Chapter I

INTRODUCTION

It is estimated that the Latin American and Caribbean region's GDP will grow by around 4.5% in 2004, which translates into a 3% increase in per capita terms. Almost all the economies of the region have made a recovery since reaching the low point in this business cycle during the first quarter of 2002.

As noted in the 2003 edition of the *Preliminary Overview of the Economies of Latin America and the Caribbean*,[1] the favourable conditions for the region that have prevailed at the international level for quite some time now have been one of the main factors that has made this recovery possible. The decline in sovereign risk premiums from their highs of September-October 2002, stronger commodity prices, the upswing in tourism and the growth of non-oil exports to the United States and other major markets have been the main positive impulses generated by the international economy. The fact remains, nonetheless, that the region's ability to capitalize upon this favourable external climate is in large measure a reflection of its implementation of domestic economic policies that are geared towards maintaining tighter fiscal and monetary control and more competitive exchange rates.

Be this as it may, it will take years to rectify the imbalances associated with the social problems that have troubled the region throughout its history. These problems grew even more severe in the 1990s during the downswing in the business cycle —a downswing from which Latin America and the Caribbean are now beginning to emerge. These last two years of growth notwithstanding, unemployment rates are still high and are very slow to decrease, and nearly half of the region's inhabitants are living in poverty.

The durability of this growth phase is, in addition, threatened by both internal and external factors. On the internal front, the weakness of demand in many of the region's economies casts some doubt as to the recovery's consolidation. On the external front, a number of economic disequilibria exist that will have to be dealt with sooner or later. Although these imbalances do not represent an imminent danger, they would appear to presage a slower pace of growth for the world economy in the medium term.

The countries of Latin America and the Caribbean are likely to expand by about 4.5% in 2004, thereby completing a second consecutive year of growth. In fact, GDP is on the rise in all but two of the countries in the region (see table I.1). Nevertheless, as a consequence of the economic stagnation of the late 1990s and the early years of this decade, per capita GDP is still close to its 1998 level.

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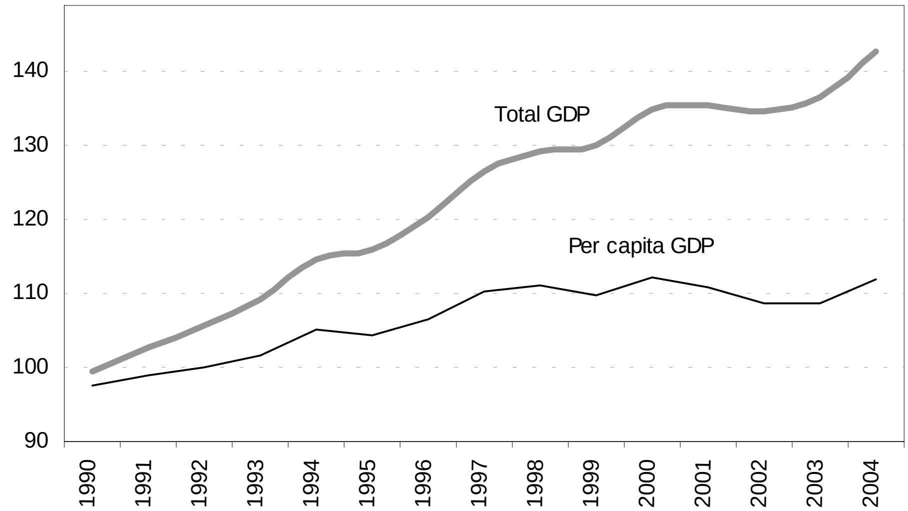
[1] Economic Commission for Latin America and the Caribbean (ECLAC), Preliminary Overview of the Economies of Latin America and the Caribbean, 2003 (LC/G.2223-P/I), Santiago, Chile, December 2003. Unites Nations publication, Sales No. E.03.II.G.186.

Figure I.1
LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH
(Indices base 1989=100)



Source: ECLAC, on the basis of official figures.

Table I.1
LATIN AMERICA AND THE CARIBBEAN: GDP, ANNUAL GROWTH RATES

	2002	**2003**	**2004** [a]
Argentina	-10.8	8.6	7.1
Bolivia	2.7	2.4	3.3
Brazil	1.5	-0.4	3.7
Chile	2.0	3.3	4.8
Colombia	1.6	3.7	3.7
Costa Rica	2.8	6.4	3.7
Cuba	1.2	2.5	3.0
Dominican Republic	4.3	-0.5	-1.0
Ecuador	3.8	2.5	5.5
El Salvador	2.1	2.0	2.0
Guatemala	2.2	2.0	3.0
Haiti	-0.3	0.5	-2.0
Honduras	2.6	3.5	3.5
Mexico	0.6	1.2	3.9
Nicaragua	0.7	2.2	3.5
Panama	2.2	4.6	5.0
Paraguay	-2.5	2.5	2.5
Peru	5.4	4.1	4.2
Uruguay	-12.0	2.3	9.5
Venezuela	-9.0	-9.3	12.0
Caribbean	1.7	3.3	2.9
Latin America and the Caribbean	-0.6	1.5	4.5

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

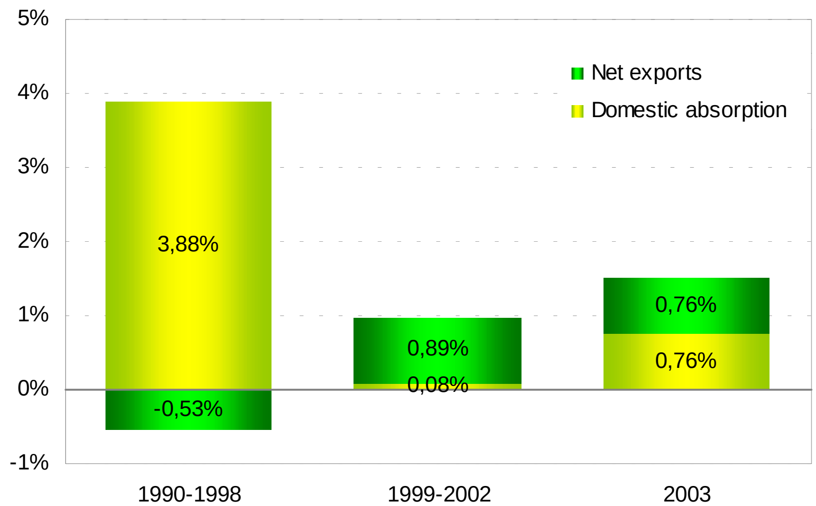
[a] Projection.

The region's growth has primarily been driven by exports, which have expanded in response to the favourable international environment created by the economic reactivation of some developed countries (notably the United States and Japan) and the forward momentum generated by China's burgeoning economy, especially for commodity-producing countries.

Given the sluggish pace of domestic absorption, particularly in the case of private consumption, net exports are expected to account for much of the region's growth in 2004, as they have in the past few years. It seems likely, however, that consumption will begin to pick up during the year as economic activity increases, employment rises and the improvement in the terms of trade boosts the countries' earnings. The available indicators for 2004 also signal the beginnings of a recovery in investment based on the upturn in economic activity and the fuller use of installed capacity that this brings with it.

Figure I.2

LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH RATES AND COMPONENTS

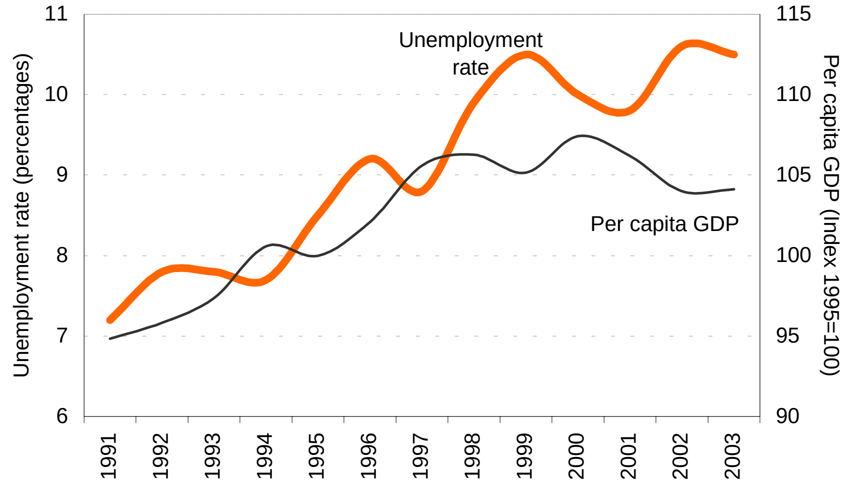


Source: ECLAC, on the basis of official figures.

The weakness of demand and the cautious way in which monetary and fiscal policy is being managed in most of the countries of the region have helped to keep inflation low. Nonetheless, during the early months of 2004 slight upswings in inflation have been observed in a number of cases. These increases have been fuelled by hikes in transport, utility and food prices in response to higher international prices for some products.

Despite the upward trend in economic activity, because the region's growth pattern is based on non-labour-intensive industries and products that contain little domestic value added, GDP growth does not translate into a rapid reduction in unemployment. This, in turn, hinders efforts to reduce the poverty that plagues nearly half of the region's population.

Figure I.3
LATIN AMERICA AND THE CARIBBEAN: GROWTH AND UNEMPLOYMENT

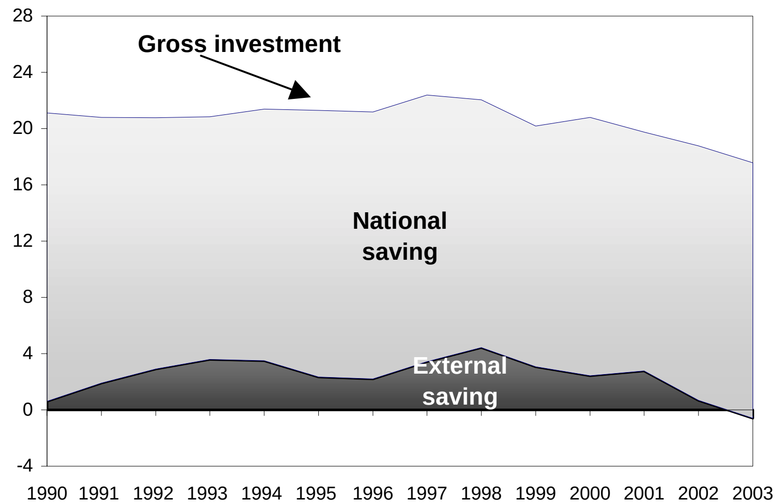


Source: ECLAC, on the basis of official figures.

Owing to the combined effect of export growth and the slow expansion of domestic absorption, many of the countries in the region have posted hefty trade surpluses. As a result, in 2003 Latin America and the Caribbean recorded a current account surplus for the first time in 50 years (0.3% GDP). A current account surplus (0.8% of GDP) is also expected for 2004.

This is certainly not good news for the region, which, in addition to suffering from a chronic inability to generate a sufficient level of internal saving, must now devote a portion of those resources to finance the rest of the world. In 2004 the region will witness a net negative transfer of over US$ 20 billion. This means that, over the six-year period from 1999 to 2004, the cumulative outflow of resources from Latin America and the Caribbean will have amounted to slightly less than 6% of the region's GDP, measured in current dollars.

Figure I.4
LATIN AMERICA AND THE CARIBBEAN: INVESTMENT AND SAVING
(Percentage of GDP in current dollars)



Source: ECLAC, on the basis of official figures.

The direction taken by the countries' economic policies has been much the same in 2004 as in 2003, with the predominant characteristic being a concern for price stability and for curbing the growth of public debt. The region's fiscal policy continues to be aimed at enlarging the primary surplus of the central government, which is expected to climb by around 1% of GDP in 2004 (the simple average growth rate for this surplus was 0.3% in 2003 and –0.4% in 2002).

Throughout much of the region, in the first half of 2004 monetary policy has focused on restraining inflation, in some cases based on explicit targets. Low international interest rates have allowed policy makers to manage monetary aggregates in line with this policy stance. In the early part of the year, many countries also saw an increase in credit thanks to improved expectations in both production sectors and the banking system.

Most of the countries have increased the flexibility of their exchange-rate regimes and, as part of this effort, have phased out restrictions on foreign-exchange operations. At the end of 2003, the average real effective exchange-rate index for Latin America and the Caribbean reflected a 2.9% depreciation relative to the end of 2002, although the trends in this respect varied widely across the countries of the region.

In South America, the currencies of Argentina, Brazil and Chile appreciated, while those of Mexico and the Central American countries depreciated. From a medium-term perspective, the rates in effect in late 2003 were about 18% higher than the 1997-2001 average.

For the region as a whole, earlier competitiveness gains were maintained in 2004, since the real effective exchange-rate index as of May 2004 was virtually the same as the 2003 average, albeit with differences across countries.

ECLAC projections regarding the continuation of the recovery in the Latin American economies that began in 2002 are optimistic, but the outlook undoubtedly includes a number of questions and challenges.

First, the United States economy's substantial external and fiscal deficits make it a certainty that, sooner or later, some sort of adjustment is going to have to be made in short-term interest rates. When it comes, this increase will dampen demand and the level of economic activity in that country, which is the world economy's prime growth engine. If the Federal Reserve's gradualistic approach proves to be successful, this adjustment will be made slowly and the threat to Latin American exports will be held at bay for the time being.

Another of the region's fears in relation to the external environment has to do with the likelihood that the Chinese economy —which, as noted earlier, has become an important market for a number of South American countries' exports— will start to cool down. Given this economy's importance as a major source of demand for commodities at the international level, an abrupt slowdown would probably cause commodity prices to drop steeply, thus driving down the export earnings of some countries in the region. If, on the other hand, it were to cool down slowly and gradually, then the reduction in international commodity prices would be likely to follow suit and the impact on the region's revenues would be softened.

The consensus view appears to be that the latter is the more probable scenario. If this proves to be true and the United States monetary authorities follow a gradualistic strategy, then there are grounds for cautious optimism about international conditions in the short run.

On the internal front, the region's ample political agenda for the second half of the year will be marked by a number of electoral processes. If these elections proceed without incident, the governance of the Latin American democracies can be consolidated, and this will greatly increase current economic policies' chances of success.

Thus, the combination of low interest rates, high real exchange rates and strong international prices commodity herald the advent of a favourable set of conditions, in the short term, that the region should use to its advantage in order to firm up the recovery of internal demand.

In the medium term, however, the countries of the region will have to find ways, first, to increase the diversification of their exports so that they can make their economies less vulnerable to the business cycle in destination markets and, second, to boost the domestic value added to their exports so that export growth will have a stronger impact on employment levels and thus help to lessen the severe social imbalances that afflict each and every one of the Latin American and Caribbean countries.