

REGIONAL ECONOMIC OUTLOOK

WESTERN HEMISPHERE



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DEPARTMENT

Outlook for Latin America and the Caribbean

OCTOBER 2021

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Prospects

Key Messages

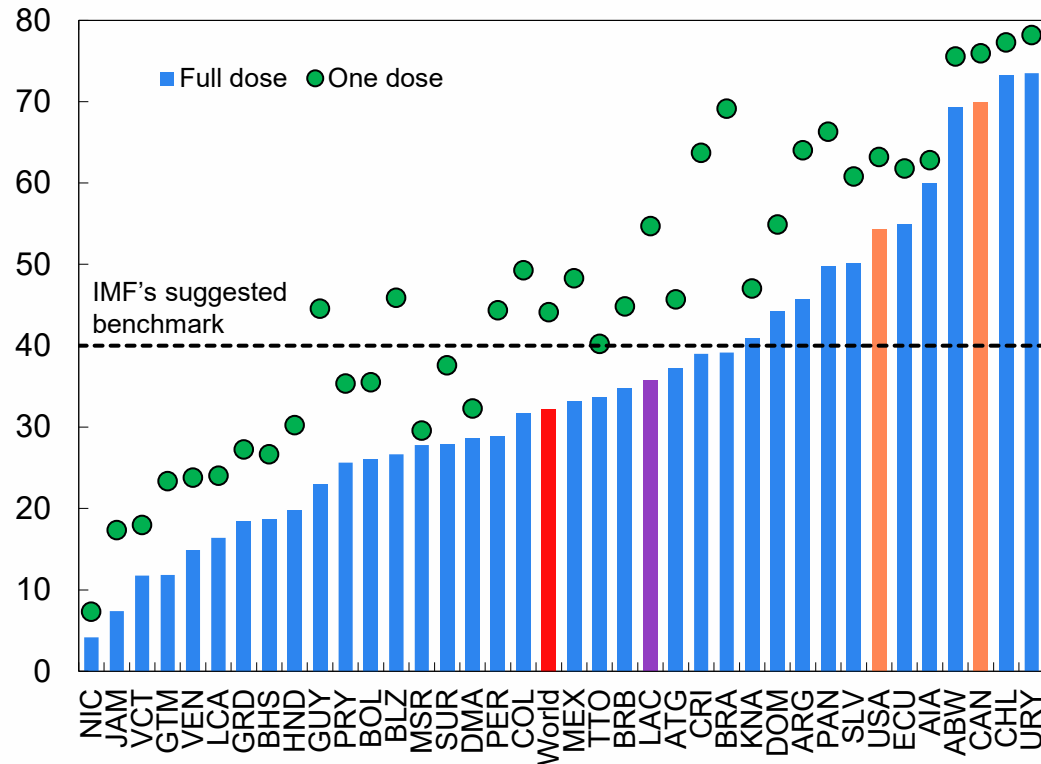
- **A race between vaccinations and variants**
- **Slow and uneven recovery of employment**
- **Monetary policy having to respond to anchor inflation dynamics**
- **Public debt dynamics necessitating withdrawal of fiscal support**
- **Policy contraction implies a heavy reliance on a private-sector recovery**
- **Limited policy space and social pressures exacerbate vulnerabilities**

Rising vaccination rate but pandemic still taking a heavy toll

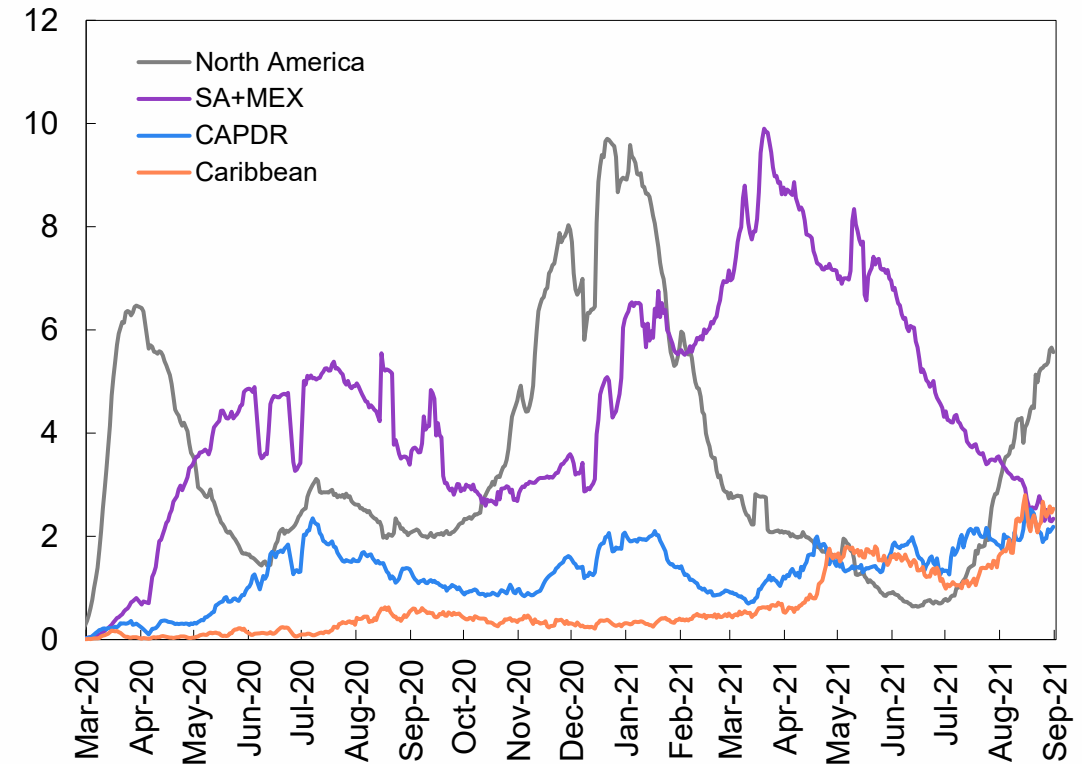
Rapid vaccination campaigns in some LAC countries...

... have helped mitigate the impact of the pandemic, with new deaths per million declining in SA+MEX though still high

Share of People Vaccinated Against COVID-19
(Percent; as of September 23, 2021)



New COVID-19 Deaths per Million
(7-day moving average; as of September 23, 2021)



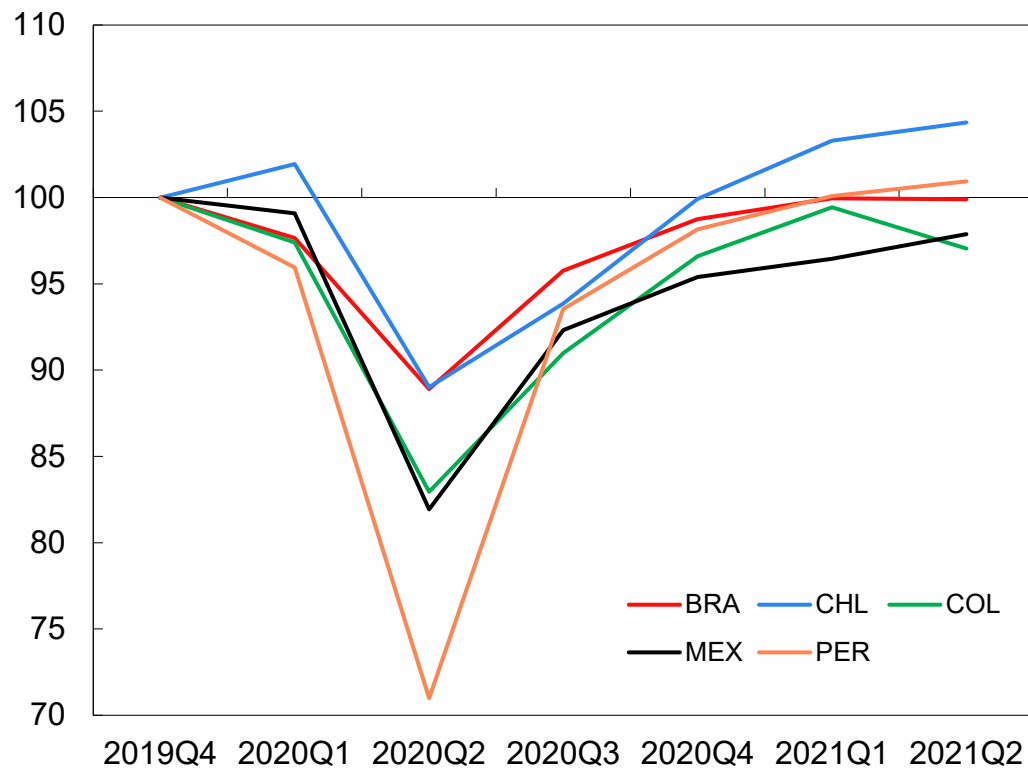
Sources: Johns Hopkins University; Our World in Data database; and IMF staff calculations.
Note: Forty percent suggested benchmark comes from the IMF Staff Discussion Note on "A Proposal to End the COVID-19 Pandemic" by Ruchir Agarwal and Gita Gopinath.

Sources: Johns Hopkins University; Our World in Data database; and IMF staff calculations.

Fast rebound of demand, upswing in inflation

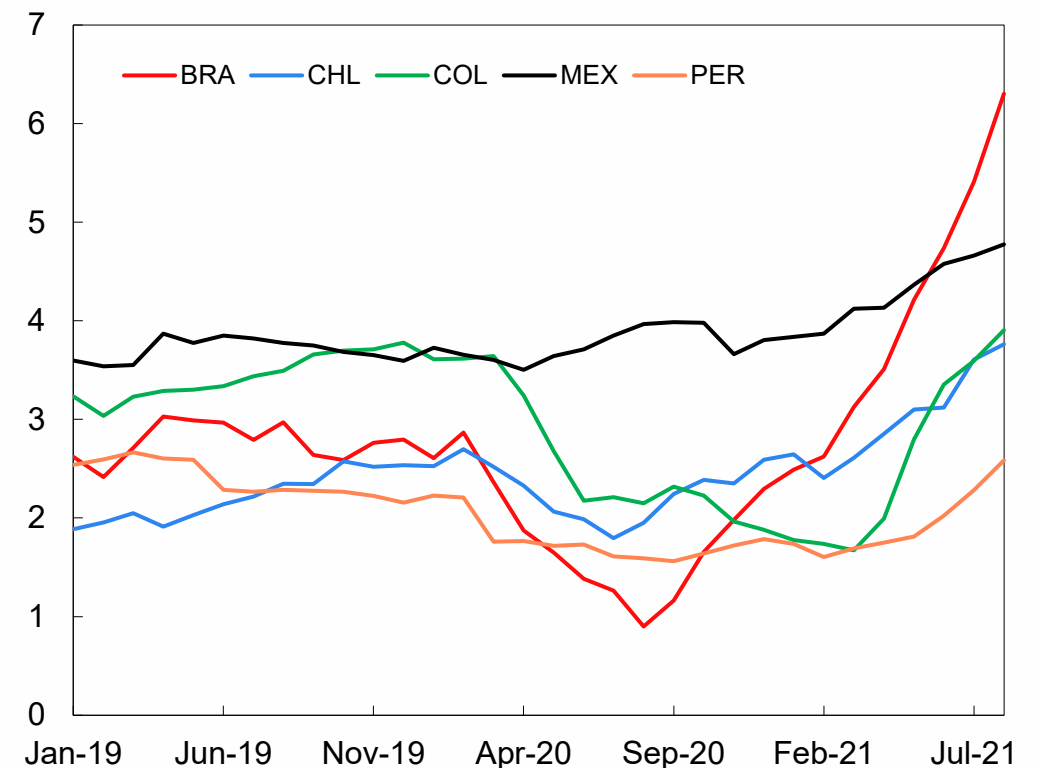
Rapid recovery in CHL/PER on the back of strong private consumption; recovery in Brazil and Peru supported by rebound in investment

Real GDP
(Index: 2019Q4 = 100)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: LA5 is purchasing-power-parity GDP-weighted average of Brazil, Chile, Colombia, Mexico, and Peru.

Core Inflation
(Year-over-year percent change)

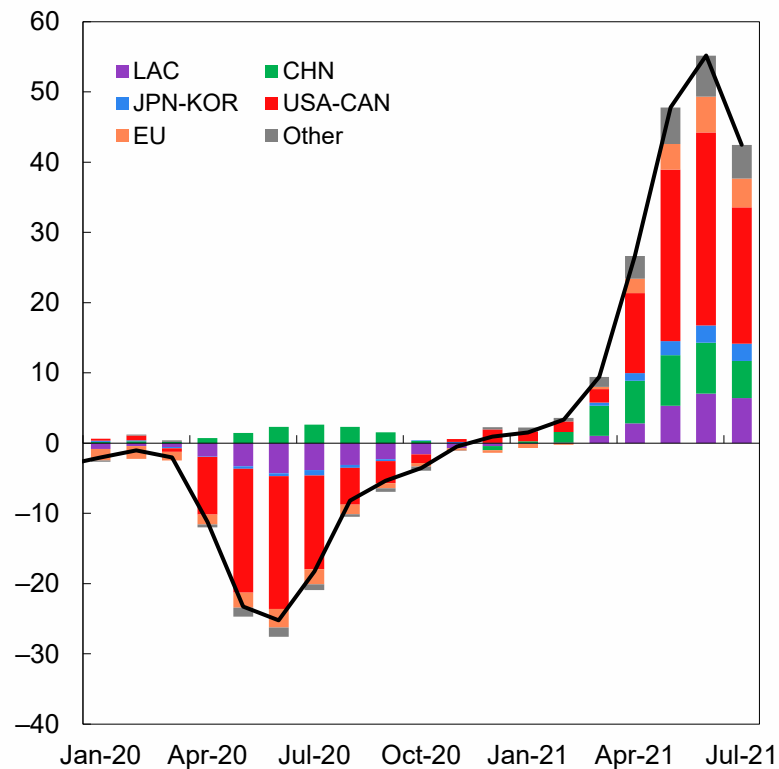


Sources: Haver Analytics; and national authorities.
Note: Peru refers to Lima.

Supportive external conditions

The recovery in trading partner growth (US/China), ...

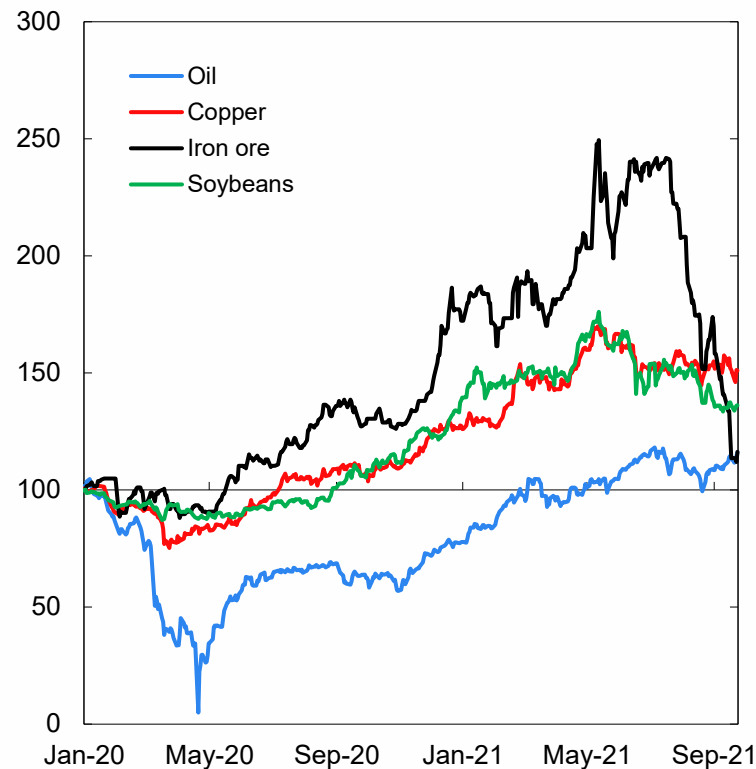
Contributions to Merchandise Exports Growth
(3-month moving sum; year-over-year percent change)



Sources: Haver Analytics; national authorities; and IMF staff calculations.
Note: Includes Argentina, Brazil, Chile, Colombia, Mexico, and Uruguay.

... commodity prices (now abating), ...

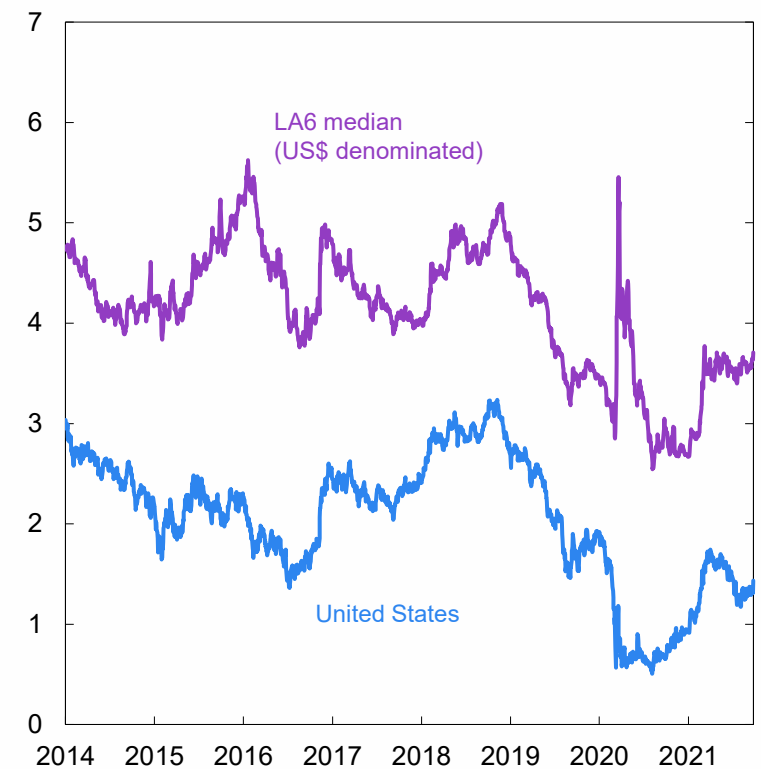
Commodity Prices
(Index: January 1, 2020 = 100)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: Oil prices refer to the average petroleum spot prices: Brent, West Texas Intermediate, and Dubai Fateh.

... and favorable financing conditions (now tightening) have created tailwinds for LAC

Ten-year Government Bond Yields
(Percent)

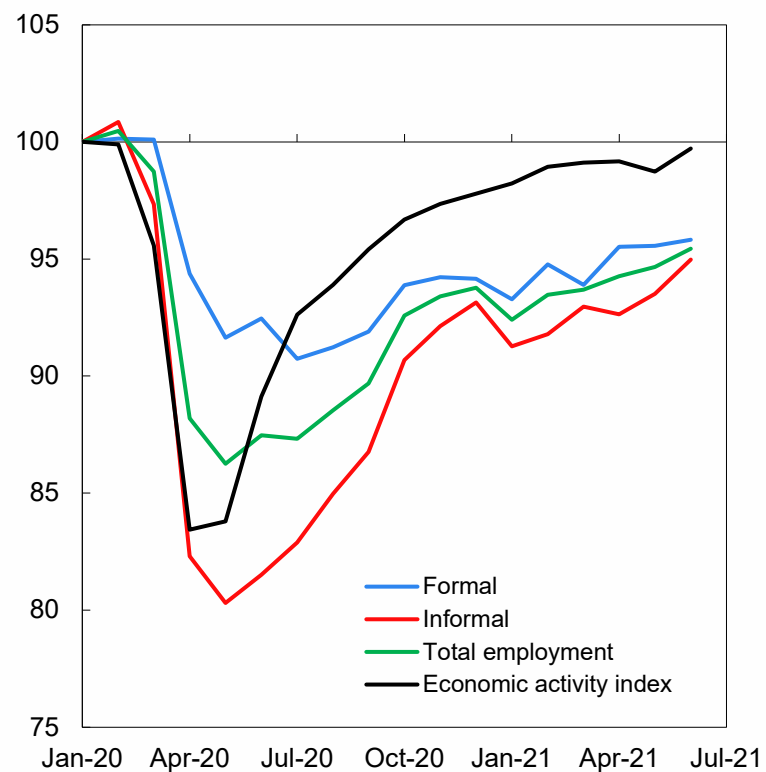


Sources: Bloomberg Finance, L.P.; Haver Analytics; and IMF staff calculations.
Note: LA6 = Brazil, Chile, Colombia, Mexico, Peru, Uruguay.

Pandemic continues to exert uneven impact on labor markets

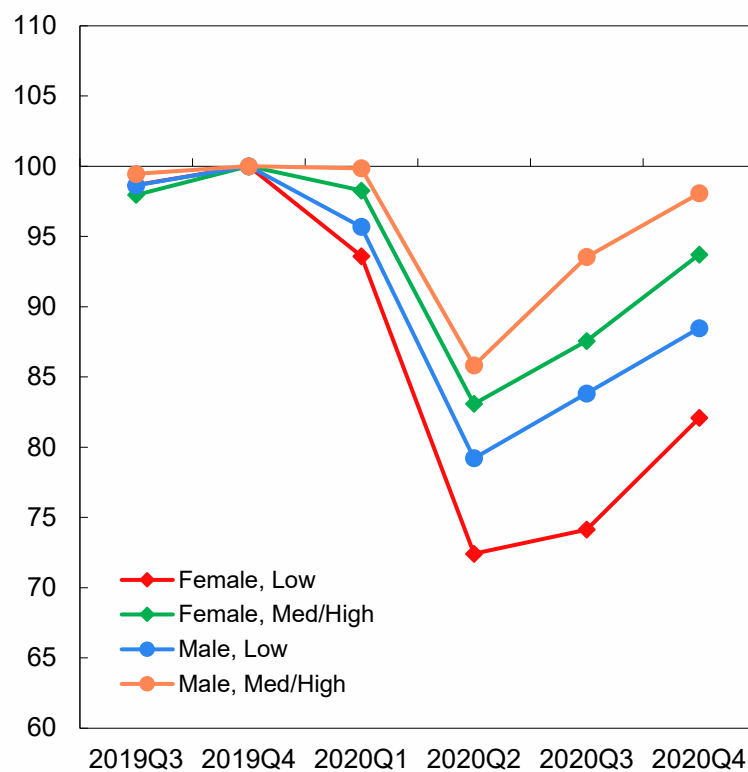
The recovery in the labor market has been lagging that in activity...

LA4: Employment and Economic Activity Index
(Index: January 2020 = 100)



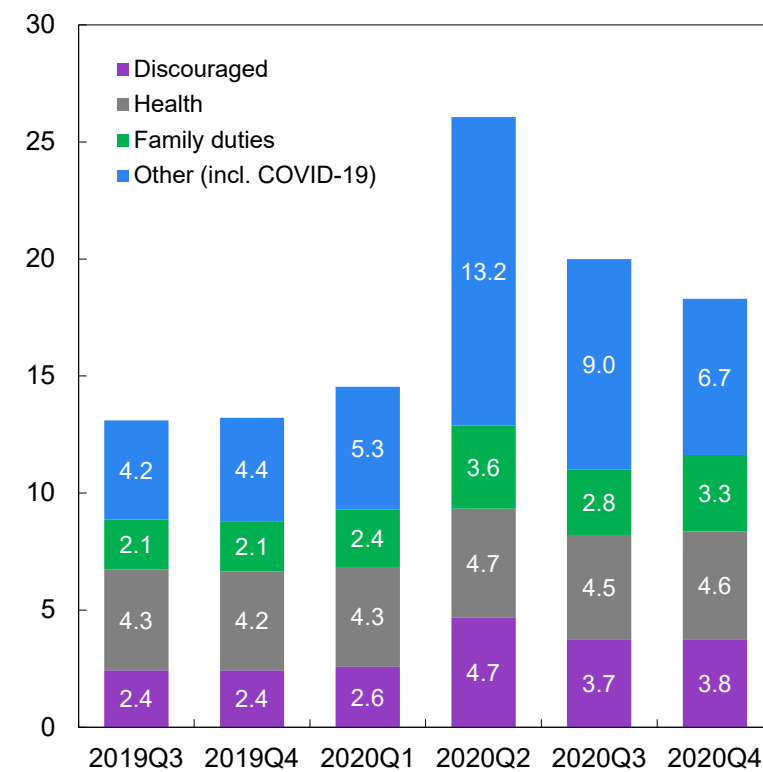
... with the disproportionate impact on female and less-educated workers, ...

LA5: Employment by Gender and Education
(Index: 2019:Q4 = 100)



... with the main reason behind labor inactivity being concern about the pandemic

LA5: Reasons for Labor Force Inactivity
(Male; millions)



Source: Haver Analytics; national authorities; and IMF staff calculations. Note: Includes Brazil, Chile, Colombia, and Mexico. Employment is labor force-weighted average; data for Brazil and Chile are three-month moving averages as reported by the authorities. Economic activity is purchasing-power-parity GDP-weighted average.

Sources: National authorities; and IMF staff calculations. Note: LA5 = Brazil, Chile, Colombia, Mexico, Peru.

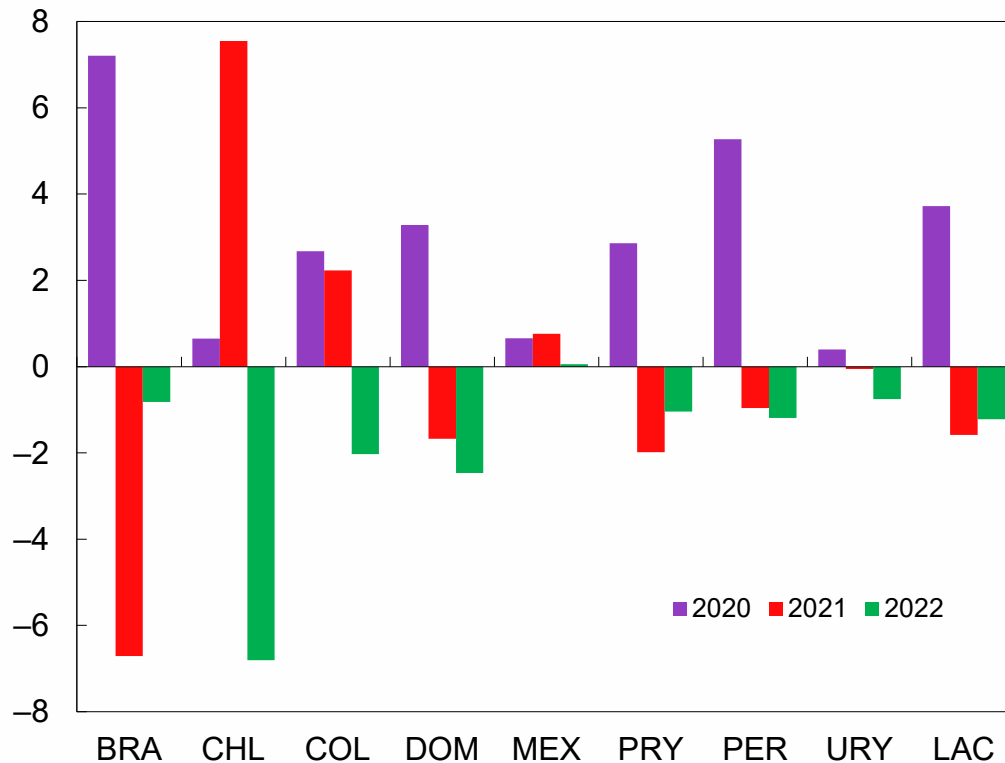
Sources: National authorities; and IMF staff calculations. Note: LA5 = Brazil, Chile, Colombia, Mexico, Peru.

Ongoing or imminent withdrawal of policy support

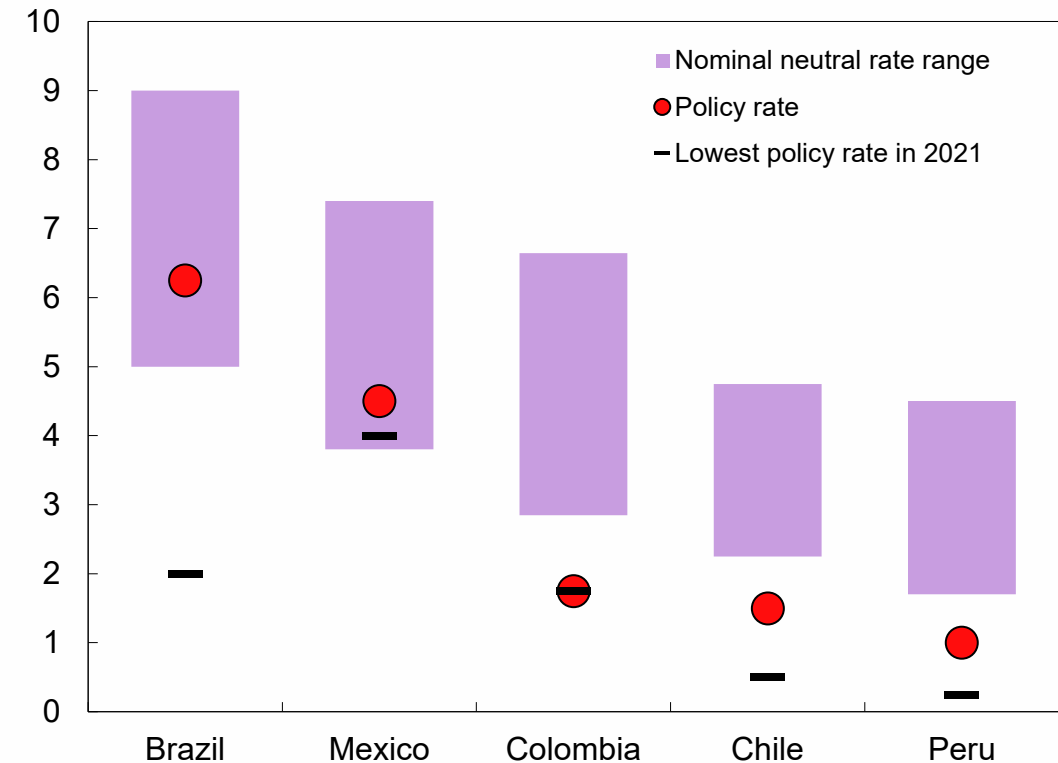
Large fiscal stimulus in BRA, DOM, PRY, and PER is expected to be largely withdrawn; still large fiscal stimulus in CHL, COL in 2021

Monetary policy has been accommodative in most LA5 countries though the tightening cycle has started

General Government Fiscal Impulse
(Percentage points of GDP; +/- = loosening/tightening)



Nominal Neutral and Policy Rates
(Percent)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Defined as the change in structural primary deficit. Chile refers to the change in structural non-mining primary balance. Colombia refers to the consolidated public sector's change in structural non-oil primary balance.

Sources: Consensus Economics; Haver Analytics; national authorities; and IMF staff calculations following (Magud and Tsounta, 2012).

A heterogenous recovery across the LAC region

Latin America and the Caribbean: Real GDP Growth
(Year-over-year percent change)

	Year of return to		Projections				
	End-2019 level	Pre-COVID trend	2019	2020	2021	2022	Avg. 2023–26
Latin America and the Caribbean	2022	...	0.1	-7.0	6.3	3.0	2.4
LAC excl. Venezuela	2022	...	0.9	-6.7	6.5	3.1	2.5
South America	2022	...	-0.1	-6.6	6.3	2.3	2.3
Argentina	2023	...	-2.1	-9.9	7.5	2.5	2.0
Brazil	2021	...	1.4	-4.1	5.2	1.5	2.1
Chile	2021	2021	1.0	-5.8	11.0	2.5	2.2
Colombia	2021	...	3.3	-6.8	7.6	3.8	3.4
Peru	2022	...	2.2	-11.0	10.0	4.6	3.5
Mexico	2022	...	-0.2	-8.3	6.2	4.0	2.1
CAPDR	2021	...	3.2	-7.1	7.7	4.6	4.0
Caribbean							
Tourism dependent	2024	...	-0.0	-9.5	2.3	4.1	2.2
Commodity exporters	2020	2022	0.4	4.0	5.6	21.1	5.6

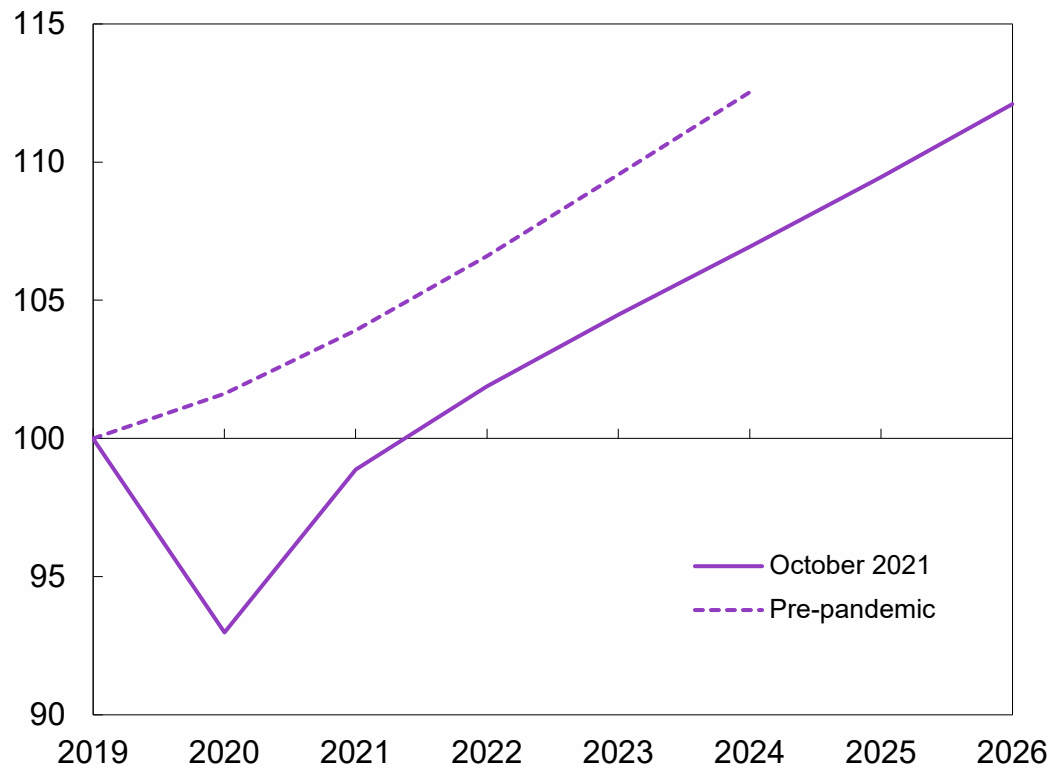
Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: PPP GDP-weighted average. Green/red denotes upward/downward revision compared with the April 2021 World Economic Outlook forecasts.

Long-term negative consequences of pandemic

LAC's real GDP is not expected to return to the pre-pandemic trend...

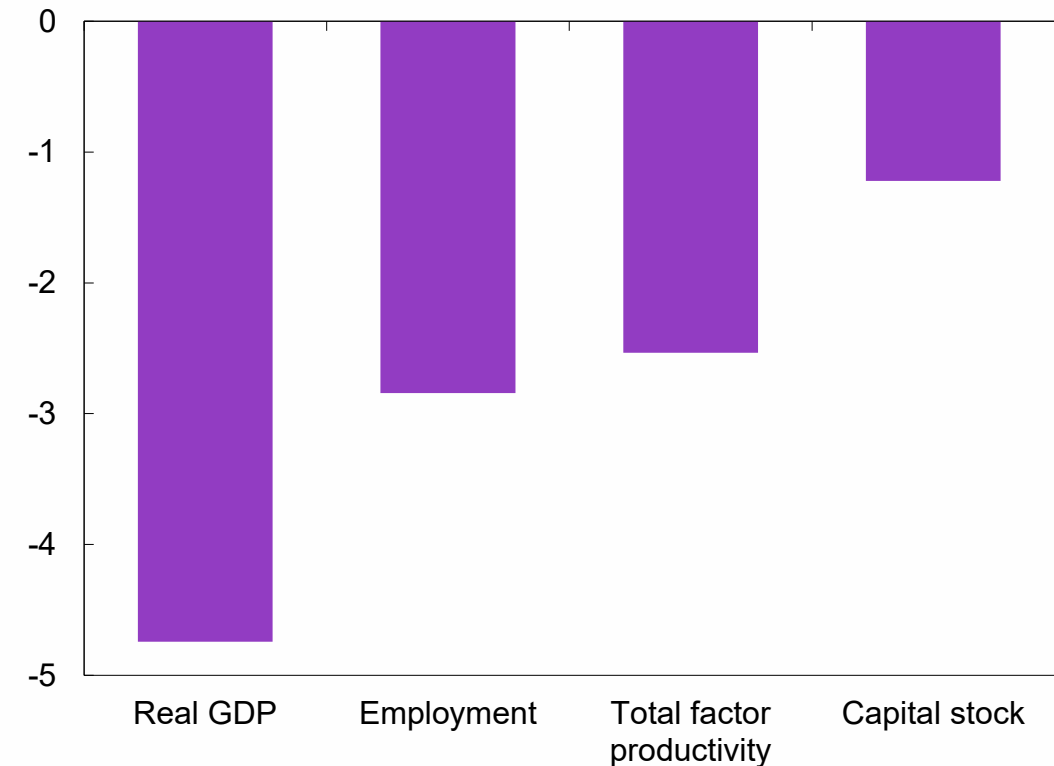
LAC: Real GDP
(Index: 2019 = 100)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Pre-pandemic WEO refers to the January 2020 WEO vintage.

... largely due to expected productivity and employment losses

LA7: Potential Output and Production Factors
Post-pandemic Relative to Pre-Pandemic
(Percent of pre-pandemic projection)

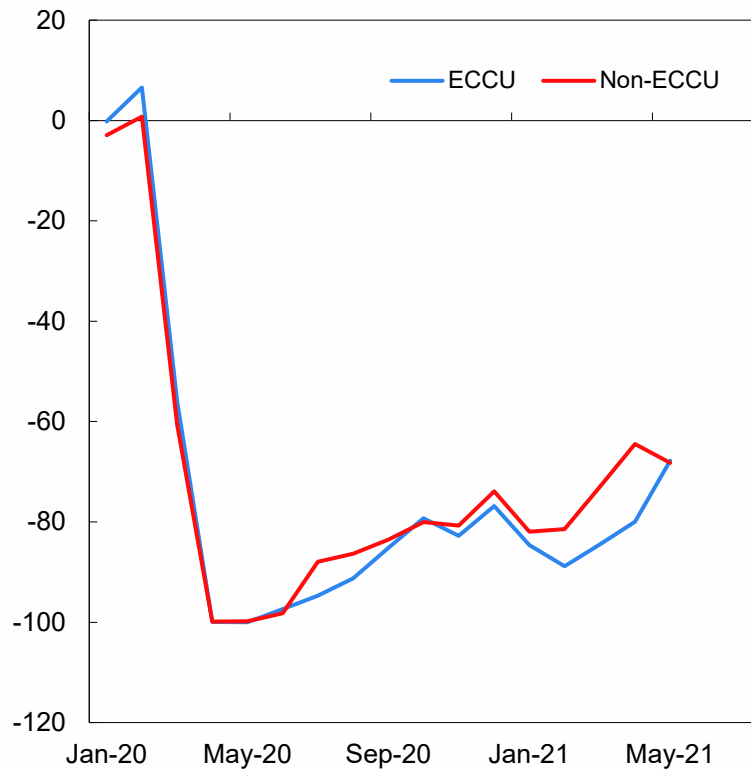


Sources: IMF, World Economic Outlook database; PWT 10.0; and IMF staff calculations.
Note: Comparison of January 2020 and October 2021 WEO projections in 2024. PPP GDP-weighted average of LA7 countries (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay).

Significant concerns about the Caribbean

Tourism recovery in the Caribbean has been slow...

The Caribbean: Total Tourist Arrivals
(Percent change relative to the same month in 2019)

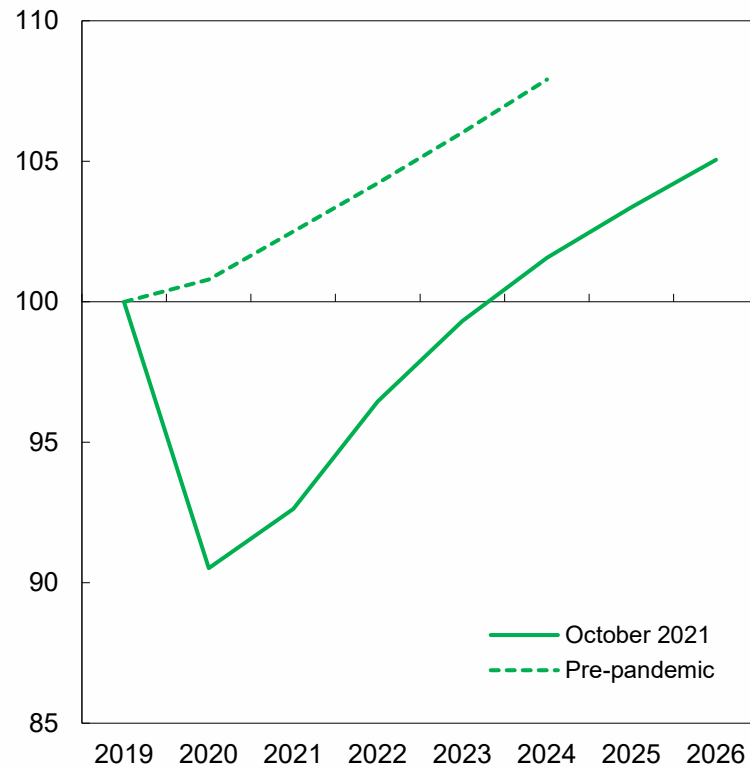


Sources: Caribbean Tourism Organization; Eastern Caribbean Central Bank; and IMF staff calculations.

Note: ECCU (Eastern Caribbean Currency Union) includes AIA, ATG, DMA, GRD, MSR, KNA, LCA, VCT. Non-ECCU includes ABW, BHS, BRB, BLZ, JAM.

... and is expected to continue weighing on GDP recovery going forward...

Tourism-Dependent Caribbean: Real GDP
(Index: 2019 = 100)

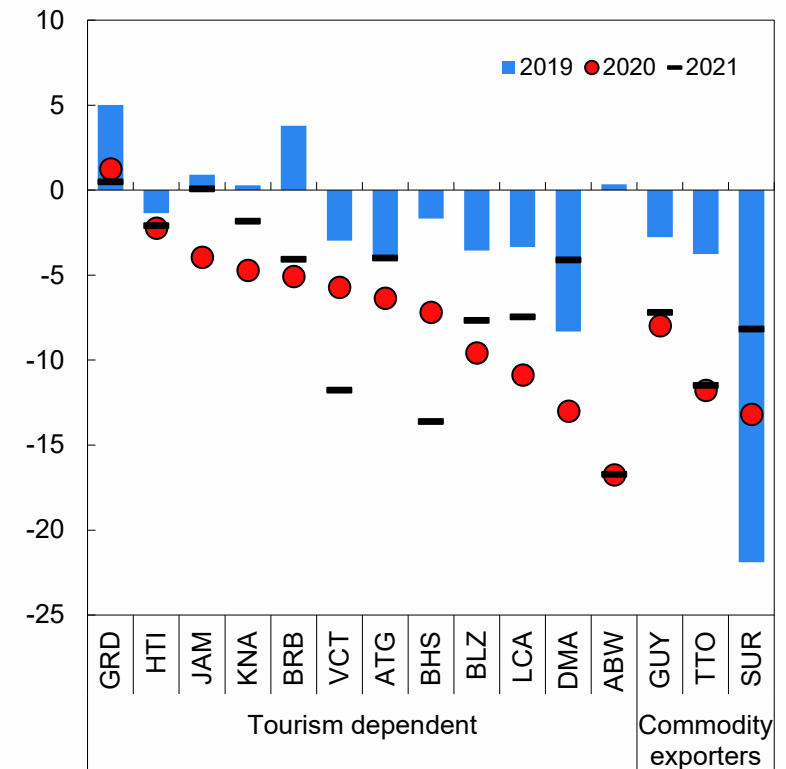


Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Pre-pandemic refers to the January 2020 WEO vintage.

... exacerbating pre-existing fiscal vulnerabilities

The Caribbean: Overall Fiscal Balance
(Percent of GDP)

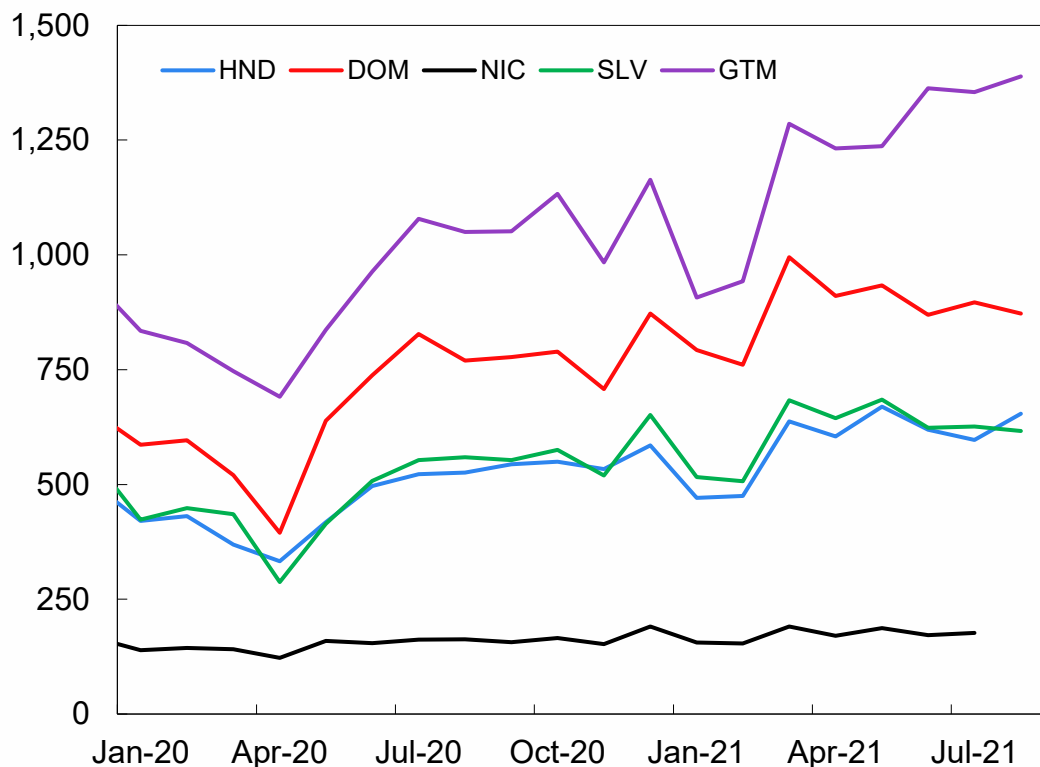


Source: IMF, World Economic Outlook database.

Positive spillovers from US supporting Central America

Strong remittances growth, ...

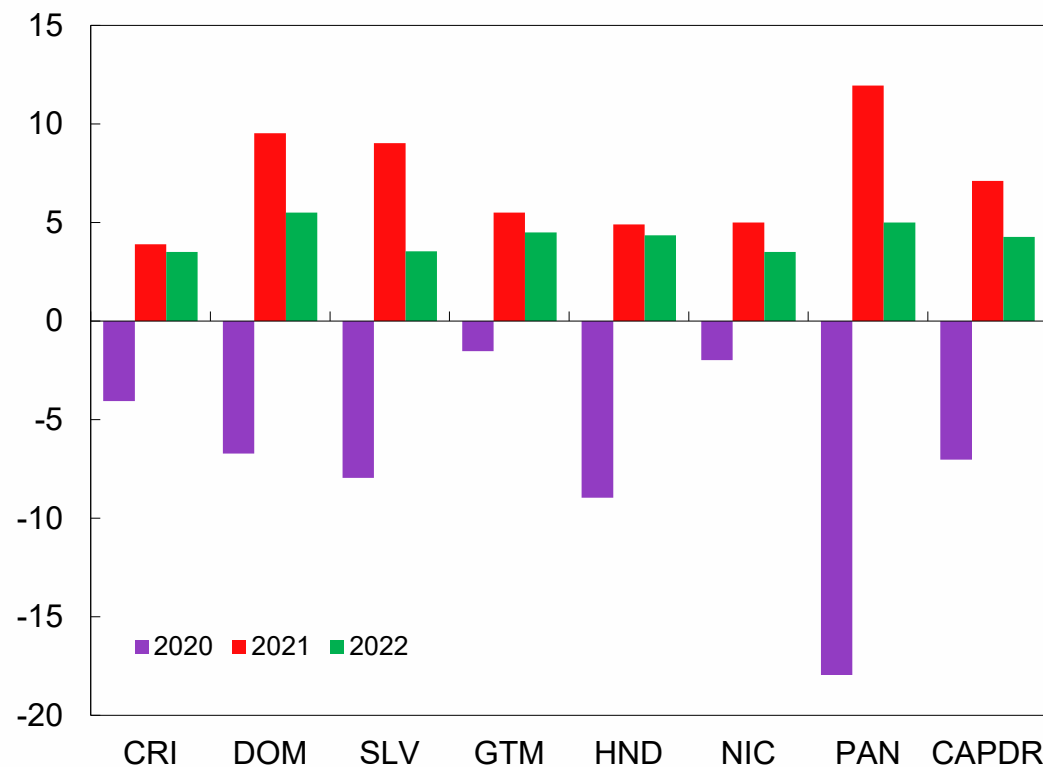
CAPDR: Remittances
(Millions of US dollars)



Sources: Haver Analytics; national authorities; and IMF staff calculations.

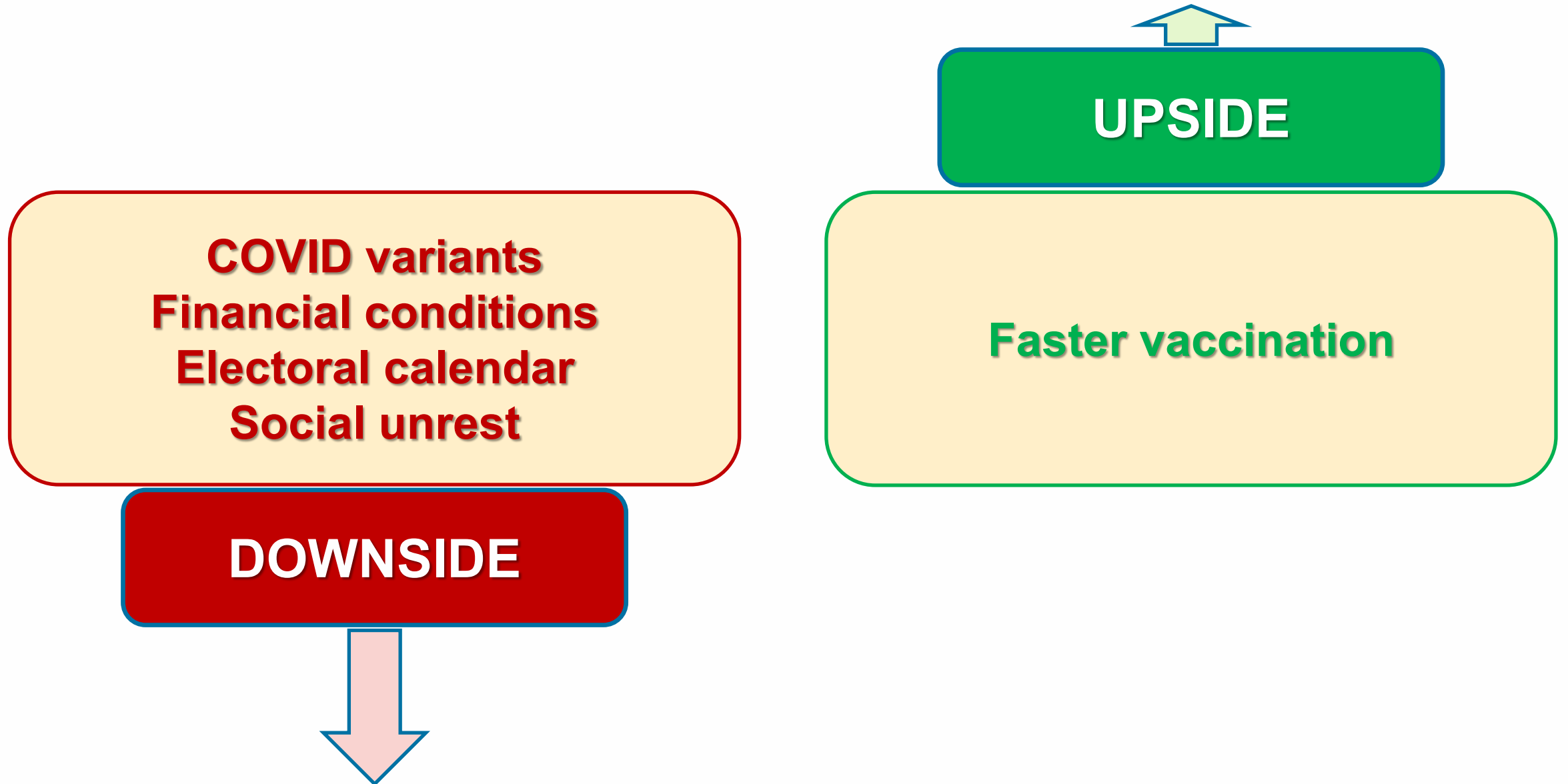
... combined with strong exports growth to the U.S. will continue supporting growth in CAPDR in 2021

CAPDR: Real GDP Growth
(Year-over-year percent change)



Source: IMF, World Economic Outlook database.

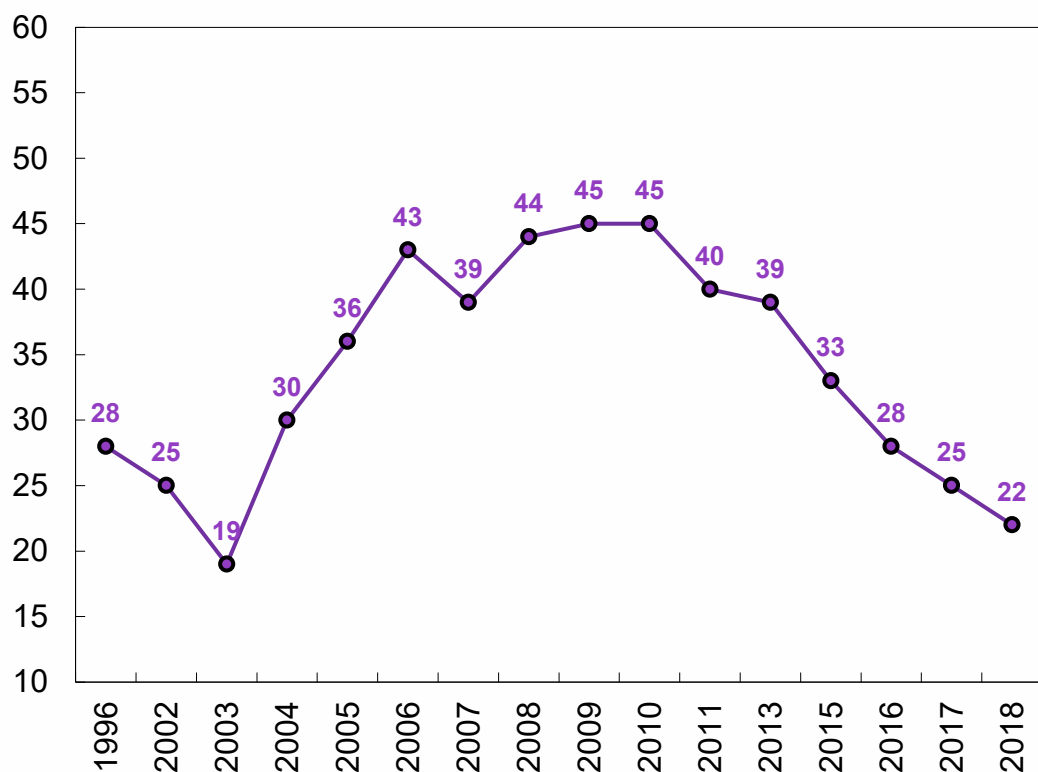
Risks are tilted to the downside



Potential for social impact of pandemic feeding into unrest

Even before the pandemic, trust in government in LAC was eroding...

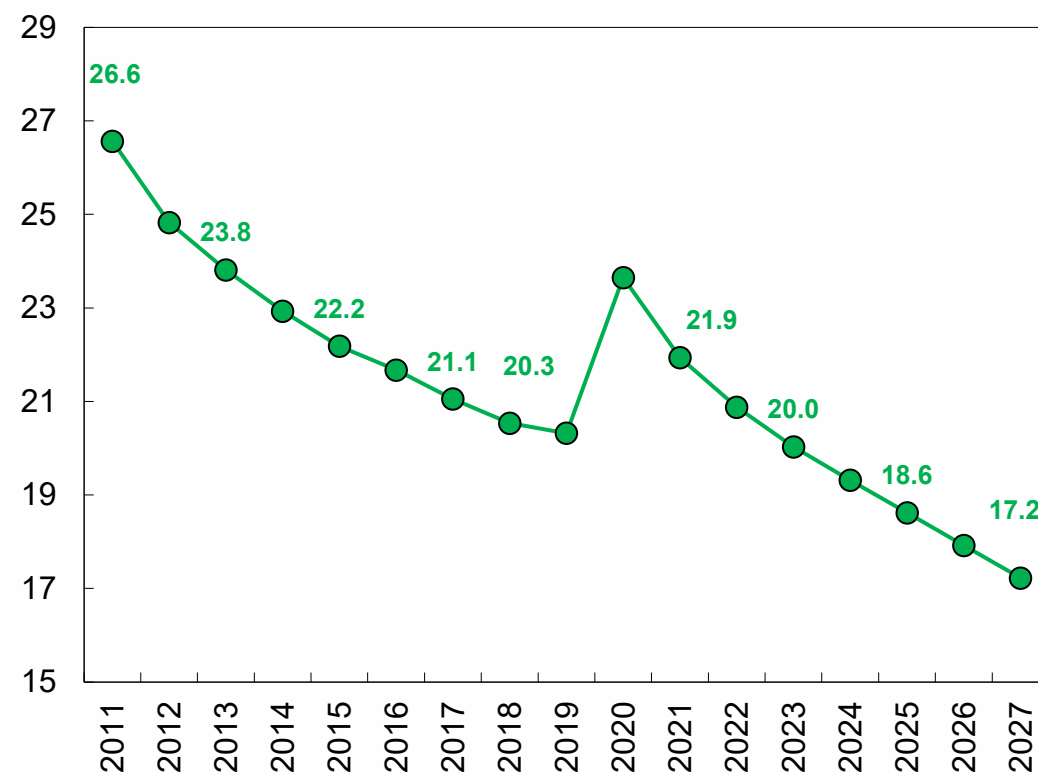
LAC: Confidence in Government
(Percent)



Source: Latinobarometro.

... and the pandemic is estimated to have increased poverty significantly, reversing the gains over the past 8 years

LAC: Poverty Ratio
(Share of population; \$5.5 threshold)



Sources: IMF, World Economic Outlook database; World Bank, World Development Indicators database; and IMF staff calculations.

Policy Priorities

Key Messages

- **Public health measures to contain the pandemic**
- **Policy rate increases may be needed to anchor inflation dynamics**
- **Targeted fiscal support within credible MT frameworks is needed**
- **Reshaping direct taxes would help**
- **Diversified approach to both climate mitigation and adaptation**

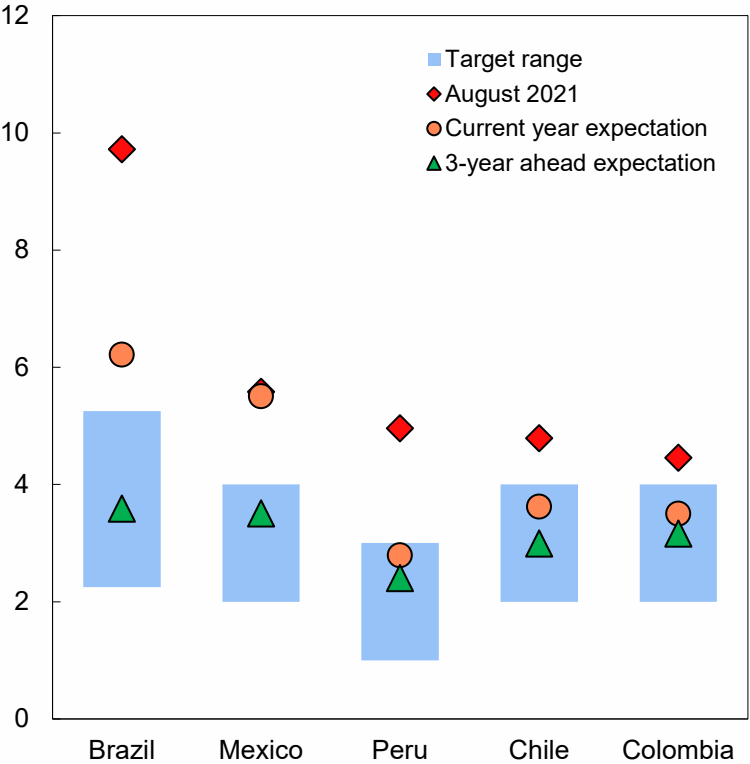
To anchor expectations may require increases in policy rates

While expectations remain well-anchored, inflation is outside the target range ...

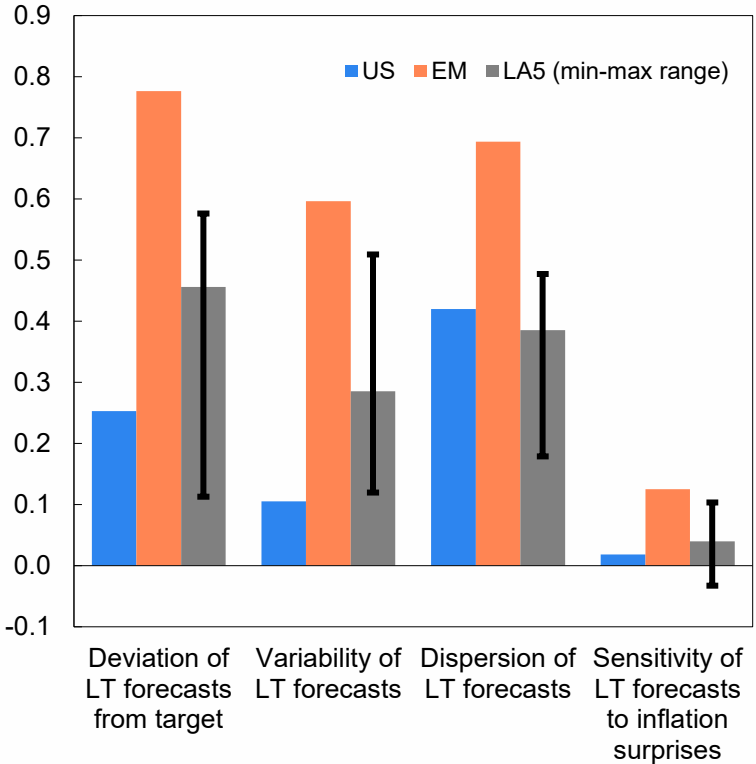
... and LA5 central bank credibility falls short that of the US Fed though higher than that of EMs on average

Market expectations point to additional rate hikes this and next year

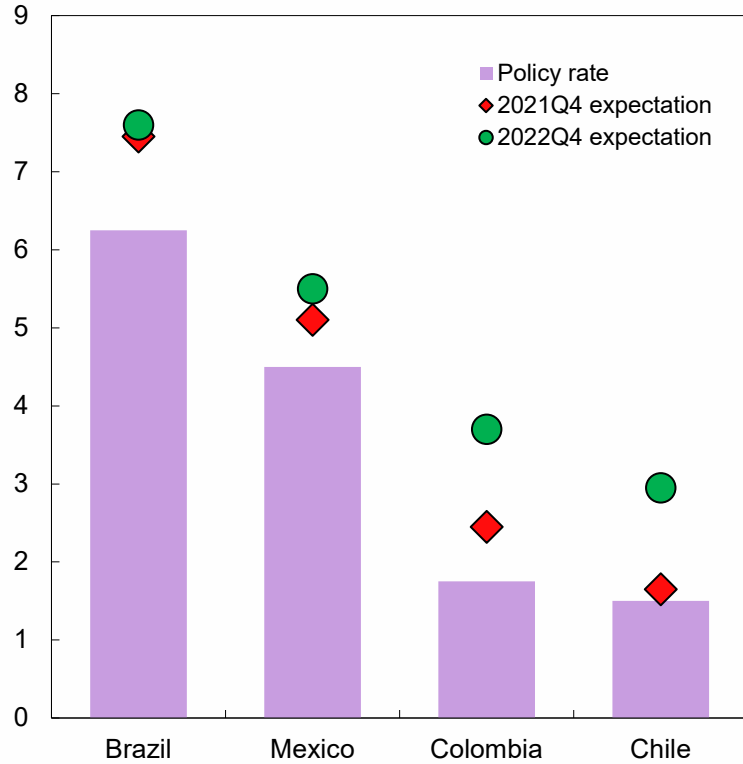
Inflation
(Year-over-year percent change)



Inflation Expectations Anchoring, 2011–21
(Index; lower means better anchored)



Policy Rates and Expectations
(Percent)



Sources: Consensus Economics; Haver Analytics; and national authorities.

Sources: Consensus Economics; national authorities; and IMF staff calculations.
Note: EM = emerging markets; LT = long term.

Sources: Bloomberg Finance L.P.; Haver Analytics; national authorities; and IMF staff calculations.
Note: Expectations refer to the Bloomberg weighted average.

Targeted near-term fiscal support with a framework for deficit reduction over the medium-term

Brazil:

- A positive to extend the targeted cash transfers into 2021
- Going forward, pace of consolidation should be guided by existing fiscal rules

Chile:

- Withdraw fiscal stimulus, while targeting support to the most vulnerable
- Put in place a consolidation plan guided by the fiscal rule

Colombia:

- Prioritize public investment and social spending as the planned consolidation proceeds
- Over the medium term, further tax reform will be needed to durably raise additional revenues

Mexico:

- Scope for additional spending on social safety nets, education, health, and quality public investment
- Over medium-term, a comprehensive tax reform that permanently raises revenues

Peru:

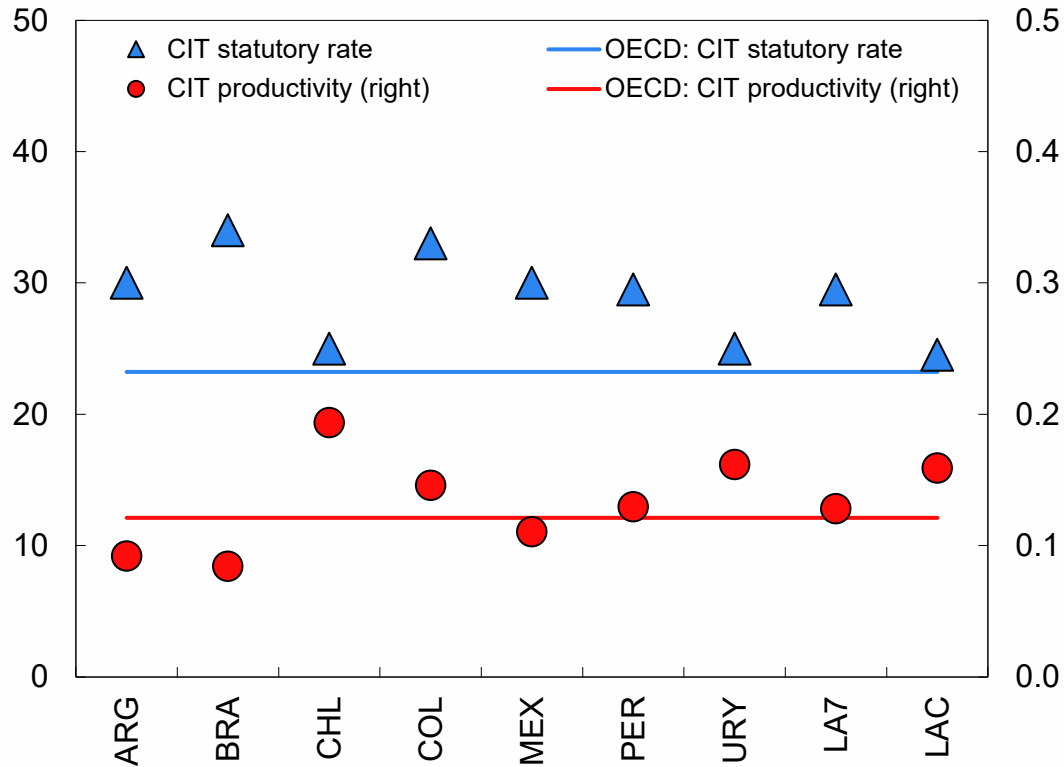
- Continue to gradually remove the fiscal stimulus by raising tax revenues while accelerating high-quality investment and maintaining support for households
- Identify a realistic path and the necessary measures to support a return to the fiscal rules

Significant scope to redesign direct taxes

LA7 statutory CIT rates are much higher, while CIT productivity in the three largest economies is lower than peers and OECD average, pointing to significant base erosion

Eliminating deductions and adding an EITC substantially increases PIT revenues while reducing inequality in LA5

Statutory Rates and Productivity, 2019
(Percent)



LA5: Micro-simulations of PIT Reforms, 2019
(Percent)

Scenario	Revenue change relative to baseline	Average effective PIT rate		Gini change relative to baseline
		All tax payers	Top 10% of earners	
Baseline	...	4.3	9.2	...
No deductions	137	6.1	14.3	-1.6
No deductions + EITC	106	6.2	14.3	-3.6

Sources: IMF, World Economic Outlook database; OECD Tax Revenue Statistics database; Tax Foundation Corporate Tax Rates around the world; and IMF staff calculations.
Note: Group averages reflect simple average. CIT = corporate income tax; LAC = Latin-America and Caribbean (excluding LA7); LA7 = ARG, BRA, CHL, COL, MEX, PER, URY; OECD = members as of end-2019 excluding LAC countries.

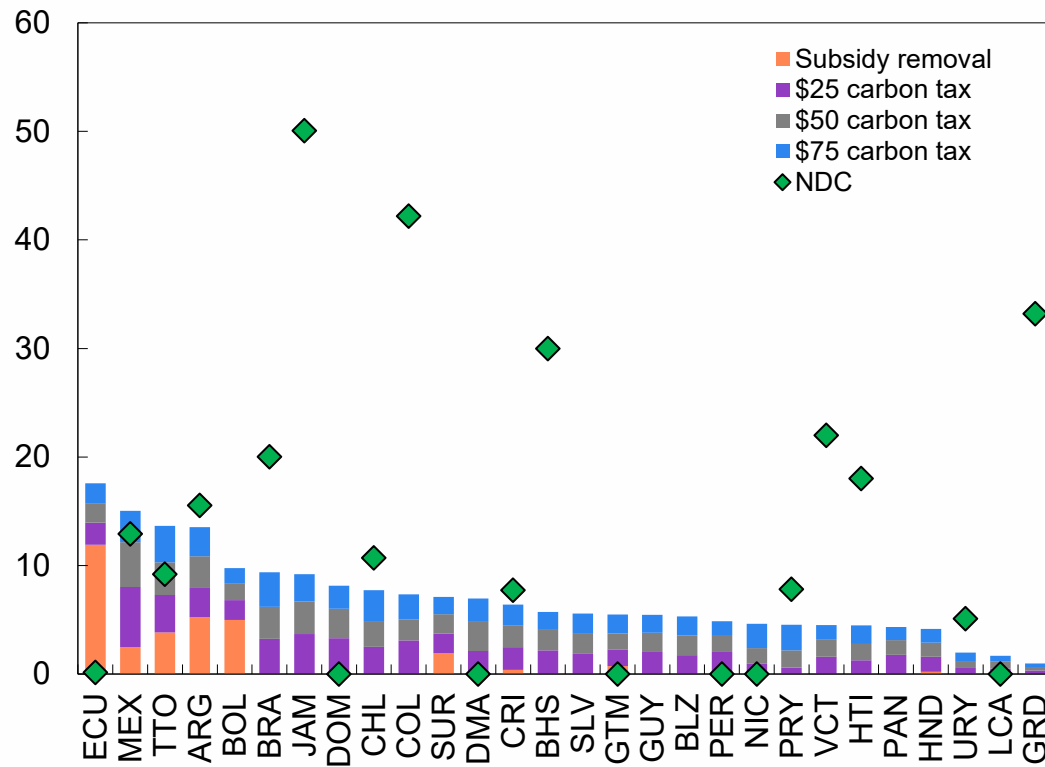
Sources: National household surveys; and IMF staff calculations.
Note: The Gini coefficient and the income percentiles are based on the distribution of labor earnings among formal workers only. LA5 refers to the simple average of Brazil, Chile, Colombia, Mexico, and Peru.

Country-specific responses needed to reduce emissions and build resilience

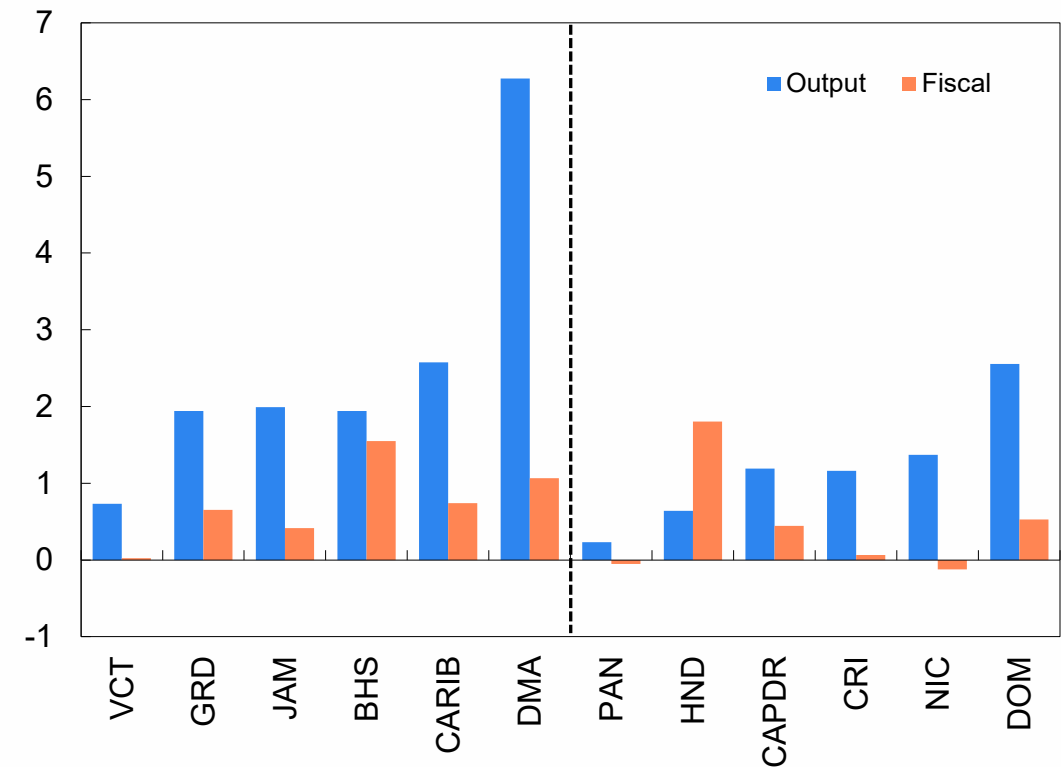
Strong mitigation policy actions are needed to reach LAC's NDCs. They could include carbon taxes, removal of fuel subsidies, feebates, ETS, NbS, and others

Scaling up investment in structural and financial climate resilience could support macroeconomic performance of the economies in the Caribbean and Central America

Reduction of Gross Greenhouse Gas Emissions (excl. LULUCF) from Illustrative Scenario of Subsidy Removal and Carbon Tax (Percent of 2030 BAU)



Output and Fiscal Gains from Resilient Investment (Percent)



Sources: Carbon Pricing Assessment Tool; and IMF staff calculations.
 Note: BAU = business as usual; LULUCF = land use, land-use change, and forestry; NDC = nationally determined contributions.

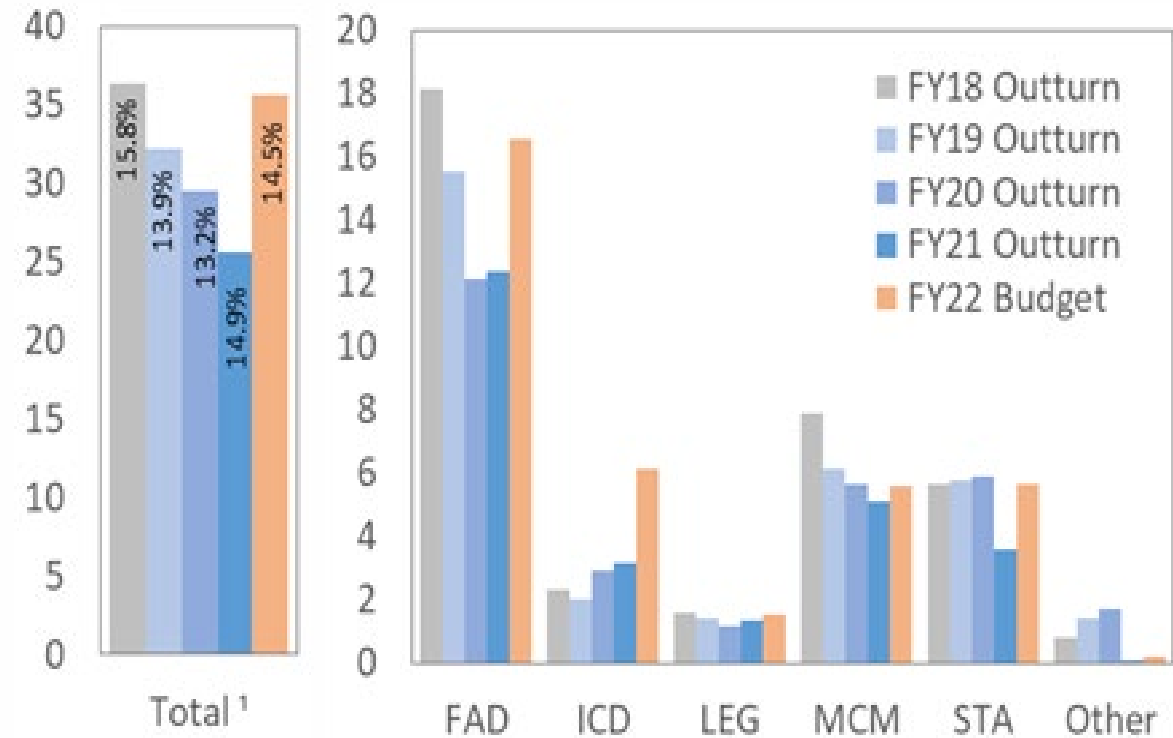
Sources: Caribbean Catastrophe Risk Insurance Facility; EM-DAT; and IMF staff calculations.

Capacity Development

Projected recovery in CD activities to the region, including in new and cross-cutting topics

- ❖ CD delivery fell substantially in FY21, but it is expected to recover in FY22 and over the medium-term.
- ❖ CD in new and cross-cutting topics benefits from acquired expertise and experience:
 - ❖ E.g., CARTAC's PFM, Macroeconomic, and Debt Management programs
- ❖ Upcoming activities in these areas include:
 - ❖ Regional seminars on climate change, financial sector risks, Fintech regulation, use of big data
 - ❖ TA missions on CBDC adoption, digital money legislation

Composition of CD Delivery to WHD Countries
(Millions of US dollars)



¹Percentages refer to WHD share of total direct spending to all area departments.



Thank You