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IMF Sees Continued Strong Growth, but also Heightened Policy Challenges for Latin America and the Caribbean in 2008

Most countries in the Western Hemisphere have so far dealt well with market turbulence and a slowing U.S. economy, and Latin America and the Caribbean have continued to grow strongly, according to the IMF's latest *Regional Economic Outlook: Western Hemisphere*, released today. Although some easing is expected in 2008, mainly as result of weaker economic activity in the United States, growth should remain relatively high, said Mr. Anoop Singh, Director of the IMF's Western Hemisphere Department. During a presentation of the report to policymakers, business leaders, and academics in São Paulo, Brazil, Mr. Singh said "we attribute the region's resilience so far to the stronger economic fundamentals now in place in most countries, and the wider consensus in Latin America on preserving macroeconomic stability." He added that "most countries have declining public debt, stronger fiscal and external positions, and sounder financial systems, and they have recently used exchange rate flexibility quite effectively."

Mr. Singh also noted, however, that with the shift in the external environment, the region faced downside risks. A stronger than expected slowdown in the United States, or a more protracted period of financial turbulence, would undoubtedly have some impact in Latin America. He said it would be important for a number of governments across Latin America and the Caribbean to strengthen policies, particularly in the fiscal area, to safeguard the recent improvements in fundamentals within the region. "Current spending growth has been extremely rapid in many countries, and the pace needs to slow to preserve fiscal balances and allow for higher spending on needed public infrastructure and key social programs," Mr. Singh said. Lower public spending growth would also make it easier for monetary policy to contain inflation, which had recently been edging up in many countries, partly reflecting food price inflation.

Looking to the longer term, Mr. Singh emphasized the need for improved financial supervision and better business conditions to raise growth and further reduce poverty and inequality in the region.

The Regional Economic Outlook 's main findings for Latin America and the Caribbean are as follows:

With the U.S. economy now expected to grow just under 2 percent this year and next, growth in Latin America and the Caribbean is expected to be 5 percent on average in 2007—the fourth year of uninterrupted, strong growth in the region. The expansion is forecast to continue in 2008, with growth of 4¼ percent, as a slower external environment is partly offset by vigorous domestic demand. With output above potential in many countries, inflation has been edging up, to 6 percent on average in 2007, and a further increase by about ½ percent is forecast for 2008. Unemployment has fallen further, and poverty has significantly declined during this expansion—much more rapidly than in the 1990s. For example, Brazil reduced its total poverty rate from 34 percent in 2002 to 27 percent in 2006. Inequality has also declined in most countries since 1999.

However, downward external risks to the outlook have recently increased, and there are some signs that recent improvements in fundamentals in the region may erode if policies do not strengthen. These issues are examined based on new research in three thematic chapters of the Regional Economic Outlook:

- *Resilience to external shocks* (Chapter 3). Compared to the 1990s, improved public and private sector balance sheets, lower and better anchored inflation expectations, and strengthened policy frameworks have made the region more resilient to changes in international financial conditions. Central banks, for example, are now able to respond to tighter international conditions with greater exchange rate flexibility than in the past. However, Latin America remains sensitive both to a slowdown in external demand and a deterioration of its terms of trade; and a credit crunch and recession in the United States would lower growth by some 2 percentage points below the baseline.

- *Strength of underlying fiscal positions* (Chapter 4). Fiscal primary surpluses in the Latin America and the Caribbean rose further last year, driven by buoyant revenue. A detailed analysis suggests that, for the most part, structural primary balances in the region remain in surplus. However, they are not as strong as reported primary balances, and they are subject to uncertainty, in part because they depend on what will happen to commodity prices. Moreover, revenue ratios are now projected to remain flat or decline modestly. If spending continues to grow at its current pace—8-10 percent in real terms—primary fiscal surpluses will quickly turn to deficits in the coming years. “In light of still-substantial debt levels in the region, the erosion of the fiscal positions based on current expenditure trends is a significant concern,” Mr. Singh noted.

- *Sustainability of credit growth* (Chapter 5). Recent average credit growth rates of almost 40 percent per year in the largest Latin American countries have raised questions about the sustainability of the ongoing boom in Latin America's financial sector. New analysis suggests that much of the recent credit growth seems to be associated with improvements in fundamentals. However, this could mask heightened vulnerabilities in particular institutions that have lowered credit standards in their pursuit of rapid expansion. Going forward, the fast pace of credit growth in several countries requires enhanced regulatory oversight and strengthening of supervisory capacity, according to the report.