

# The Outlook for Latin America and the Caribbean Region

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# Outline

- **The Global Economy and the U.S. Outlook**
- **Outlook for Latin America and the Caribbean**
- **Economic Challenges for the Caribbean**
  - **Regional Integration Issues**
  - **Tax Incentives and Investment**
  - **Trade Preference Erosion**
- **Conclusion**

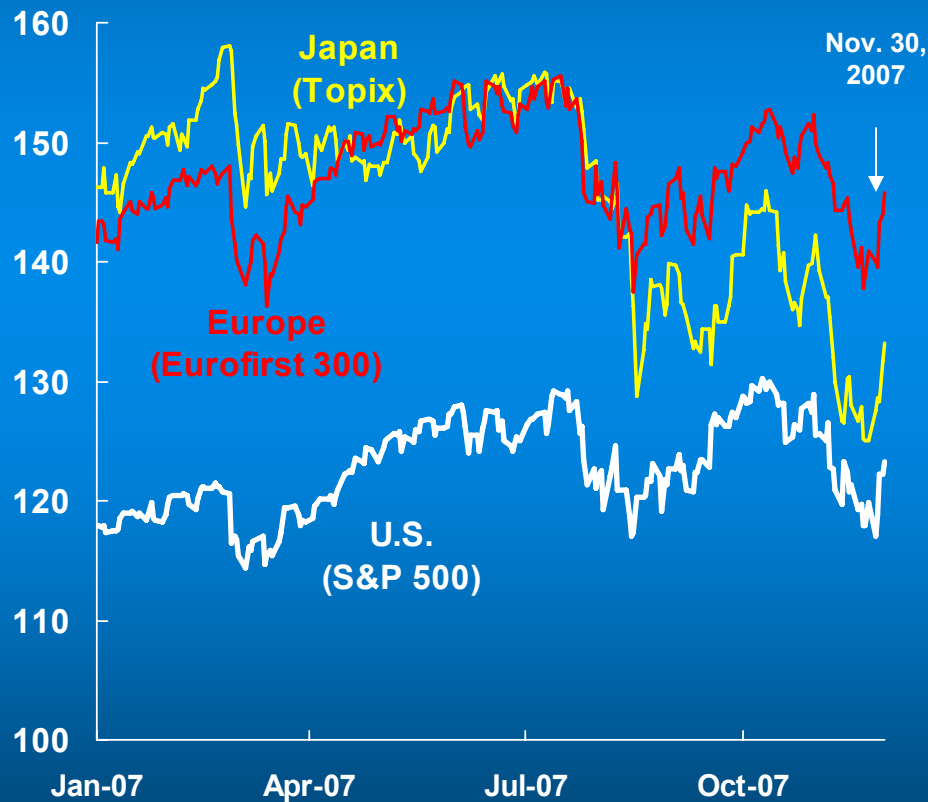
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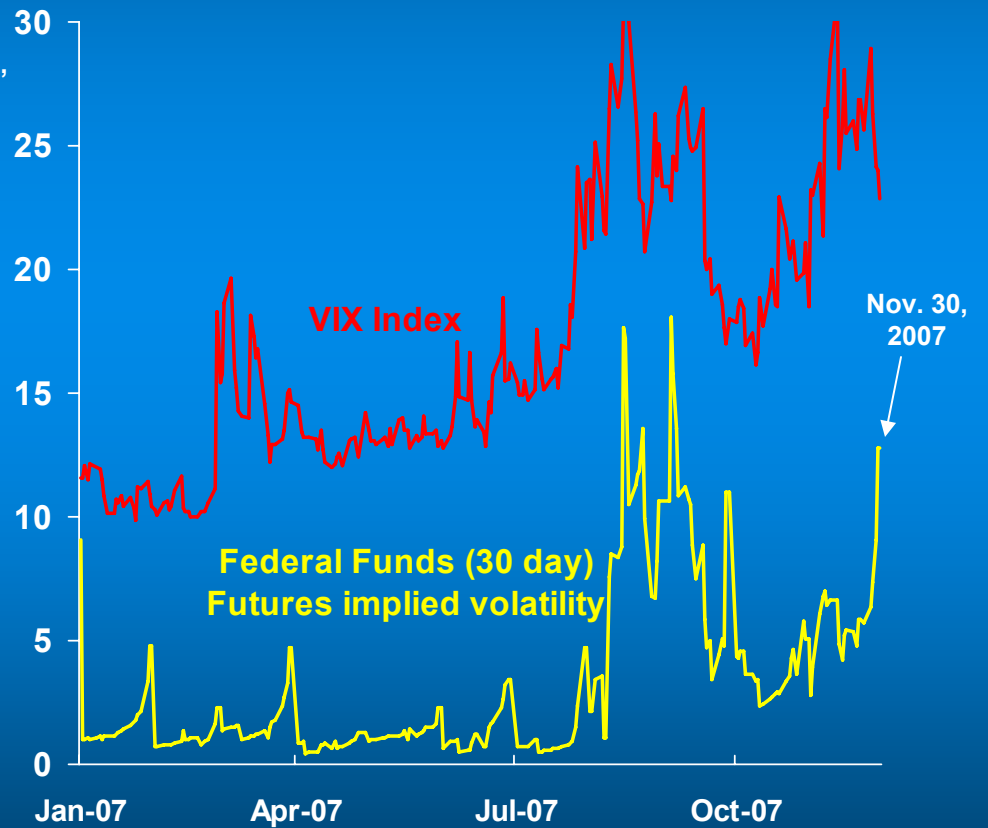
# Recent financial volatility has shaken the global economy...

### Equity Markets in the U.S., Europe, and Japan

(January 3, 2005 = 100)

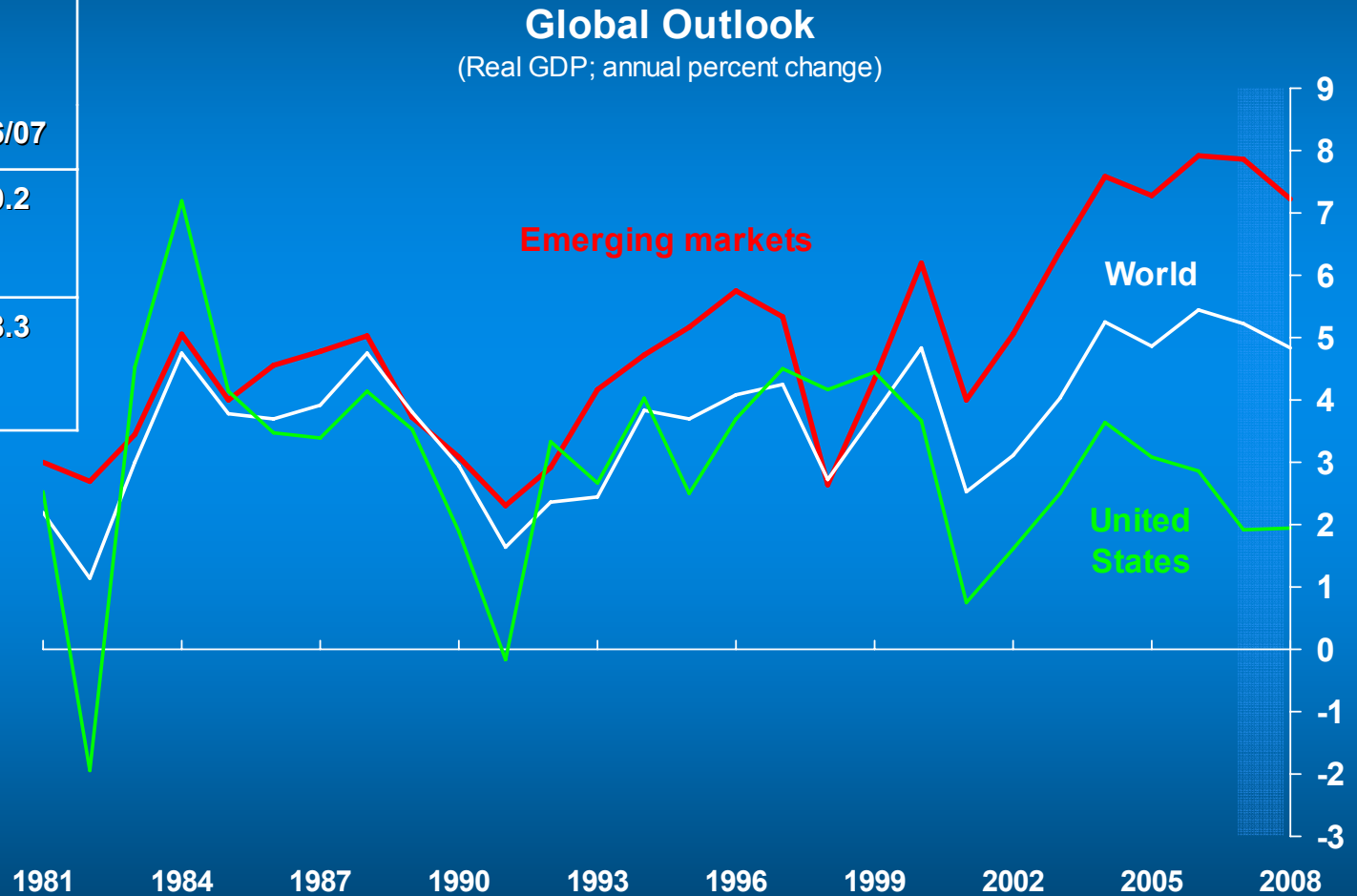


### U.S. Financial Market Volatility



...although it has come at a time of robust global growth, sustained in part by fast-growing emerging market countries

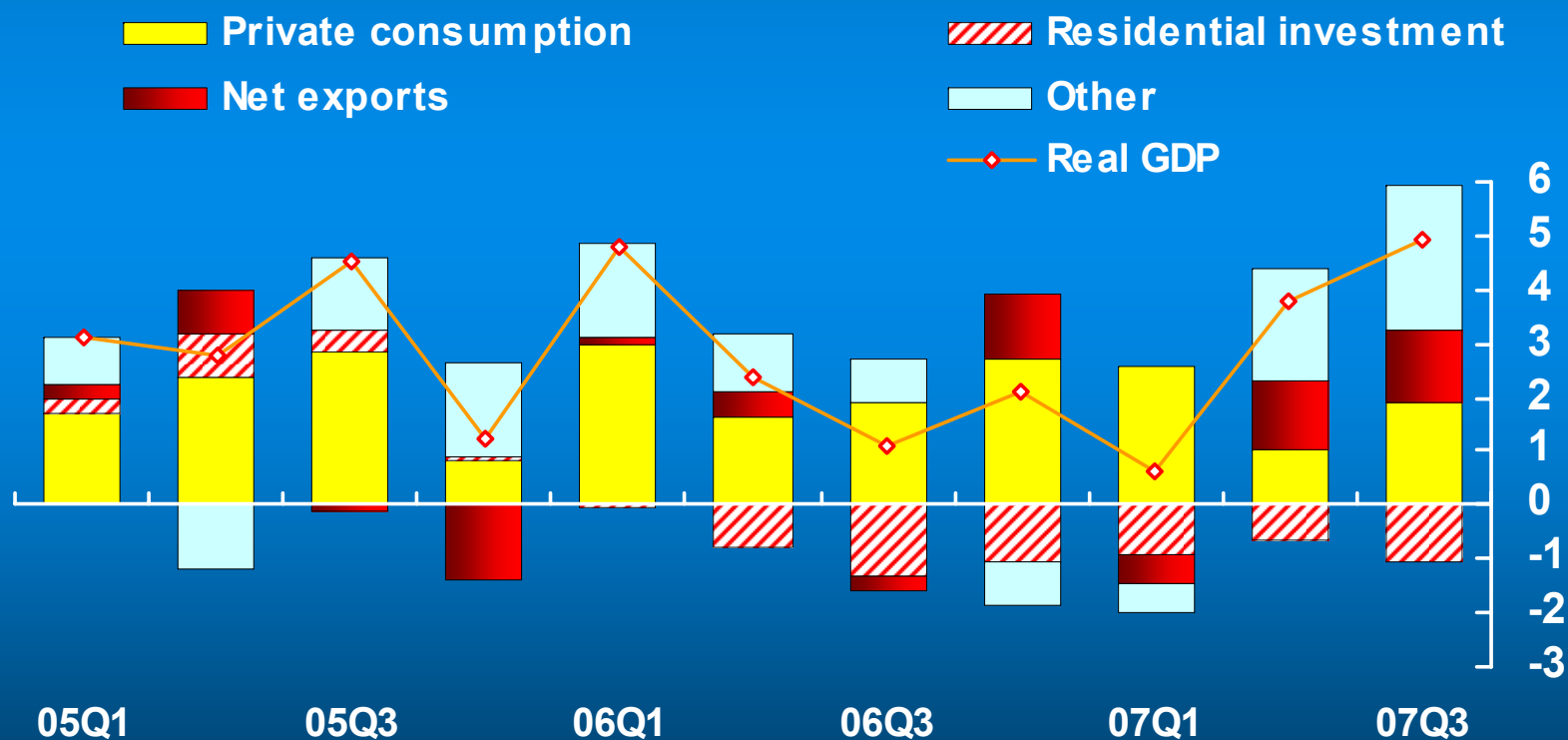
Contributions to growth (PPP weighted; in percent)		
	94/95	06/07
BRICs (Brazil, Russia, India, and China)	34.2	49.2
Industrialized countries	33.8	18.3



In the U.S., consumption and net exports have so far sustained growth, and Q3 growth was unexpectedly strong

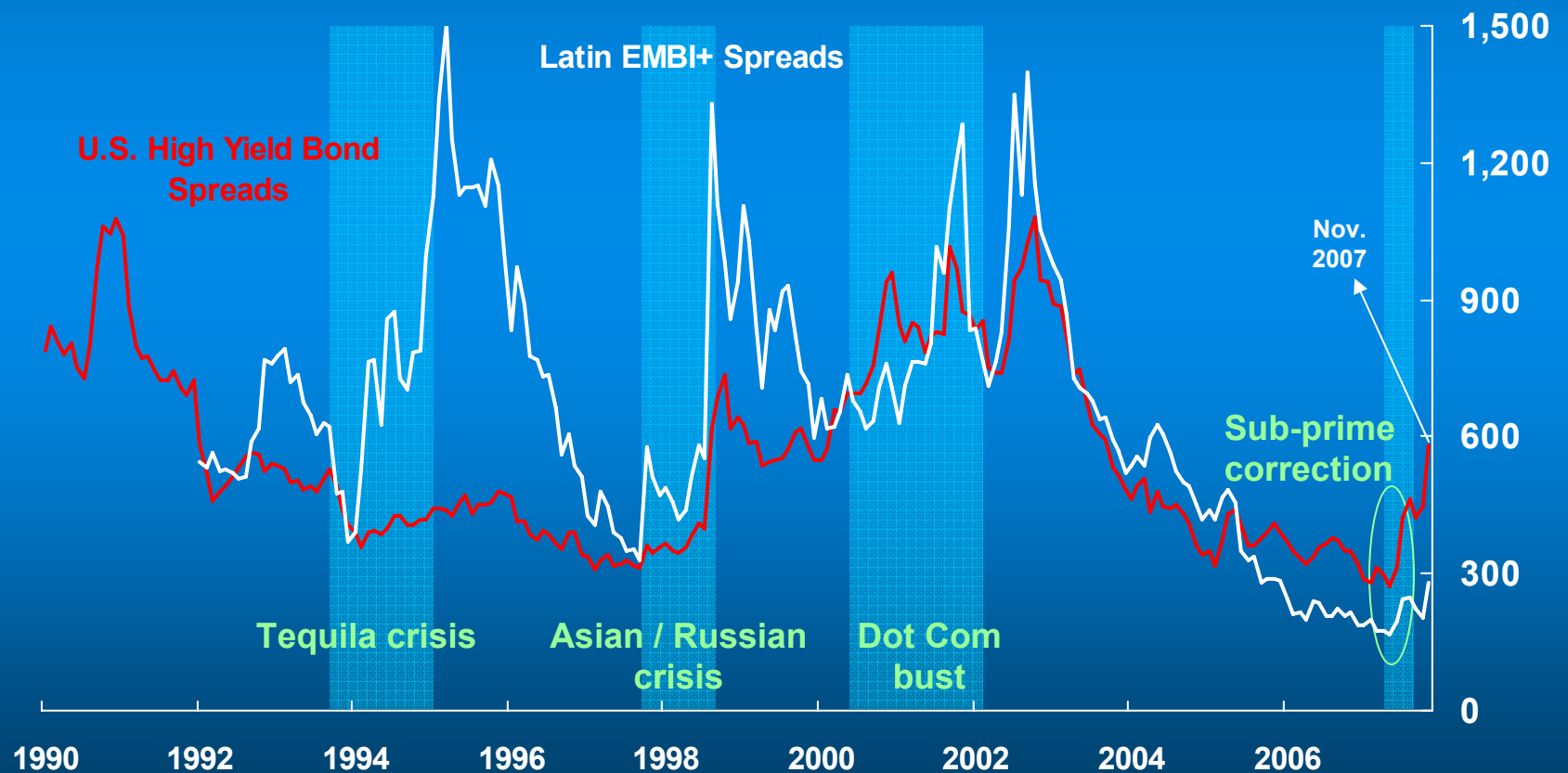
### U.S. Real GDP Growth and Contributions

(Annualized quarterly contributions to growth; %)



Unlike in the past, Latin America has been little affected so far by turbulence in the U.S. and international markets

### U.S. High Yield Bond Spreads and Latin EMBI Spreads (Basis points)



However the U.S. housing downturn has continued, and the fourth quarter has gotten off to a slow start.

### Sales of New and Existing Homes

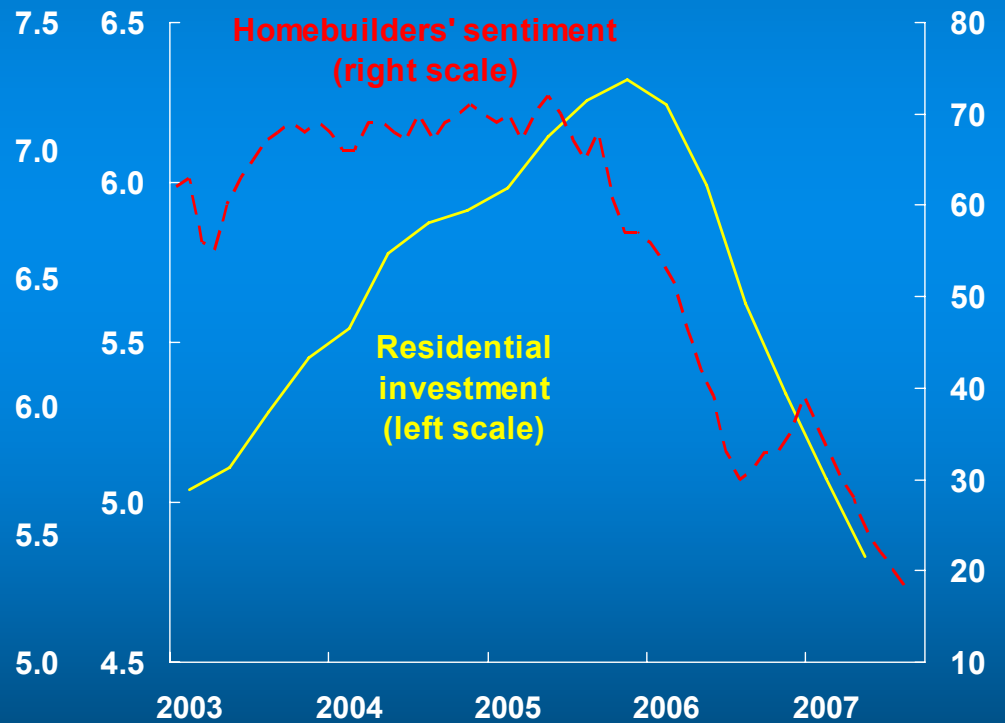
(Million units, annualized, three-month moving average)



### Residential Investment and Homebuilders' Sentiment

Percent of GDP

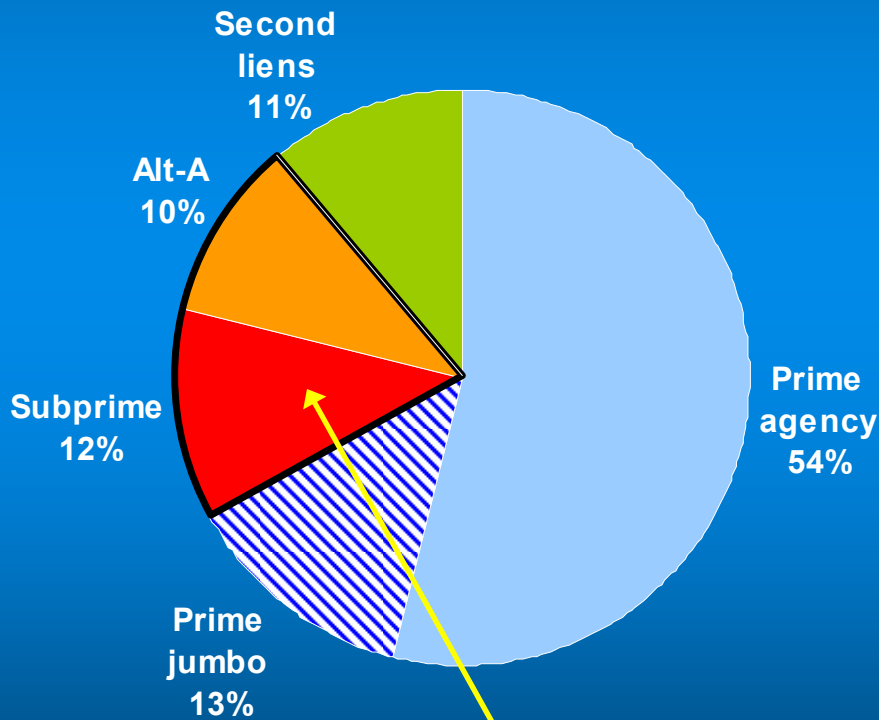
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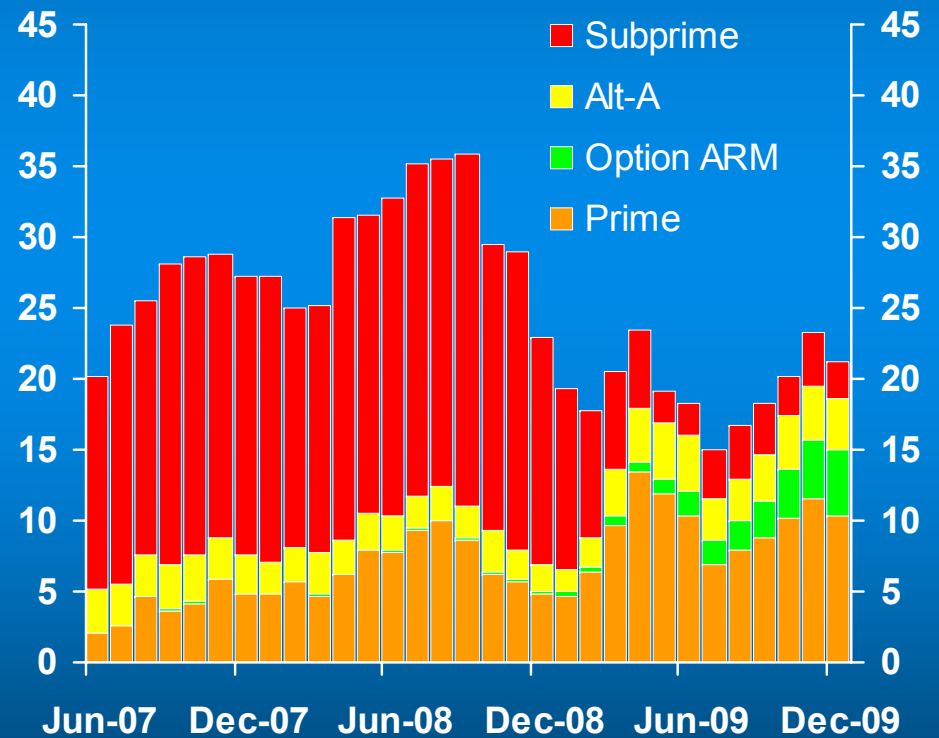
# The large share of subprime and adjustable rate mortgages could hurt consumer spending when rates adjust.

**Mortgages Outstanding**  
(percent of total)



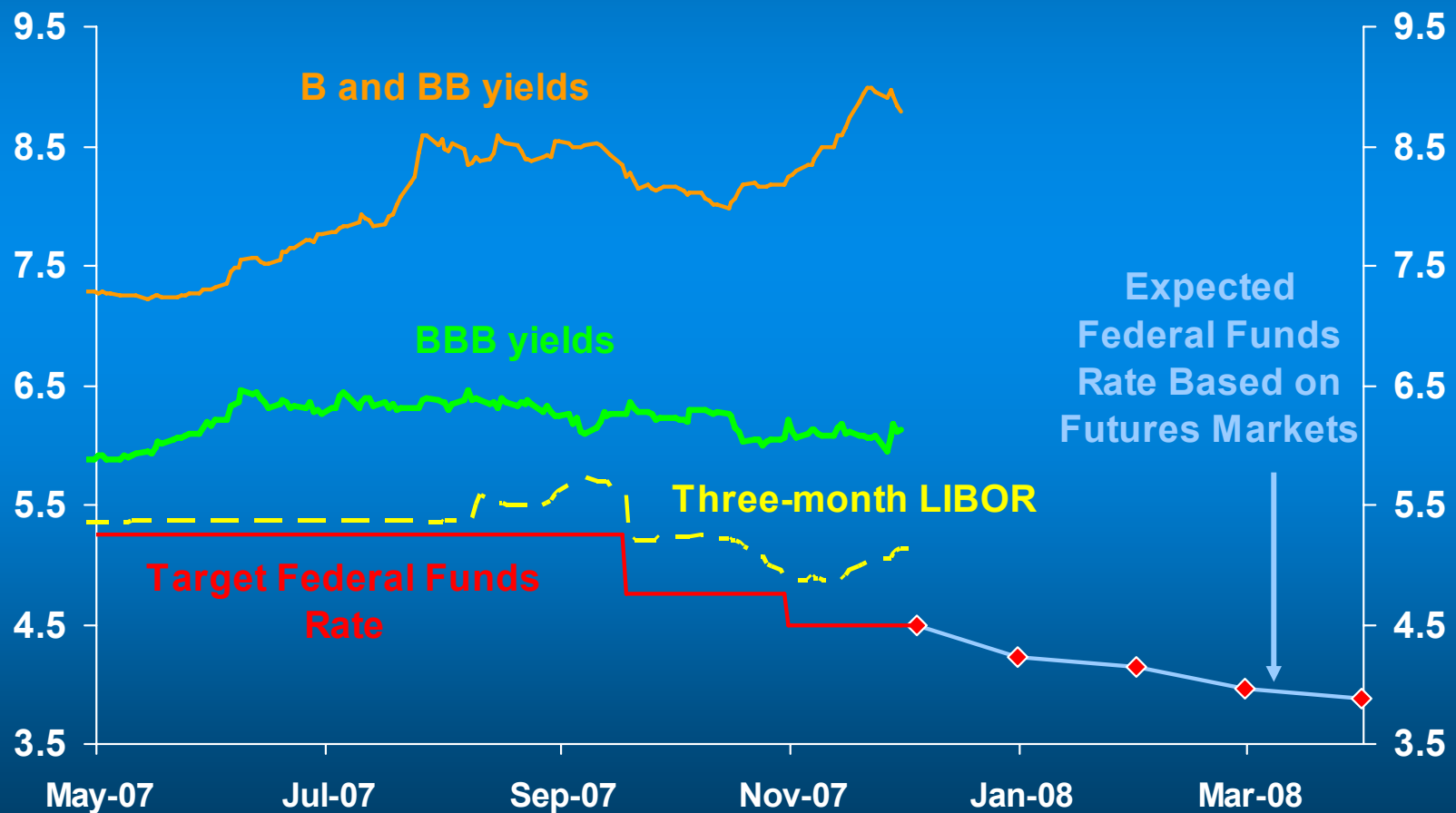
\$2.2 trillion; 13% of GDP

**Adjustable Rate Mortgage Resets**  
(billion U.S. dollars)



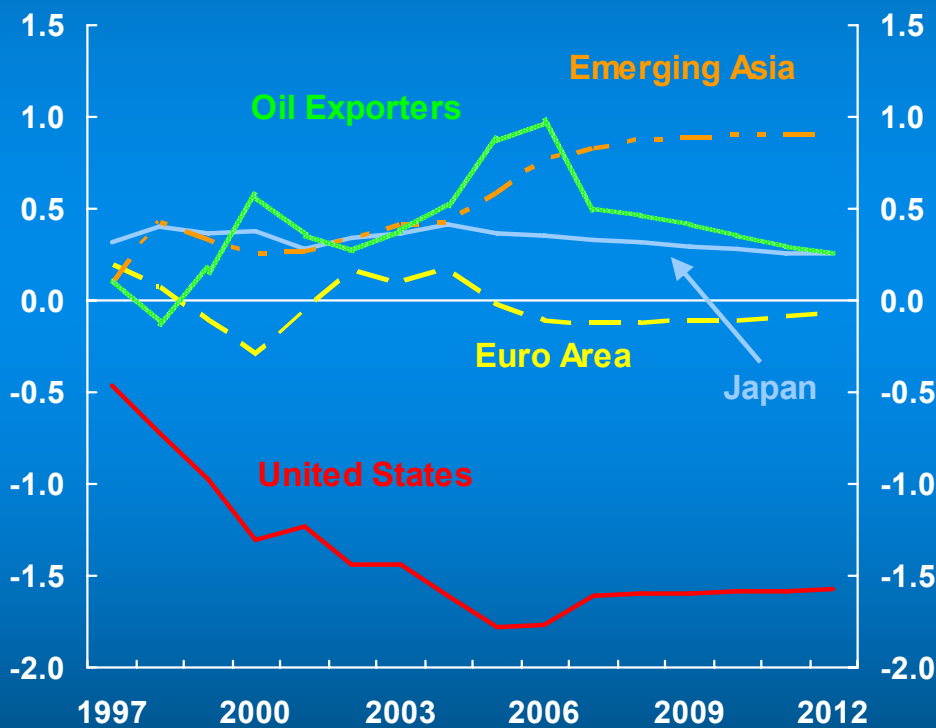
While the Fed has cut interest rates,  
subprime corporate rates continue to rise.

U.S. Short-Term Interest Rates  
(In percent)

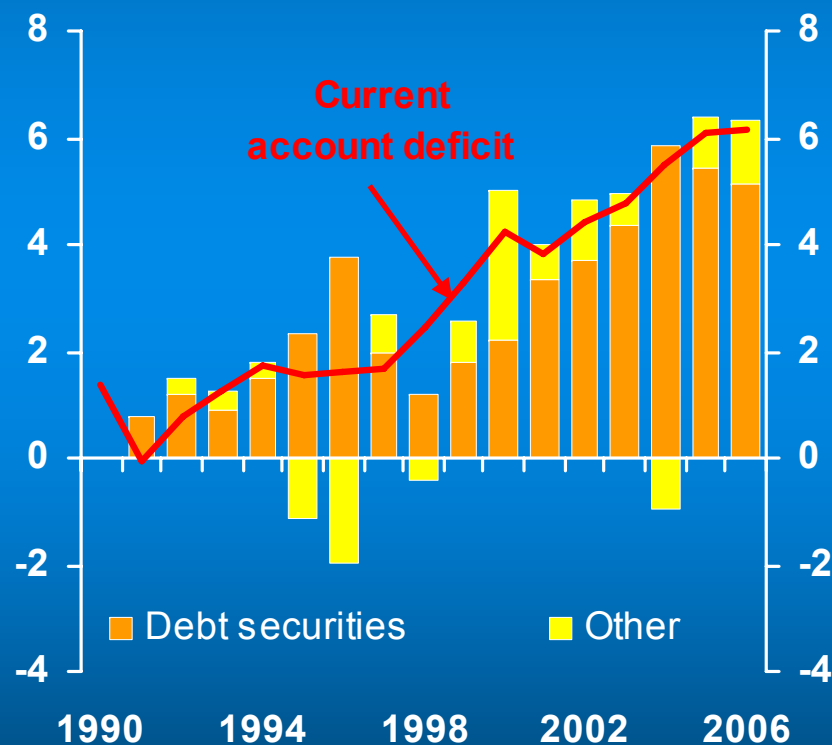


# With continuing external deficits, concern over asset-backed securities could affect financing costs and the dollar.

**Current account balance**  
(percent of World GDP)



**U.S. net capital flows**  
(percent of GDP)

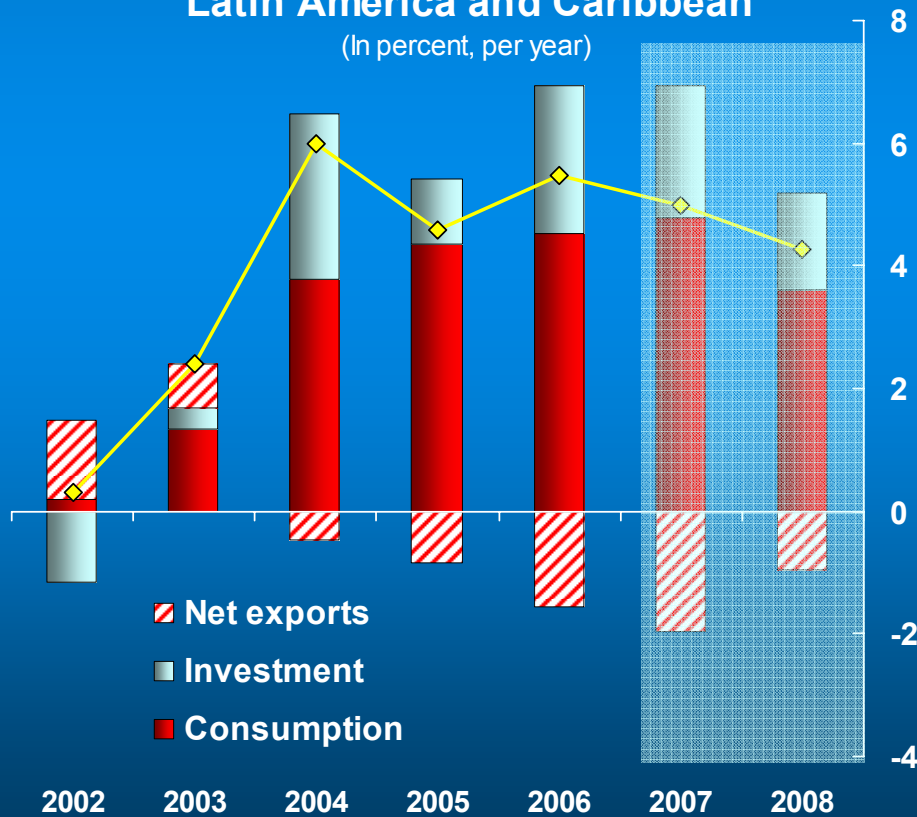


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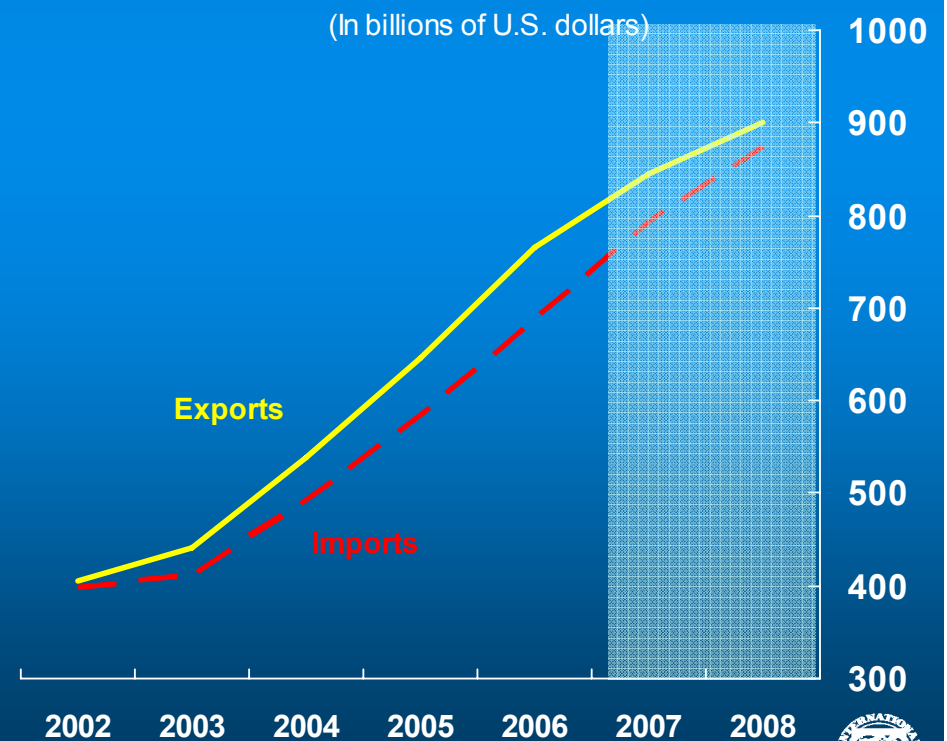
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The regional economic outlook remains robust, as strong domestic demand is offsetting the drag from higher import growth.

**Contributions to Growth:**  
Latin America and Caribbean  
(In percent, per year)

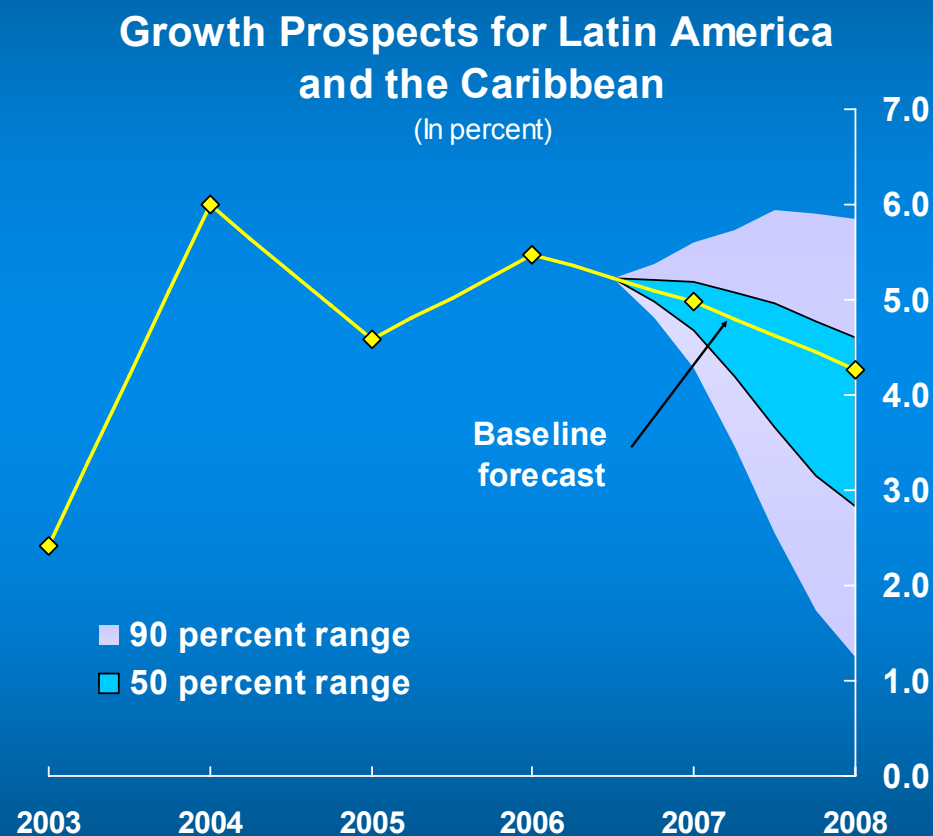


**Exports and Imports: Latin America & Caribbean**  
(In billions of U.S. dollars)



## But the external environment is subject to downside risks.

- Weaker external growth
- Further tightening in U.S. and global credit markets
- Volatile commodity prices
- Remittances may be more sensitive to US cycles.

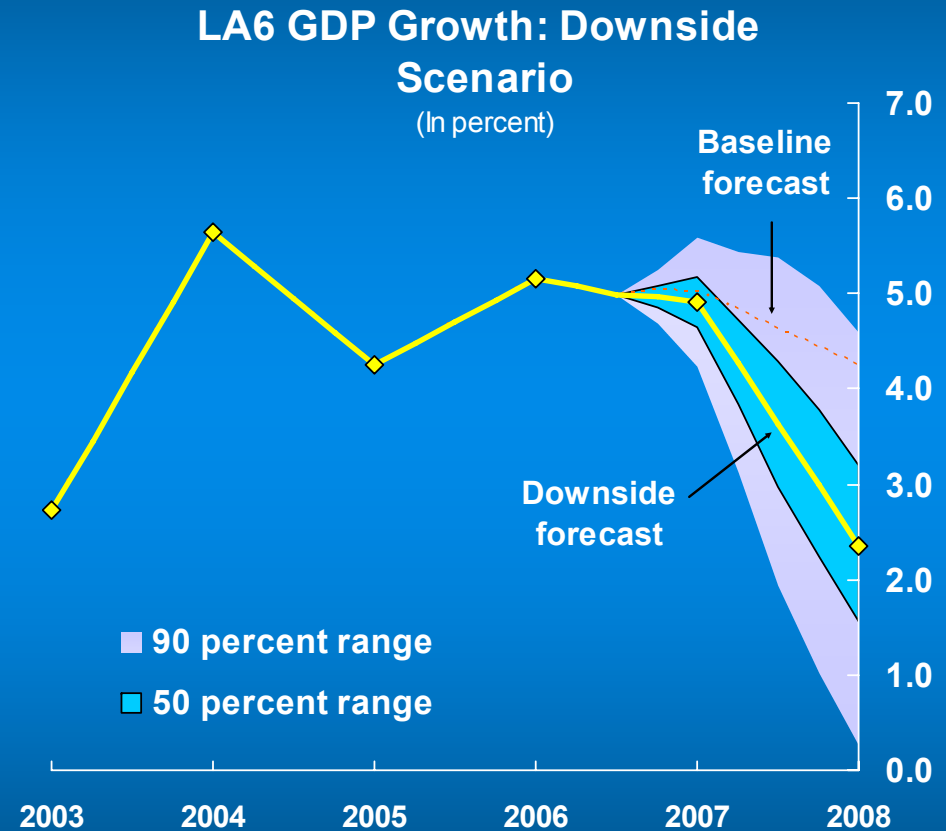


## A sharp external slowing would erode the outlook

- Sharper U.S. slowdown in early '08
- Credit crunch in the U.S.

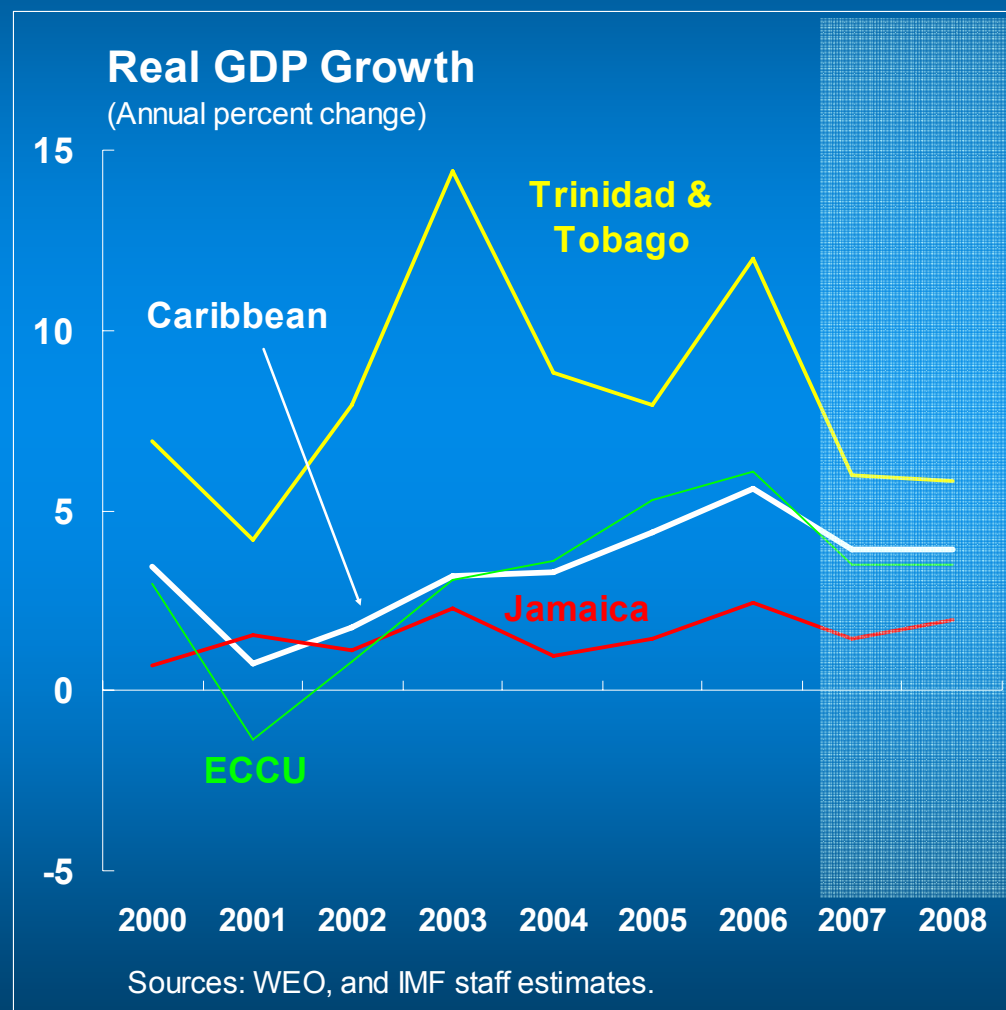


The region's growth falls significantly (up to 2 pp in 2008 below our baseline forecast)



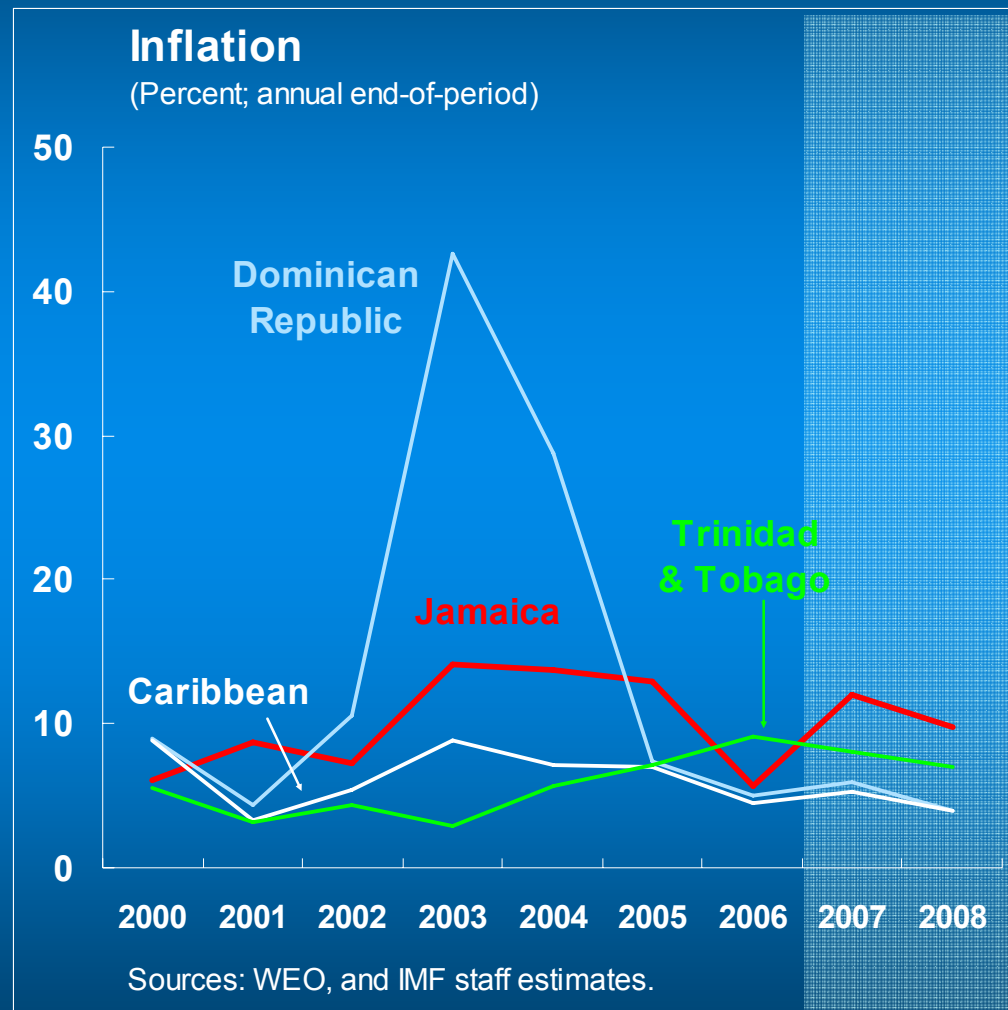
## Caribbean growth has been robust.

- Last year regional GDP expanded by 5½ percent.
- Growth is expected to slow down moderately.
- While outlook remains broadly favorable, downside risks have increased more recently.



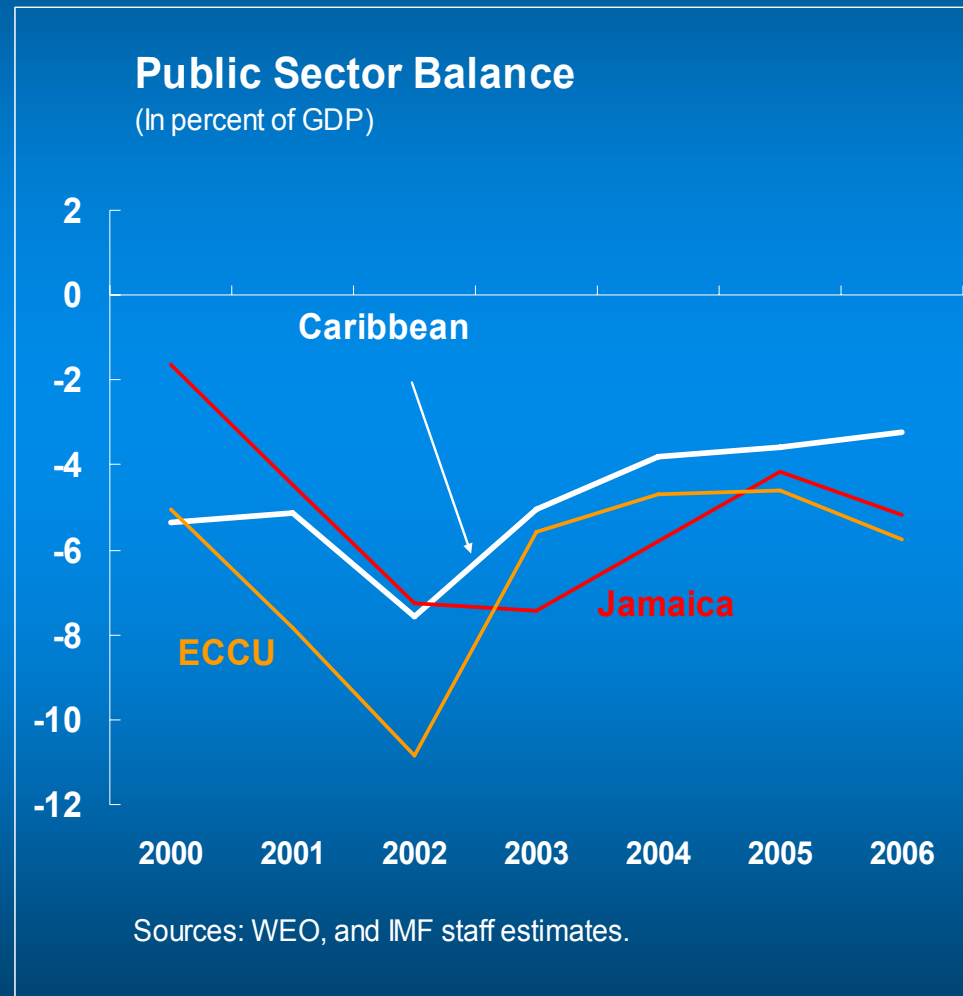


# Strengthened policy frameworks have helped contain inflation.



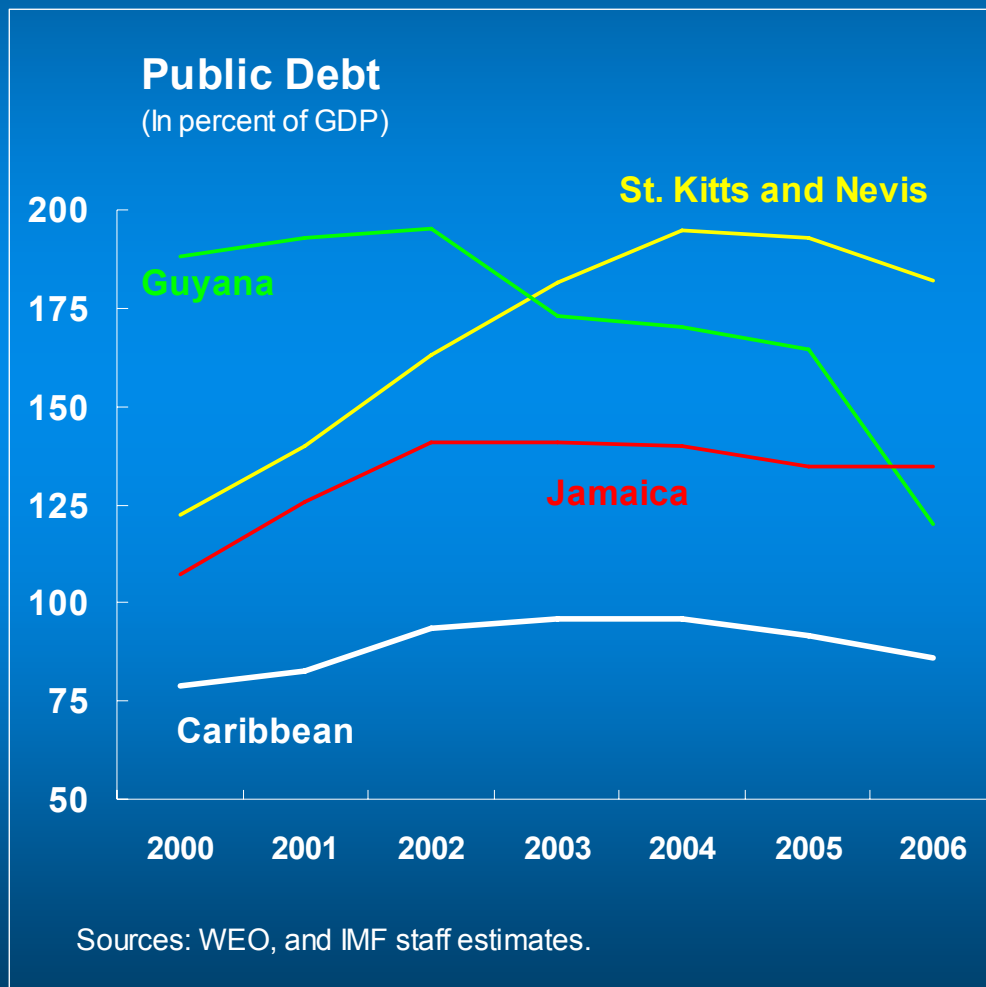
# Economic expansion has allowed public balances to strengthen

- Public balances improved.
- Tax reforms, more fiscal flexibility.
- More recently, in some countries fiscal efforts have waned.



# Reducing debt is critical to increase resilience to adverse shocks.

- Debt ratios have declined since 2003.
- Debt is still very high.
- Commitment to further debt reductions.



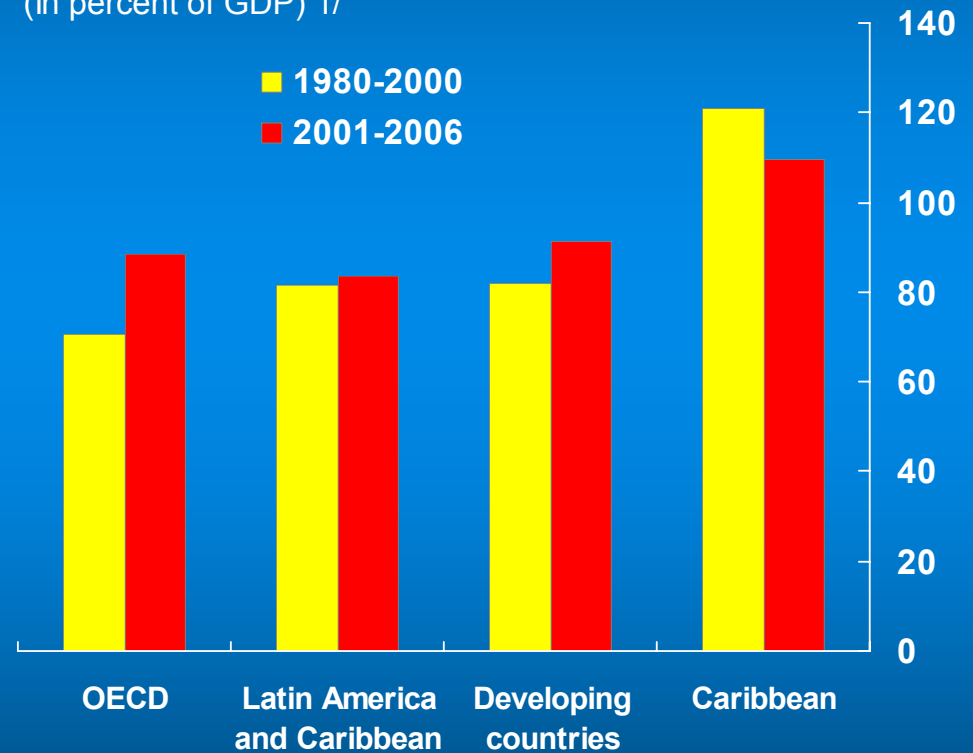
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# Regional integration promises significant benefits.

- Caribbean economies are small and very open.
- Regional cooperation promotes economies of scale and risk sharing.

**Exports Plus Imports of Goods and Services**  
(In percent of GDP) 1/



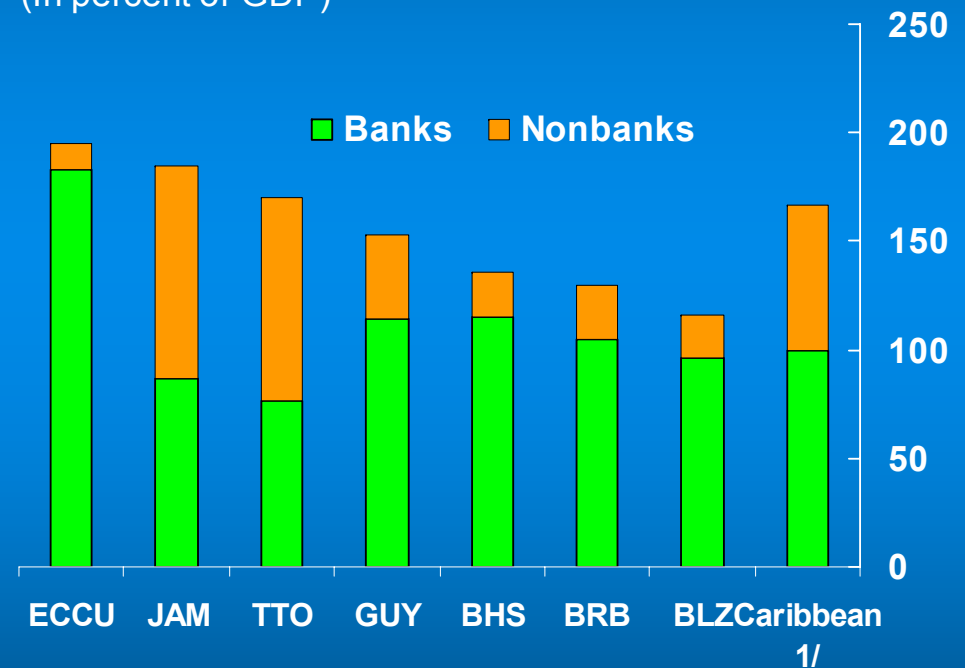
Source: WEO.

1/ Exports plus imports of goods and services.

# Financial sectors are large but often not well developed.

- Large but underdeveloped financial sectors.
- Primary markets dominated by government securities.
- Secondary markets illiquid.
- Stock market turnover low.

**Assets of Financial Institutions**  
(In percent of GDP)



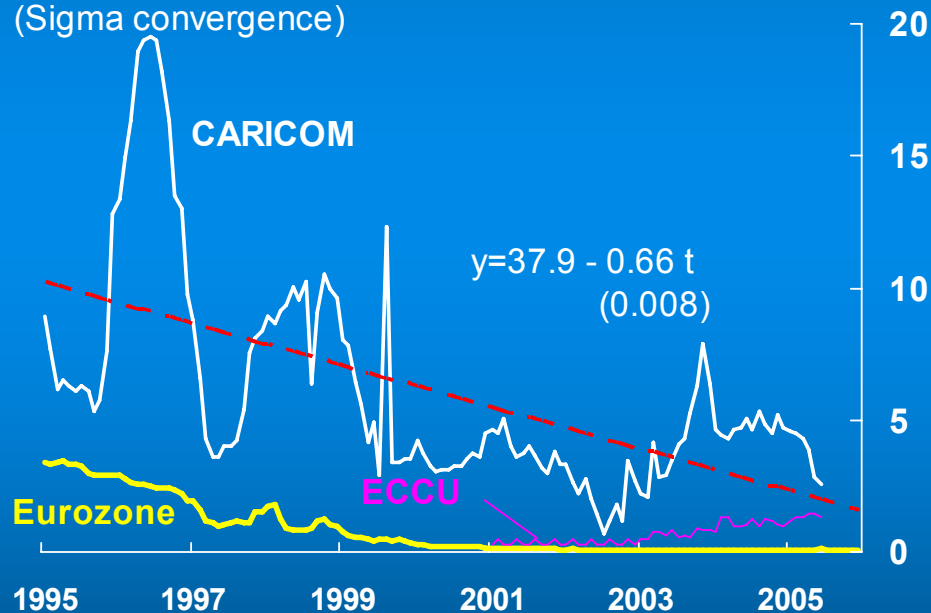
Sources: National authorities; and IMF staff calculations.  
1/ Weighted average.

# Integration has progressed within CARICOM creating new challenges.

- Interest rate convergence
- Further integration ...
  - promises benefits,
  - but also harbors risks.
- Strengthen institutions and regulatory oversight.

## Cross-Country Standard Deviation of Short-term Interest Rate, Adjusted for Exchange Rates

(Sigma convergence)



Sources: National authorities; and IMF staff calculations.

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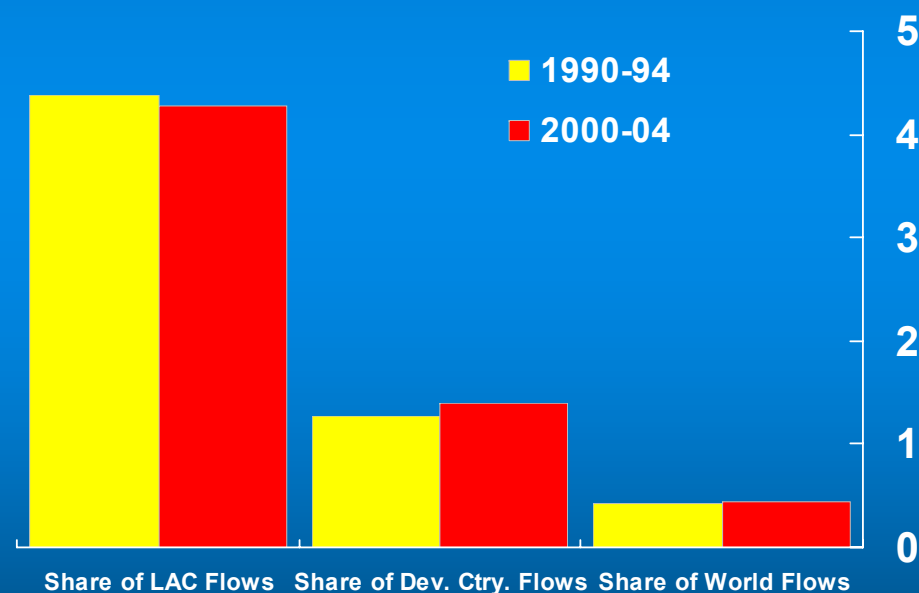
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# Tax incentives are a costly way to attract investment.

- FDI—a key anchor of the region’s developmental strategy.
- But tax incentives are costly.
- Other factors also attract FDI:
  - infrastructure,
  - strong institutions,
  - stable economic conditions.
- Regional coordination to contain harmful tax competition.

**Caribbean FDI as a Share of Regional Investment Flows**  
(In percent)



Sources: National authorities; and IMF staff estimates.

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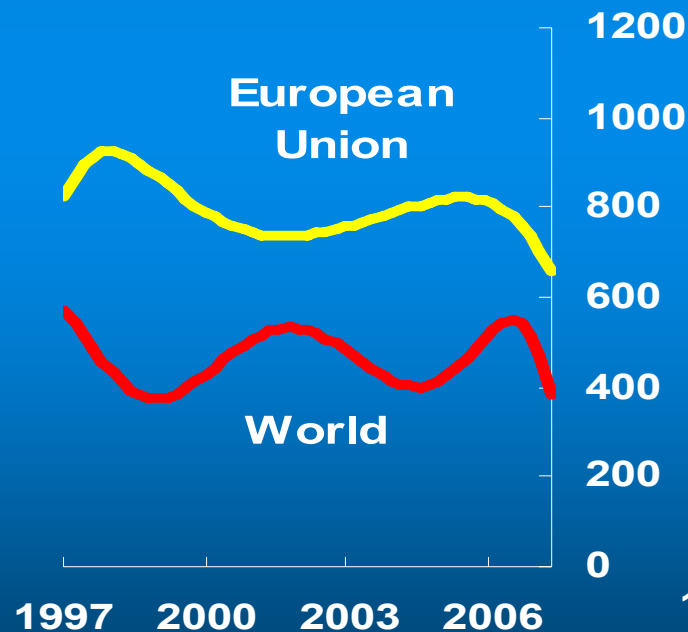
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# Preference erosion for bananas and sugar is resulting in significant output losses.

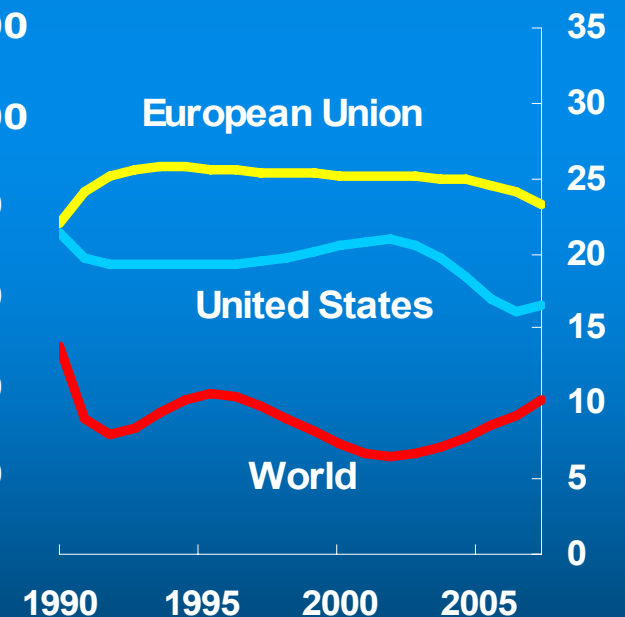
Large economic impact—value of implicit subsidies:

- Windward Islands (8% of GDP—bananas).
- Guyana (10% of GDP—sugar).

**Real Banana Prices, 1997 - 2007**  
(U.S. dollars per metric ton)



**Real Sugar Prices, 1990 - 2007**  
(U.S. cents per lb.)



# Affected Countries need to develop adaptation strategies

- Targeted safety nets and job search support.
- More efficient agricultural production.
- Shift out of traditional agriculture.

# Conclusions

- Baseline outlook for Caribbean favorable.
- But region remains vulnerable to shocks.
- Policy priorities:
  - Lower debt and reform public spending;
  - Investment climate/FDI;
  - Advance financial sector reforms.

End