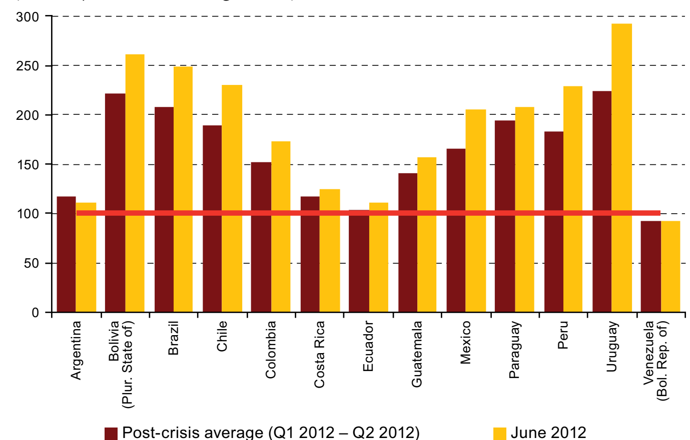


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of officia l Source: ECLAC, on the basis of official figures.

Figure 39

Latin America: variation in international reserves

(Index: pre-crisis average=100)



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

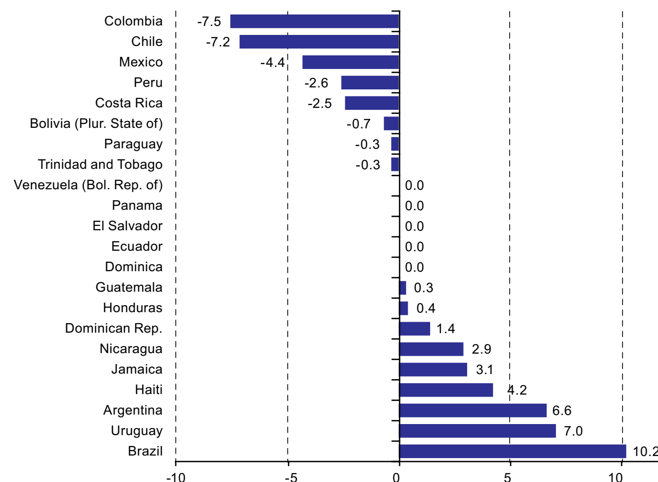
30. Several of the region's currencies have appreciated in 2012

- **With financial markets remaining volatile and the countries of the region offering higher relative returns than other parts of the world, especially Europe, some of the currencies in the region have appreciated strongly**. This has been especially true for countries that are more integrated into international financial markets, except for Brazil. The Colombian peso appreciated by 7.5% and the Chilean peso by 7.2% between December 2011 and July 2012, for example. Some countries have adopted measures to discourage short-term capital inflows and reduce dollarization: accordingly, the Brazilian real and the Uruguayan peso depreciated in nominal terms by 10.2% and 7.0%, respectively, in the same period.
- The path of the nominal exchange rate, added to price dynamics, has meant real effective currency appreciation in many countries. Between December 2011 and July 2012 the real effective exchange rate fell by 8.3% in Colombia and by 6.2% in the Bolivarian Republic of Venezuela.

■ Figure 40 ■

Latin America and the Caribbean: rate of variation in the nominal exchange rate, december 2011 to july 2012

(Percentages)



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

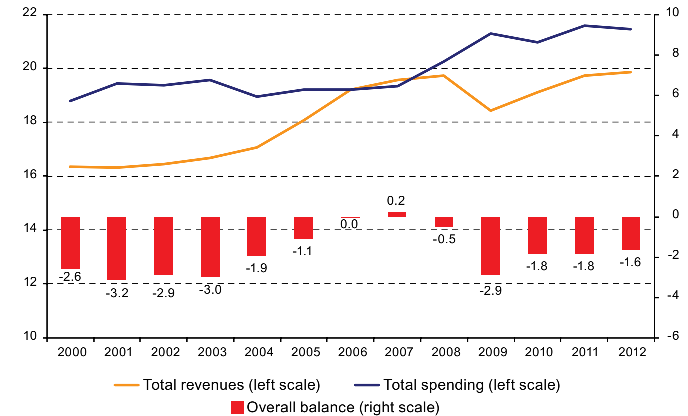
31. The fiscal accounts are expected to improve in 2012

- **The region's overall fiscal balance in 2011 was similar on average to that of 2010, with public revenue climbing strongly and by similar percentages of GDP in both years. The average overall fiscal balance is expected to improve slightly in 2012**, with revenues continuing to expand above GDP growth and spending tending to slow. The average primary balance should therefore turn positive again.
- Public revenues have made a good recovery in most of the region's countries in the past few years and have, in many cases, regained the levels seen before the crisis of 2008-2009. In 2011, total revenues amounted to 19.7% of GDP, slightly more than in 2008. These results owe much to the upturn in the terms of trade (in countries whose fiscal revenues are in large measure natural-resource-related), and to growth in tax receipts on the back of strengthening domestic demand and imports.
- The average masks very different situations, however: revenues far exceed pre-crisis levels in Argentina and Ecuador, but still fall short of these levels in the Bolivarian Republic of Venezuela, Chile and Peru.

■ Figure 41 ■

Latin America and the Caribbean (19 countries): central government fiscal indicators, 2000-2012

(Simple averages, as a percentage of GDP)

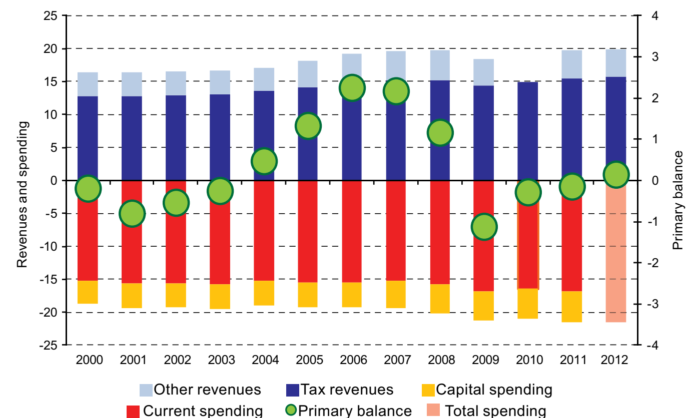


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

■ Figure 42 ■

Latin America and the Caribbean: variation in revenues and expenditures and overall fiscal balance, 2000-2012 [a]

(Percentages of GDP)



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

[a] Figures for 2012 are provisional.

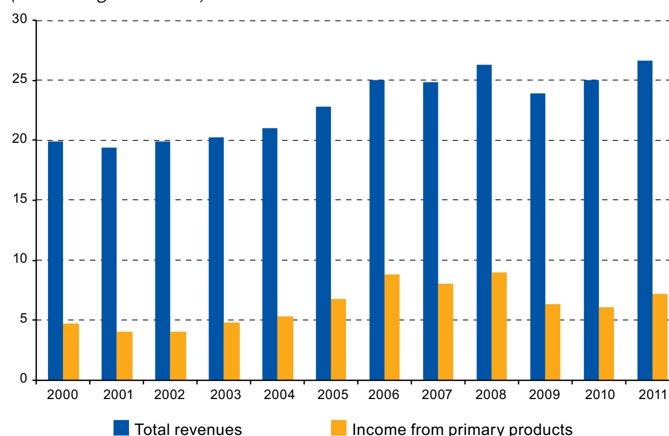
32. 2012 fiscal revenues are projected to just exceed 2011 levels

- Revenues from the export of primary products have burgeoned in some countries in the past few years. Steeply rising commodity prices have helped to swell central governments' fiscal income, whether directly (from taxation and profits of State enterprises in the Bolivarian Republic of Venezuela, Chile, Colombia, Ecuador, Mexico and the Plurinational State of Bolivia) or from taxation of private enterprise (withholding tax on exports in Argentina, royalties and income tax in Chile and Peru).
- Total revenues in 2012 are expected to slightly exceed the 2011 figure as a proportion of GDP in several countries of the region. One exception is Chile, where forecasts suggest a dip of almost one GDP percentage point in non-tax income, but above-GDP growth in receipts from both direct and indirect taxes. For Brazil, although GDP growth forecasts have been revised downwards, a larger wage bill and falling interest rates suggest that tax receipts will hold relatively steady and spending should fall sharply by comparison with 2011.
- If commodity prices continue to fall, the effects may start to be fully felt in the first semester of 2013 in countries, like Chile and Peru, whose revenue relies strongly on direct taxation of private mining and drilling enterprises.

■ Figure 43 ■

Latin America and the Caribbean (9 countries [a]): total fiscal revenues and income from primary products

(Percentages of GDP)



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

[a] Includes Argentina (central government), the Bolivarian Republic of Venezuela, Chile, Colombia, Ecuador (non-financial public sector), Mexico (public sector), Peru, the Plurinational State of Bolivia, and Trinidad and Tobago.

■ Table 4 ■

Selected countries: fiscal indicators, 2011-2012

(Variations and percentages of GDP)

	Revenues	Spending	Balance	
	(Variation in percentages of GDP)		2011	2012
Brazil	…	…	-2.6	-1.4
Chile	-1.1	0.5	1.3	-0.3
Colombia	0.9	0.5	-2.8	-2.4
Guatemala	…	…	-2.8	-2.4
Honduras	0.5	-0.4	-4.6	-3.7
Peru	0.1	0.9	1.9	1.1
Uruguay	0.3	1.6	-0.7	-1.7

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

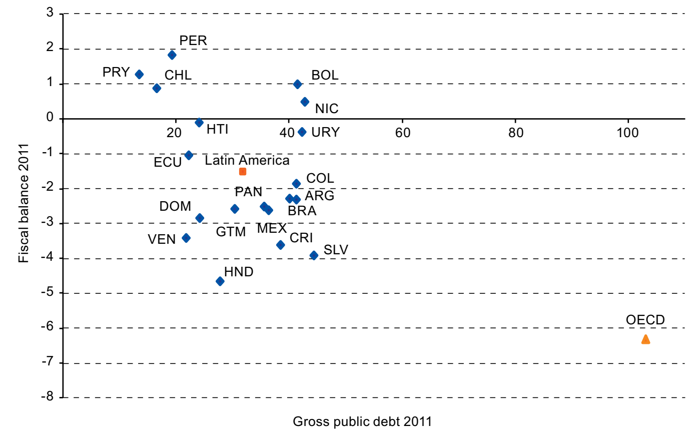
33. Public accounts are expected to continue consolidating

- **Central government public spending rose on average in 2011, although the situation varied across the region**. Spending rose as a proportion of GDP in Argentina, the Bolivarian Republic of Venezuela, Ecuador and the Plurinational State of Bolivia, but fell in Chile, Costa Rica, Honduras and Uruguay. Recent forecasts indicate that spending execution for 2012 will be very much as budgeted and, given that spending rises in most budgets differed little from GDP projections and were consistent with deficit and public debt targets, public spending in relation to GDP should vary little in 2012.
- As the official projections show, the harsh external conditions have had little effect on expectations for consolidation of the public accounts, since they have no significant impact on assumptions associated with revenue projections or with the fiscal rules in place in the region. Many ECLAC publications have documented the large drop in public debt in relation to GDP and the change in public debt composition, with domestic debt recently coming to account for a much larger share. The region's external public debt now represents around 15% of GDP, compared with 85% in 1990 (ECLAC/OECD, 2011).
- The first figure compares overall balances in 2011 (flow) and the "legacy" effect (debt stock) on the fiscal accounts. The results show diverse situations, but without sharp extremes and a far cry from the fiscal imbalances being posted in OECD. A few countries show an overall fiscal surplus —Chile, Paraguay, Peru and the Plurinational State of Bolivia— but in general borrowing needs were quite limited in 2011 and remain so in 2012, so the fiscal position is not expected to show large variations in borrowing levels.

■ Figure 44 ■

Latin America and OECD: overall fiscal balance and public debt, 2011

(Percentages of GDP)

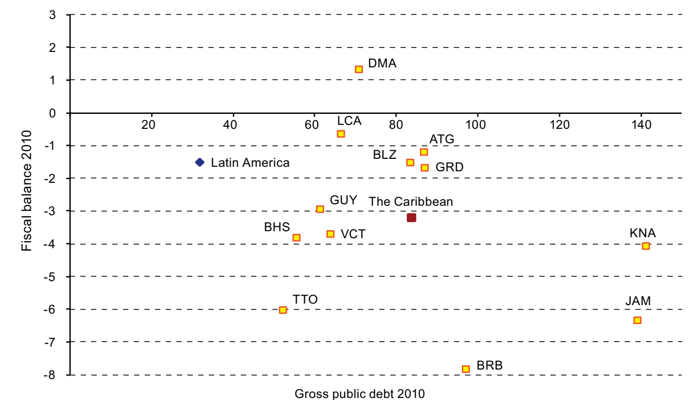


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures, and OECD.

■ Figure 45 ■

Latin America and the Caribbean: overall fiscal balance and public debt, 2010

(Percentages of GDP)



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

34. With the exception of most of the Caribbean countries, the region has the fiscal space to tackle adversities

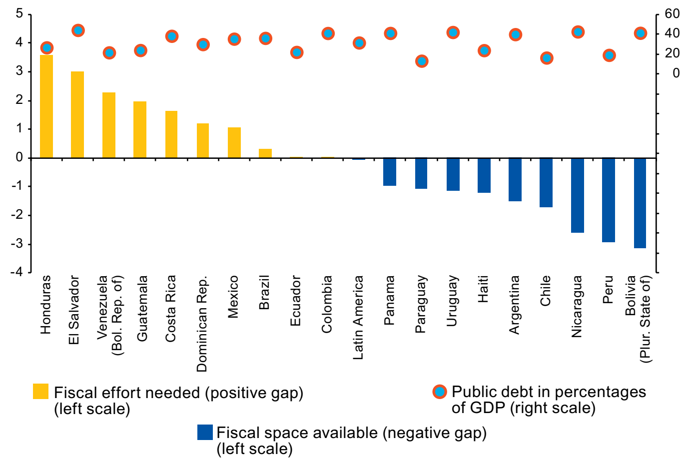
- **Although the situation is fairly diverse in 19 Latin American and Caribbean countries for which information is available, in general debt levels have fallen across the board in the past few years**. In 2011, a number of countries —the Bolivarian Republic of Venezuela, Chile, Ecuador, Guatemala, Haiti, Honduras, Paraguay and Peru— had public debt levels of less than 30% of GDP and others —the Dominican Republic, Mexico and the Plurinational State of Bolivia— were close to the regional average. The remainder —Argentina, Brazil, Colombia, Costa Rica, El Salvador, Nicaragua, Panama and Uruguay— still showed levels which, although not especially high, were above the average for the region. The fiscal policies in place in the region suggest that the downward trend should continue in the next few years. In fact, all the projections indicate a regional average of around 30% of GDP by 2015. The situation is different for the great majority of the Caribbean countries, where public debt represents over 70% of GDP on average, except in the Bahamas, Suriname and Trinidad and Tobago.
- One way of illustrating the fiscal space available is to calculate sustainability indicators. The simplest of these is the primary balance that would be needed to stabilize public debt as a percentage of GDP. The figure shows the difference between the actual primary balance in 2011 and the primary balance that would be needed to kept debt levels constant in 2012. This indicator thus measures, in GDP points, the leeway countries have to increase spending or forgo revenues in order to provide economic stimulus, without increasing the economy´s public debt burden.
- Naturally, the countries with a larger overall deficit also show a positive gap between the actual primary balance and that needed to stabilize the debt. Thus, Costa Rica, Honduras and El Salvador would have to make a "fiscal effort" of around 3 GDP points to achieve a primary balance compatible with the target of stabilizing the public debt to GDP ratio. Conversely, Chile, Peru and the Plurinational State of Bolivia are running large enough primary surpluses to keep reducing their public debt in 2012 and still have large fiscal spaces.
- An alternative methodology is to adopt a common debt standard or rule, as in ECLAC (2012). If 40% of GDP is taken as a standard, the exercise shows a larger fiscal space available, as depicted in the figure. This is because most of the countries had debt levels well below the 40% standard in 2011 and can, therefore, finance short-term fiscal stimulus packages through borrowing.[4]
- As noted and as these figures show, many of the region's countries are well placed to deploy countercyclical monetary and fiscal policies to deal with temporary lulls in aggregate demand. As a result, starting in 2008, for the first time ever fiscal policy became a key instrument of macroeconomic stabilization for the governments of the region. If forecasts for a long period of low growth are borne out, however, the scope of countercyclical fiscal policy will be limited, necessarily temporary and short-term. The singular success of countercyclical fiscal policy in the region in 2009 must not be allowed to overshadow the other (and no less important) functions of fiscal policymaking, such as the provision of public goods, the redistribution of available income and the promotion of long-run growth (see ECLAC, 2010). On this last point, the vulnerabilities arising from the concentration of production and exports in a few primary goods —the reprimarization of the economies of the region— seem to represent an obvious Achilles' heel for several countries' fiscal sectors in the event of a turnaround in the favourable terms of trade they have enjoyed in recent years.

[4] These indicators are intended merely to illustrate the effort needed or the fiscal space available in the short term, not the probability or feasibility of debt stabilization, since they do not take into account the countries' particular objectives (which may be other than debt stabilization) or potential changes in financing conditions. Furthermore, the gross debt indicator used does not include available financial assets, which are considerable in some countries, notable examples being Peru's Fiscal Stabilization Fund and Chile's Economic and Social Stabilization Fund.

■ Figure 46 ■

Latin America: gap between the primary balance needed to stabilize the debt in 2012 and the actual primary balance in 2011

(Percentages of GDP)

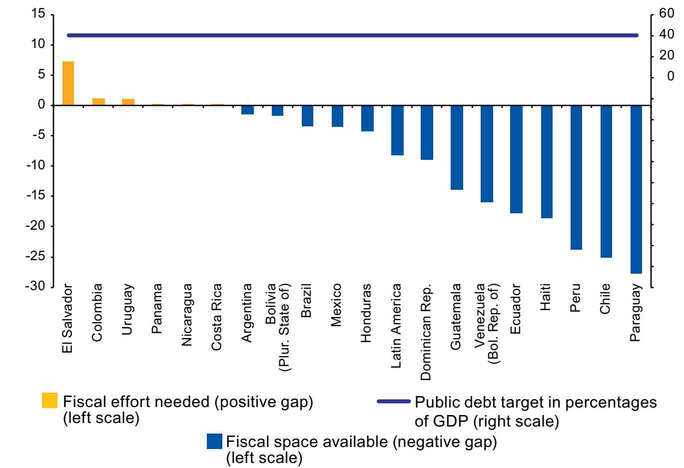


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

■ Figure 47 ■

Latin America: gap between the primary balance needed to stabilize the debt at 40% of GDP in 2012 and the actual primary balance in 2011

(Percentages of GDP)



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

35. Conclusions and recommendations

- **Global economic growth could slow further in the second half of 2012 and into 2013**. Although United Nations projections at July 2012 show the world economy growing by 2.8% in 2012 and 2.5% in 2013, subsequent events are likely to prompt fresh downward revisions. Deterioration in the euro zone economy and difficulties in finding effective routes out of the debt crisis in Southern European economies are worsening volatility and uncertainty in financial markets. As a result, cross-border and interbank credit lines have been shrinking in Europe, especially for the most heavily indebted economies, making the adjustment even more difficult. Regulators in the more solvent European economies are putting pressure on local banks to raise their capital and liquidity provisions to increase preparedness for a possible break-up of the euro, at the cost of limiting their exposure in Mediterranean countries. And since so much of Europe's trade is conducted within the region exports from the entire euro zone are suffering. These processes are filtering through the channels of trade and finance and beginning to act as a drag on growth in other regions of the world.
- **The efforts to defend the euro and European integration more broadly are highly complex—technically, institutionally and politically**. The sheer scale of the debt crisis in the euro area now precludes any sort of temporary fix or low-cost solution. In fact, the crisis has been worsened precisely by partial policy measures, which have further raised the technical and political goal posts. The main lines of policy action now needed to tackle the euro zone crisis include:
  - Providing the necessary liquidity to the most indebted economies at rates compatible with long-term equilibrium.
  - Restructuring public and bank debt and shutting down insolvent institutions, with support from the bailout funds available from the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF).
  - Definitive separation of banks and sovereign entities in strategies for exit from the crisis.
  - Limited mutualization of debt through euro bond issues.
  - Fast-tracking of banking union, with Europe-wide consolidated supervision and deposit guarantees, at least up to certain thresholds, in order to avoid massive bank runs.
  - Progress towards fiscal union, with credible medium-term fiscal consolidation schedules that will allow for fiscal policies to provide short-term stimulus.[4]
  - A growth pact which must also be credible and capable of having an immediate impact.
- **In the United States, complex negotiations are approaching in late 2012 over fiscal and public debt dilemmas**, immediately after the presidential elections in November. Without agreements in those areas, the United States economy could slip back in to recession in the first quarter of 2013. In this scenario, the slacker economic activity in the United States and the European Union would impact heavily on world economic growth and act as a drag on the economies of China and other developing countries.[5]
- **Economic growth projections for China stand at around 8%**. Exports, imports and manufacturing production are all slowing, partly because of the difficulties in the European Union, China's main export market. Within China's domestic market, inflationary pressures and real estate bubbles appear to be subsiding well and there is leeway for a more expansionary monetary and fiscal stance in the second half of 2012. Among other possible measures, fresh cuts are expected in interest rates and bank reserve requirements, as well as tax breaks to stimulate consumption and special credit schemes for SMEs.
- **The main impacts of international trends are likely to be transmitted to Latin America and the Caribbean through the trade channel**, as external demand for the region's goods

[4] The evidence from recoveries from previous recessions caused by financial crises suggests that fiscal austerity must be imposed after recovery, not before. Immediate fiscal austerity makes for a much slower recovery and at a far higher cost in terms of growth, employment and social impact.

[5] It is worth recalling that the United States and Europe account, in similar proportions, for US$ 20 trillion of global consumption, whereas China accounts for only US$ 2 trillion. In other words, Chinese consumption would have to rise tenfold to offset lower consumption in Europe and the United States (Matthijs, 2012).

and services exports wanes and raw materials prices slip. A worsening financial situation in the European periphery and harsher adjustments in emerging Asia are eroding trade flow momentum and international commodity prices. These trends are already having an impact on Latin America and the Caribbean. In this context, **ECLAC projects that the region's export values will edge up just 5%, 18 percentage points below their 2011 growth**.

- The combination of the complex international situation and developments in individual countries weighed on economic activity in Latin America and the Caribbean throughout 2011. The slowdown came to a halt in the first quarter of 2012 but resumed in the second, signalling a potential scenario in which growth could be slower than in the past for a prolonged period. **It is therefore estimated that, at 3.2%, the region's economy will expand less than in 2011**.
- In the first semester of 2012, external financial conditions remained marred by turbulence arising from the problems several euro zone countries were having in meeting sovereign debt obligations. This has gradually pushed up the perception of sovereign risk for Latin American and Caribbean countries. **In this new setting, with few exceptions, the countries of the region continued to strengthen their external positions by building up international reserves**.
- **In this highly uncertain international environment, caution has guided monetary policy management, particularly in the face of high perceived volatility in the global financial market**. Most of the region's central banks have kept their policy rates steady; any changes have tended to be downward. Domestic credit continues to swell in most of the countries of the region, although more slowly in the first two quarters of 2012 in several countries.
- **In 2012 the overall fiscal balance for the region is expected to improve slightly on average**, with revenues still rising above the rate of GDP growth and expenditure growth tending to slacken. The primary balance (before interest payments) is therefore expected to turn positive again. Public revenues have recovered strongly in much of the region in the past few years and have regained pre-crisis levels in many countries. If raw material prices continue to drop, the effects may be felt in the first semester of 2013 in countries whose revenue relies heavily on direct taxation of private mining and drilling enterprises.
- **With certain exceptions, the countries have enough fiscal space to weather fresh adverse scenarios**. The difficult external situation has not yet affected the ongoing consolidation of the public accounts, inasmuch as public debt continues to decline in GDP terms and the domestic proportion of debt financing is still rising. This is not the case in the great majority of the Caribbean countries, however, where public debt still represents a large percentage of GDP.
- **Many countries in the region are well placed to deploy countercyclical monetary and fiscal policies to cushion the impact of temporary external shocks on aggregate demand**. Starting in 2008, fiscal policy became an important instrument of macroeconomic stabilization in the region. However, if forecasts for a long period of low growth are borne out, the scope of countercyclical fiscal policy will be limited. In addition, net commodity exporters are fiscally vulnerable to a change in the favourable terms of trade which have prevailed in several countries of the region.
- **For the medium term, the industrialized countries (the "North") are likely to remain locked into a pattern of low growth, while the developing countries (the "South") will experience a slight slowdown**. All the agencies which forecast these data suggest that the United States will be the best performer in the developed world. Among the developing countries, China will continue to be the fastest-growing economy this decade. In 2011-2017, the Asian region is forecast to contribute half of global growth. The Latin American and Caribbean region will contribute just over 8.3%, slightly more than Western Europe and almost twice as much as Africa. The industrialized countries overall will contribute less than a third.
- **The developing countries will also be more dynamic in terms of world trade and FDI**. The weight of the developing countries in global exports has risen strongly since the mid-1980s. If the growth rates of the various categories of trade flows for the past decade are extrapolated for the next few years, South-South trade may account for a greater proportion of world trade than North-North trade by around 2017. Similarly, over half of inward global FDI flows went to developing countries in 2011 and this share is likely to continue until 2014.
- **The sharp contrast between slowdown in the industrialized economies and steady growth, albeit not as strong as in**

2003-2007, in the developing economies raises the question of how far this decoupling can go. Projections confirm that growth will continue to be driven by emerging economies, with China and East Asia, in particular, pulling along the rest of the developing world, given China's increasing trade links with the rest of Asia and with Africa and Latin America. However, the magnitude of the decoupling is limited. In the first semester of 2012, in fact, exports from emerging economies were already slackening considerably, reflecting the direct impacts of the slowdown in Europe and the United States as well as the indirect effects of these slowdowns on China's exports and of these, in turn, on China's imports of raw materials. At the same time, risk aversion is prompting financial flight to United States and German sovereign bonds, squeezing the financing available for trade in the euro area and worsening the drag of weaker European growth on trade. Financing for commodity trade, in any case, relies heavily on European financial agents which —facing capital and liquidity exigencies of their own— are diverting resources from such financing and adding another brake to global trade growth.

- **The world economy's current slowdown is cyclical and the lowest points will be in 2012 and 2013, when emerging economy growth will be affected too**. The emerging economies may regain faster growth tracks starting in 2014, although at rates lower than in 2003-2007. In this connection, raising future potential growth will take major efforts to rise to the supply side challenges of productivity, innovation, education, infrastructure, logistics and transport.
- **This major transformation of the world economy challenges the region to rethink its international positioning strategies and global partnership schemes**. Latin America and the Caribbean must continue to strengthen linkages with other developing regions, particularly Asia-Pacific, the main hub of world economic growth. Growth in Asia, and China in particular, has given the region resilience and growth capacity. It has also raised major challenges, such as resisting the temptation to entrench an export pattern based on natural resources with little processing (in the case of South America) and diversifying Mexico's and Central America's manufacturing exports away from the United States market. The region must therefore seek a modality of participating in the global economy in which it can maximize the benefits of its growing linkages with Asia and other developing regions, while also reducing the related costs.
- **The principal challenge lying ahead of the region is an internal one: how to tie the domestic innovation and competitiveness agenda in with the renewed economic linkages with the Asia-Pacific region**. For instance, more innovation and knowledge must be embedded into exports to avoid over-reprimarization. This calls for active supply side policies to drive gains in productivity, innovation, infrastructure, transport, logistics and skills. There is scope to build a regional cooperation agenda with China and other key Asia-Pacific actors in all these areas. The region must therefore work to craft a prompt and coordinated response to the proposal made by China's Prime Minister, Wen Jiabao, in his recent remarks at ECLAC in reference to a varied cooperation agenda between China and Latin America. The recent meeting of the troika of Ministers of Foreign Affairs of the Community of Latin American and Caribbean Sates (CELAC) with the Minister of Foreign Affairs of China should certainly provide interesting inputs for progress in that direction.
- **More and better cooperation and regional integration would be a very useful stepping stone for improving both the region's economic growth outlook and its international linkages**. Joint regional or subregional initiatives on innovation, competitiveness, infrastructure and sustainability, including for combating climate change, would leverage the contribution of national public policies to development. By tapping these areas of potential, the countries of the region could generate attractive trade and investment opportunities that would stimulate intraregional trade and help build up regional value chains. With broader regional markets and gradual convergence of rules, the region would be well placed to attract more FDI, diversify its exports and improve the quality of its trade ties with China and Asia-Pacific in general. Major synergies exist between the two strategies proposed here: strengthening regional integration, on the one hand, and building up linkages with other developing regions, on the other.

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