2020

Preliminary Overview of the Economies of Latin America and the Caribbean

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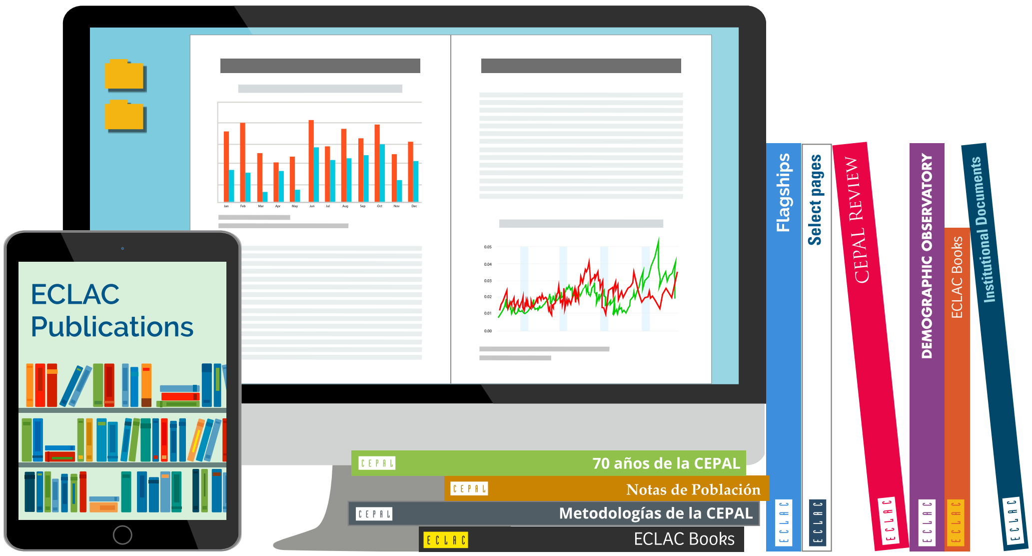

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In the preparation of this edition, the Economic Development Division was assisted by the Statistics Division, the ECLAC subregional headquarters in Mexico City and Port of Spain, and the Commission's country offices in Bogotá, Brasilia, Buenos Aires, Montevideo and Washington, D.C.

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Executive summary

At the global level, the year 2020 has been marked by a severe health and economic crisis and by great uncertainty arising from the unknown dynamics and evolution of the coronavirus disease (COVID-19) pandemic. As a result, 2020 is expected to produce the greatest contraction in GDP since 1946, with economic activity falling across the board in both developed and developing economies. Where GDP has not contracted outright, as in China, its growth has slowed considerably.

The crisis has also triggered a large slump in international trade, heavy fluctuations in commodity prices and great volatility in financial markets. The lockdown measures adopted in the great majority of countries around the world to contain the spread of the pandemic have badly hit tourism and related activities, such as commercial aviation and restaurant and hotel services. The disruption of certain industrial and commercial activities has had a heavy impact on labour markets around the world, and thus also affected the ability of migrants to send remittances to their countries of origin.

Unprecedented fiscal and monetary packages have been announced around the world to tackle the effects of the pandemic, for amounts close to US$ 12 trillion in fiscal measures and US$ 7.5 trillion in monetary measures.[1] These efforts have helped alleviate the situation, softening the impacts of the drop in economic activity, but also producing high levels of liquidity which has underpinned a rise in global debt.

The form taken by the crisis has not been the same from one country to another, and nor will the magnitude of its consequences or their persistence. Factors such as countries' capacity to react to the health emergency in the short term and to adopt policies to support the worst-hit sectors have been largely accounted for the dynamics of economic activity over the year. At the same time, the severity of the economic shutdown has not been same across countries either, nor was the performance of economic activity before the pandemic. Structural factors, such as the degree of integration into international trade and global value chains, the productive structure, demographic factors and the formalization of labour markets, have also been crucial in understanding the extent to which economies have been affected in the current crisis.

In this context, Latin America and the Caribbean is the hardest hit region of the emerging world in a comparison of health, social and inequality indicators.[2] The region's historical structural weaknesses and gaps, its limited fiscal space, more limited social protection coverage and access, high labour informality, uneven production structure and low productivity, are key to understanding the magnitude of the pandemic's effects on its economies, as well as the difficulties in implementing policies to offset those effects and the challenges of generating a sustainable and inclusive economic recovery.

The region went into the pandemic having already racked up a six-year run of weak growth —0.3% on average over 2014–2019 and just 0.1% in the last of those years. With the outbreak of the pandemic, on top of this slack economic growth came negative external shocks and the need to implement lockdown and physical distancing policies and to shut down production activities, which turned the health crisis into the worst economic, social and production crisis the region has experienced in 120 years, with a 7.7% contraction in regional GDP. That contraction in economic activity is bringing large rises in the unemployment rate, which is projected at around 10.7%, a heavy fall in labour market participation and considerable increases in poverty and inequality.

At the global level, despite a slight upward revision of the mid-year projections, in 2020 the global economy is expected to contract by 4.4%, with recession widespread across all countries and regions. The growth dynamic partly reflects a better-than-expected

[1] See International Monetary Fund (IMF), IMF *Annual Report 2020: A Year Like No Other*, Washington, D.C., 2020.

[2] See IMF, *Regional Economic Outlook. Western Hemisphere Pandemic: Persistence Clouds the Recovery,* Washington, D.C., 2020.

second quarter in some of the major economies thanks to large fiscal packages, and the upturn underpinned by reopenings in the third quarter.

For the group of developed economies, the contraction in 2020 is projected at 5.8%. In the case of the United States, despite the rise in infections and the acceleration of the pandemic, the strong growth posted in the third quarter has continued into the fourth, so that the contraction of the country's economy is forecast at 4.1% in 2020. In the eurozone, after opening and signs of economic recovery during the northern hemisphere summer, numbers of COVID-19 cases began to rise against in late October in many countries, including Germany, France and Italy, leading to new lockdowns. This will cause GDP to fall in the fourth quarter and end 2020 overall with an 8% estimated contraction.

A downturn of 3.3% is expected for the group of emerging and developing economies, China being the only main developing economy to post positive growth (1.9%).

In 2021, world GDP is projected to grow by 5.2%. However, this projection is subject to revision if, among other factors, the distribution and administration of COVID-19 vaccines is slower than expected, especially in the emerging economies. For the developed economies, growth of 3.9% is expected in 2021, meaning that, on average, the recovery in these economies is not expected to bring a return to pre-crisis GDP levels. The United States economy is expected to post economic growth of 3.6% and the eurozone, 5.1% in 2021.

For emerging and developing economies, growth of 6% is projected in 2021, led mainly by China (with growth of 8.1%), driven by a strong real estate sector, buoyed by fiscal spending on investment and infrastructure and, from the second quarter onward, a recovery in the external sector. If China is excluded from the group of emerging and developing economies, the growth projection for 2021 is 5.0%, too little to return to pre-pandemic levels of activity in this group of economies.

With respect to world trade, the World Trade Organization (WTO)[3] projects a fall of 9.2% for 2020, and a recovery of 7.2% for 2021. The drop in 2020 will be the largest since the global economic and financial crisis of 2009 (when the fall was almost 13%). In the first nine months of 2020, the volume of trade fell 7.2% year-on-year, with a recovery from June onward. China stands out, as it shows a recovery in trade from the second quarter on, on both the import and export sides.

In the early months of 2020 commodity prices fell heavily, but began to recover as of May and, with the exception of energy products, by October had risen above pre-pandemic levels. In October, agricultural product prices were 5% above their December 2019 level, industrial metals were 10% higher, and precious metals 30% higher. However, the October prices of energy products were still around 33% below their December 2019 level.

For 2021, the outlook for commodity prices is uncertain, as the evolution of the pandemic is a determining factor. IMF projections in October forecast a 9% increase in average commodity prices in 2021, with a 4% increase for agrifood products, 3% for base metals and 16% for energy products.

Global financial markets have been strongly driven by the fiscal and monetary policies of developed economies and by news on the evolution of the pandemic and the COVID-19 vaccine. Expansionary monetary and fiscal policy actions substantially reduced financial volatility, which had hit record levels in mid-March. They also helped to boost global liquidity, which has reduced returns and increased appetite for risk among investors.

[3] World Trade Organization (WTO), "Trade shows signs of rebound from COVID-19, recovery still uncertain", *Press Release*, No. 862, 6 October 2020 [online] https://www.wto.org/spanish/news_s/pres20_s/pr862_s.htm.

The disconnect between the financial and the real economy has continued. A shift in risk perception leading to greater risk aversion would have adverse impacts on emerging economies in general and in Latin America and the Caribbean in particular. Changes in conditions of access to financial markets would find emerging economies more vulnerable owing to sharp rises in debt ratios, which for some firms and even governments could become unmanageable if there are further falls in economic activity. The total for government and corporate debt of developed countries hit 432% of GDP in the third quarter of 2020, exceeding the previous high of 380% of GDP (in 2019), according to the Institute of International Finance (IIF), while for emerging economies the ratio is 250%. The increase in debt has been accompanied by acceptance of higher risk levels by investors seeking greater returns. Much of the debt built up since the global financial crisis has been acquired by the non-financial corporate sector, whose performance has been hurt by the disruption of supply chains and the global growth contraction, with consequent difficulties in repaying debt.

With respect to the Latin American and Caribbean region, the decline in commodity prices resulted in lower export prices, especially for countries that export hydrocarbons (-19%), while smaller falls are forecast for exporters of agro-industrial and mining products (both -3%). In terms of volume, all export subgroups show falls, as the international crisis reduced external demand.

In this context, the terms of trade declined on average by 2% in the region, although with differences between the subregions. The worst affected group is hydrocarbon-exporting countries, whose terms of trade are projected to decline by 14%. For exporters of industrial minerals and metals and of agro-industrial products, the terms of trade are expected to improve slightly, by 3% and 03%, respectively. Similarly, for the countries of Central America and the Caribbean, excluding Trinidad and Tobago, the terms of trade have improved (5% and 3.4% respectively) as a result of the sizeable energy components in their import baskets.

Remittances, a key component of the transfers balance, have showed a mixed performance between countries, In Mexico, the region's largest recipient of remittances —with over a third of all these flows— remittances were up year on year by 9% in August 2020. They also rose in Jamaica (18%), the Dominican Republic (11%), Nicaragua (9%), Guatemala (4%) and El Salvador (1%). Conversely, remittances have fallen in several countries over the year thus far, as in the Plurinational State of Bolivia (-26%), Peru (-22%), Paraguay (-16%), Costa Rica (-10%), Ecuador (-10%), Honduras (-2%) and Colombia (-1%).

The region's current account deficit has shrunk considerably in 2020, despite the fall in exports, to 0.4% of GDP (compared to 1.8% in 2019) owing to a sharp contraction in imports, which have rendered their worst performance since the global financial crisis, with an expected decline of 14% by volume. The region's exports are set to contract by 13% by value, with a drop of 7% in prices and 6% in volumes.

Financial inflows to the region have been driven by increased global liquidity. In the third quarter of 2020, the financial flow tracker developed by ECLAC showed that financial flows to the region continued to rise, consistently with the evolution of international bond issues by the countries of the region. On average, the financial flows received by the region in 2020 should both cover the current account deficit and support reserve accumulation.

After a sharp spike at the beginning of the crisis, sovereign risk in the region has tended to decrease and stabilize as a result of significant improvements in September in Argentina and Ecuador. As measured by the Emerging Market Bond Index Global (EMBIG), sovereign risk reached 467 basis points at the end of October, well below the 702 basis points recorded at the end of April, but still above the 346 points seen at the end of 2019.

Debt issuance on international markets in the first 10 months of 2020 was up 19% on the same period the previous year. Sovereign bonds accounted for 40% of total issuances up to October, followed by private corporate sector debt (27% of the total) and quasi-sovereign bond issues (20%).

Sovereign issuance increased by 45% year-on-year up to October 2020. Mexico issued a sustainable sovereign bond, linked to achievement of the United Nations Sustainable Development Goals, the first country to issue bonds of this type. The bond was issued for a total of 750 million euros, with a yield of 1.35%, the second lowest in the country's history. In the last week of November, Peru issued a bond with a 100-year term to maturity for the first time in its history, for a total of US$ 1 billion. The country's aim was to take advantage of low dollar interest rates to raise financing for plans to combat the pandemic, amid falling public revenues. The bid-to-cover ratio was over 11.5, with a yield just 170 basis points above that offered on United States Treasury bonds. This bond was part of a larger borrowing programme, with further issues for US$ 1 billion at 12 years and US$ 2 billion at 40 years.

Quasi-sovereign issuance grew 24%, driven primarily by the October issues from Petróleos Mexicanos (PEMEX), which raised US$ 1.5 billion, and Petrobras, for US$ 1 billion. Private corporate debt contracted by 20%, mainly owing to a US$ 8 billion decline in issuance in Brazil. Lastly, issuance by the banking sector almost doubled.

With regard to economic growth, the South American economies saw a sharp contraction over the first three quarters (-7.7% year on year), compared with growth of close to zero in the prior-year period. The Central American economies went from growth of 3.2% in the first three quarters of 2019 to a fall of 5.9% in the first three quarters of 2020. In Central America and Mexico combined, growth in the first three quarters of 2020 was negative by -9.2%, 9.6 percentage points down on the same period in 2019.

The contraction in regional GDP reflects a heavy fall all components of domestic demand, as well as lower external demand. All the components of aggregate demand —consumption, investment and exports — were sharply down. Although the current conditions adversely affect all sectors, some are more intensively impacted than others. The worst affected have been manufacturing, construction, commerce and transport. Agriculture was less affected, as were essential services, financial services and mining.

With regard to labour markets, the unemployment rate is expected to be around 10.7% on average in 2020, with a heavy fall in labour market participation compared with 2019 levels. That fall has in fact mitigated the rise in unemployment: with participation levels similar to those of 2019, unemployment would have exceeded 18%. Lockdown and physical distancing measures adopted to contain the spread of the pandemic have meant that informal employment has been worse affected than formal employment. Thus, unlike the usual pattern in economic crises, informality indicators have tended to fall. Vulnerable groups were disproportionately affected by job losses: informal workers, young people, those with lower levels of formal education, women and migrants. Specifically, women's employment fell more heavily than men's and more withdrew from the labour market to take on additional care work in their households.

Employment levels stabilized mid-year and began a slow recovery, consisting mainly of the reactivation of informal work, while the gradual resumption of formal firms' activities was chiefly reflected in the return of "absent employed" to their jobs and in an increase in working hours. The rise in the regional employment rate did not produce a decline in unemployment, because participation rose owing to a gradual return to the labour market by people who had been temporarily inactive. The moderate increase in employment rates was absorbed principally by men, suggesting that many women continued to be intensively dedicated to care work in the context of limited functioning of preschool and older persons' care systems and educational establishments. As a result, gender labour gaps widened again.

Massive losses of labour income resulted from the fall in employment and the drop in the earnings of many of those who remained in work. This trend eased only in the third quarter. Labour income losses are estimated at 10.1% of regional GDP,[4] illustrating the grave subsistence problems of many households, the severe weakening of domestic demand and the urgent need to adopt and broaden support measures for these households.

The performance of labour markets in 2021 will depend on the strength and form of the economic recovery, which will depend on turn on the extent to which the COVID-19 pandemic is controlled. Given the strong correlation between economic growth and employment generation —especially wage employment— the various scenarios of economic recovery prepared by ECLAC will have corresponding impacts on the upturn of the employment rate. As the most likely scenario is a slow and gradual recovery, it may be supposed that the level of employment (especially wage employment) will also recover slowly.

Fiscal policy has been the most important tool used by the countries of the region to respond to the economic and social effects of the pandemic. This has been reflected in measures aimed at tax relief, public spending and liquidity for the production sector, which have influenced the evolution of the public accounts in 2020. As the region begins to overcome the effects of the pandemic, it will be essential to maintain and deepen an active fiscal policy stance capable of underpinning economic recovery and establishing the conditions for progressing towards transformative and sustainable development over the medium term. For this, it will be necessary to develop fiscal policy sustainability frameworks centred on expanding fiscal capacity in the countries of the region, by strengthening revenues progressively and efficiently, and making public spending more efficient, effective and equitable.

Central government public revenues have also been affected by the economic crisis stemming from the COVID-19 pandemic. In Latin America, public revenues were 13.1% of GDP on average for the period January–September 2020, compared to 13.6% of GDP in the year-earlier period. The contraction was steeper in the Caribbean, with total revenues down to 12.4% of GDP in the first six months of 2020 compared with 13.2% in the prior-year period. However, the impact of the crisis varied markedly across the different sources of revenues.

The contraction in tax revenues has been the main source of the downturn in total central government revenues both in Latin America and in the Caribbean. The suspension of economic activity and the sharp drop in private consumption have seriously undermined tax collection, and this has been exacerbated in some countries by tax-relief measures implemented to support household and business liquidity. However, the tax take began to improve from June onward, especially in value added tax. This upturn could come under threat, however, depending on how the pandemic evolves.

By contrast, revenues from other sources —non-tax revenues, capital receipts, grants and other categories— have shown opposing trends in Latin America and in the Caribbean. The rise in revenue from other sources in Latin America, which chiefly reflected non-recurring revenue in some countries, somewhat mitigated the fall in tax income. However, this performance has not been widespread and the petroleum revenues of the crude oil exporting countries have seen heavy declines, which could worsen depending on how international prices evolve. In the Caribbean, the contraction in tax revenues was worsened by a reduction in other revenues as well, in particular the drop in inflows from citizenship by investment programmes.

4 International Labour Organization (ILO), *ILO Monitor: COVID-19 and the world of work*, sixth edition, 23 September 2020 [online] ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_755910.pdf.

The countries have adopted major fiscal packages to lessen the social and economic impacts of the crisis. These have included a strong component of public spending, reflecting its importance as a tool to protect family well-being and preserve production capacity. As a result, total spending in the region shows a large rise. In Latin America, central government public outlays came to 18.1% of GDP in the first nine months of 2020, as against 15.2% of GDP for the same period in 2019, an increase of 2.9 GDP percentage points. In the Caribbean total spending stood at 14.8% of GDP in the year to June, compared with 12.8% in the same period of 2019, a rise of 2.0 GDP points.

The make-up of the packages adopted has largely determined the evolution of total spending components. Current transfers have been the tool most widely used during the year, reflecting the provision of one-off grants for families, payroll assistance to businesses and financial support for subnational governments and other government institutions to tackle the crisis. Conversely, smaller rises have been registered in payments for goods and services and in interest payments, although the latter also rose substantially in some countries. Capital expenditures —the main fiscal adjustment variable over the past decade— have held steady in GDP terms in the subregional averages.

These trends have affected the fiscal position of the region's countries. The overall central government balance in Latin America stood at -5.0% of GDP on average for the first nine months of 2020, compared with -1.6% for the same period of 2019. This pattern is repeated in the Caribbean, with an overall central government deficit averaging -2.4% of GDP for the year to June, versus a 0.5% surplus for the same period of 2019. Both subregions also posted significant primary deficits.

The deterioration of the fiscal accounts has put strong pressure on the financing needs of most of the countries in the region, which has led to an uptrend in public debt. In September 2020, Latin America's average central government public debt stood at 53.4% of GDP, or 7.4 percentage points higher than at the turn of the year. At the subregional level, central government public debt levels in South America and the group of countries comprising Central America, the Dominican Republic and Mexico rose to 56% and 50.8% of GDP, respectively, in the second quarter of 2020. This meant indebtedness levels higher by 7.4 GDP percentage points in South America and by 7.3 GDP points in the Central America, Dominican Republic and Mexico grouping.

The rise in public debt will translate into heavy pressure on the public accounts, especially in relation to debt servicing, which will represent an additional burden on future budgets. Over the medium term, the region should take steps to prevent public debt from becoming unsustainable. As noted in the *Economic Survey of Latin America and the Caribbean, 2020*,[5] the medium-term fiscal policy sustainability framework should focus on strengthening public revenues and improving the efficiency, effectiveness and equity of public spending.

The central banks in the countries of the region have also stepped up their efforts to sustain aggregate demand and preserve macrofinancial stability. Firstly, this has led to the adoption of expansionary monetary policies, in conjunction with actions by the treasuries, to support domestic aggregate demand. Conventional instruments, such as interest-rate cuts, changes in legal reserve ratios and the strengthening of mechanisms to promote financial intermediation, have been complemented by less conventional mechanisms, such as outright purchases by central banks of private and public securities held by financial institutions, and direct financing of the public sector. These policies have resulted in a significant liquidity expansion, alongside a general increase in lending to both the public and the private sectors, but especially in central bank financing for the public sector.

[5] Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2020* (LC/PUB.2020/12-P), Santiago, 2020.

Secondly, macroprudential regulations have also been adapted to preserve the stability of the financial system and the proper functioning of the payment system, and to lessen the impact of systemic risks on the performance of the region's economies. Central banks have stepped up their interventions in foreign-exchange markets and have modified reserve requirement ratios for deposits, especially those denominated in foreign currency. Currency swap arrangements have been set up with central banks outside the region, and credit lines with international organizations have been activated. Some central banks have also strengthened capital controls, in order to soften the impact of the volatility experienced by financial flows to and from the region in 2020.

In this context of robust monetary stimulus and faltering economic activity, lending rates have tended to fall in most of the region's economies, except in the dollarized countries, and in the non-Spanish-speaking Caribbean economies with fixed exchange rates. In those cases, lending rose in the reporting period, reflecting the tighter constraints these countries face in expanding liquidity.

The instability generated on international financial markets by the pandemic, in conjunction with uncertainty on the commodity markets, triggered sharp exchange-rate corrections; and the region's currencies fluctuated widely in the first three quarters of 2020. Most of the region's currencies depreciated against the dollar, continuing the trend seen in 2019. In the first 10 months of 2020, the domestic currencies of 17 of the region's economies lost value against the dollar relative to their end-2019 exchange rate, recording an average depreciation of 16.3%.

In order to mitigate exchange-rate volatility, the region's central banks have adopted various foreign-exchange measures, including greater market intervention, through the purchase or sale of foreign currencies, and also through regulations governing financial flows. Brazil, Chile, Colombia, the Dominican Republic, Guatemala, Jamaica, Mexico and Peru all announced an increase in the amounts and scope of currency market interventions. In addition, the authorities have used various instruments to provide foreign-currency liquidity, such as forward contracts and currency swaps.

The growth of international reserves regionwide in 2020 may be attributed to a number of factors, including the contraction in imports, owing to the sharp drop in consumption and investment, together with the recovery of commodity prices in the second half of the year.

The capacity of the region's monetary authorities to protect their currencies in 2020 has also been strengthened by the agreements reached by a number of Latin American central banks with IMF and the United States Federal Reserve System. The emergency loans and grants provided by multilateral organizations, together with borrowing on the voluntary markets by some of the region's countries, have also contributed to the increase in the stock of international reserves. They have also made it possible to finance additional expenditure which, in general, has been used to shore up domestic aggregate demand.

Positive growth is projected for Latin America and the Caribbean in 2021, with a regional average estimated at 3.7%. Generally speaking, however, these rates reflect a significant statistical rebound effect —3.1 percentage points of that projection— coming after the heavy fall in economic activity in 2020. What is more, that 3.7% growth would mean regaining only 44% of the GDP loss seen in 2020.

The 2021 projections are naturally subject to change, given the uncertainty surrounding several factors next year. First, it is assumed that vaccination against COVID-19 could begin in the region in 2021, with the economic impact of that process starting to be felt in the second half of the year. However, should that assumption fail, the region's growth could underperform the projections made.

In second place, the projections implicitly assume that the central banks of the major economies will maintain an expansionary monetary policy, which would sustain dollar liquidity globally and boost growth in the respective economies. Premature monetary tightening and withdrawal of fiscal stimulus could truncate the recovery in the large economies, with the consequent adverse impacts on the region through trade and the other channels through which external shocks are transmitted. At the regional level, it is also expected that monetary stimuli will remain in place and that fiscal stimuli will not be withdrawn prematurely. Otherwise, the expected recovery in activity could stall. Resurgent inflation could be a constraint for some countries, along with potential volatility on financial markets.

Third, the growth projections for 2021 do not envisage a worsening of global financial conditions on the same scale as in the first quarter of 2020. On the contrary, they assume financial conditions similar to those prevailing in the second half of 2020, when the countries have generally been able to obtain financing on favourable terms.

However, a worsening financial panorama for the emerging countries, involving a sudden stop in new financing —or in the rollover of previous loans— could pose a major problem for many economies in which debt ratios have risen to cope with the pandemic. Moreover, potential currency depreciations —in a context of reduced risk appetite— would put pressure precisely on countries with higher levels of foreign-currency-denominated debt.

Fourth, commodity prices have been assumed to increase in 2021 in line with the forecasts made by specialized institutions (as discussed in the section on the international context). Should this forecast not be borne out, the countries of South America —a net commodity exporting subregion— would suffer a negative shock to their income levels and growth prospects.

Finally, the scars left by the most severe crisis in decades, with rising levels of unemployment, poverty and inequality, could accentuate latent social tensions, which would have repercussions for the recovery of the countries' economic activity. Moreover, on the international front, geopolitical tensions, including technological and trade frictions between countries, could upset the international context in which the region operates and, hence, undermine its economic performance and prospects.

As noted earlier, before the COVID-19 pandemic the region was already experiencing low growth rates and showing growing social and macroeconomic vulnerabilities. This, added to the highly simultaneous external and domestic shocks and supply and demand shocks, makes it likely that demand will be slow to recover and that the economic and social costs of this crisis could continue to mount throughout 2021. In its report *Economic Survey of Latin America and the Caribbean, 2020,* ECLAC projected a scenario in which growth rebounded in the region in 2021 then returned to its average growth trajectory of the past decade, 1.8%. In this scenario, the level of GDP of 2019 would be regained in 2024. However, if growth returns to the average rate of the past six years, including the rebound in 2021, it would take more than a decade to bring GDP back to its 2019 level.

For these reasons, underpinning a recovery and placing the region on a path towards sustainable development will require active fiscal and monetary policies capable of driving not only growth, but also social inclusion and universal social protection. In combination with this, industrial policies will be needed to support productivity gains while also meeting the technological and environmental challenges that face the productive structure in the countries of the region.

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