Executive summary

2022

Preliminary Overview of the Economies of Latin America and the Caribbean

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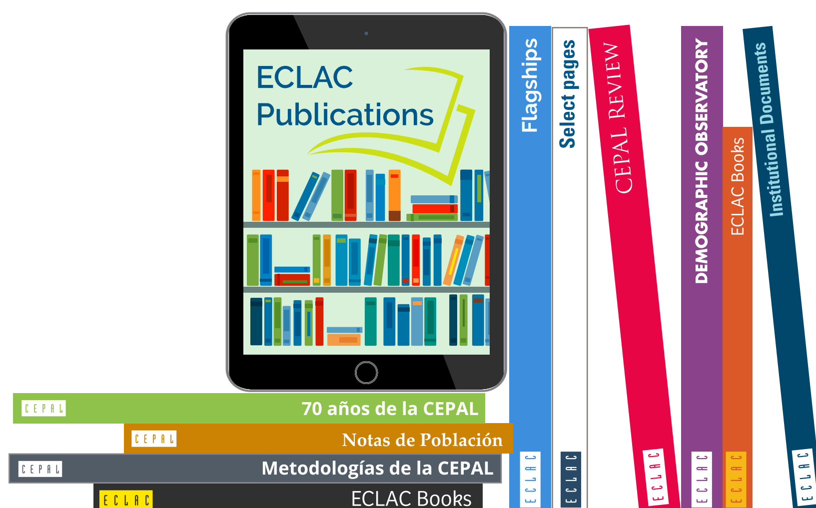

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Preliminary Overview of the Economies of Latin America and the Caribbean

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The *Preliminary Overview of the Economies of Latin America and the Caribbean* is an annual publication prepared by the Economic Development Division of the Economic Commission for Latin America and the Caribbean (ECLAC). This 2022 edition was prepared under the supervision of Daniel Titelman, Chief of the Division, while Ramón Pineda Salazar, Economic Affairs Officer in the same Division, was responsible for its overall coordination.

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

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- Three dots (...) indicate that data are not available or are not separately reported.
- A dash (-) indicates that the amount is nil or negligible.
- A full stop (.) is used to indicate decimals.
- The word “dollars” refers to United States dollars, unless otherwise specified.
- A slash (/) between years (e.g. 2013/2014) indicates a 12-month period falling between the two years.
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Executive summary

Growth in economic activity in 2022 was faster than expected in the first half of the year in Latin America and the Caribbean, but slowed in the second half. This slowdown will continue into 2023, meaning that the growth rate for the coming year will be significantly lower than in 2022.

The sharp slowdown in growth has been accompanied by continued inflationary pressures. Although inflation is not expected to accelerate, it will remain high in 2023, influencing monetary policy measures, especially policy rates in the region. On the fiscal side, although the primary deficit has narrowed, debt levels are still high. Fiscal space may therefore be expected to continue to determine public spending patterns. Added to these macroeconomic complexities are a decline in creation of formal jobs, a rise in informality, stagnation or falls in real wages, drops in investment and growing social demands. All this puts pressure on macroeconomic policy, which must reconcile efforts to promote economic recovery through investment and job creation, on the one hand, and to control inflation and pursue fiscal sustainability, on the other.

Not only is the region's internal situation complex, but the global panorama has continued to deteriorate and growth forecasts for world economic activity and trade have both been cut. Global GDP growth projections have been lowered, primarily in response to the effects of the Russian Federation's invasion of Ukraine. Growth is now expected to be 3.1% at the end of 2022, compared with the rate of 4.4% projected before the war. The slowdown is expected to intensify in 2023, with world GDP growing by 2.6%. Advanced economies are forecast to grow by 0.6% and emerging and developing economies by 3.7%.

Regarding the main trading partners of Latin America and the Caribbean, the United States is expected to grow by 1.9% in 2022, more than 2 percentage points below the forecast before the war. An even sharper slowdown is forecast for 2023, with growth of just 0.7%. For the eurozone, growth of 3.2% is forecast for 2022, as the bloc's activity has proven more resilient than originally anticipated. However, the effects of the war in Ukraine will be reflected more strongly in next year's growth rate, which is forecast to slow sharply to just 0.3% (2.4 points less than forecast before the war). Lastly, in China, growth is expected to be 3.3% in 2022 —the lowest rate in more than four decades— and slightly higher in 2023 (4.4%).

Based on the expected decline in global economic activity, projected world trade volume growth in 2023 was lowered from the figure of 3.4% given in April to just 1.0% in October.

The invasion of Ukraine last February, and the effect this has had on food and energy prices, accentuated inflationary trends that were already apparent in 2021. Producer and consumer price indexes increased across the board in 2022, in some cases hitting levels not seen for decades.

In this context of high inflation and a risk of expectations becoming unanchored, the global monetary policy response has been the most synchronized in several decades, with the largest number of simultaneous policy rate hikes since at least 1970. Among the major central banks, the United States Federal Reserve had raised its policy rate by 375 basis points by November 2022, putting it at 4.0%; the European Central Bank (ECB) set its rate at 1.5% in October; and the Bank of England had raised rates 275 basis points in 2022 to 3.0% by November. In all three cases, further rate hikes are expected until at least mid-2023.

In addition to higher monetary policy rates to reduce available liquidity, since early 2022 major central banks have also been shrinking their balance sheets, which reached unprecedented sizes in 2020 in the context of the crisis of the coronavirus disease (COVID-19) pandemic. For example, the Federal Reserve has adopted a

monetary strategy of quantitative tightening, part of which is reinvesting the principal of maturing long-term treasury bonds only to the extent that they exceed a monthly cap of US$ 60 billion, starting in September 2022. ECB decided to end net bond purchases in July 2022, although it will continue to reinvest the principal of bonds when they mature. The Bank of England began quantitative tightening in early November 2022, when it started selling government bonds.

These restrictive monetary policies caused global liquidity to tighten in 2022. From 2021 to 2022, the growth rate of the money supply fell from 15.8% to 2.07% in the United States, from 6.95% to 5.33% in Japan, from 11.2% to 10.5% in the United Kingdom and from 11.21% to 5.83% in the eurozone.

In recent months, commodity prices in general, and food and energy prices in particular, have been falling. This downtrend is expected to continue in 2023, but the prices of some commodities will nevertheless remain above 2021 levels. Specifically, in 2023 the prices of energy goods are forecast to be over 40% higher than in 2021 and prices for food 11% higher. However, in the case of base metals and minerals, prices are expected to be 17% lower than in 2021.

In addition to energy and food inflation easing, global supply chain disruptions —another of the supply-side factors that drove inflationary pressures from late 2020 onward— have also abated in recent months.

For advanced economies, inflation is projected to close 2023 at 4.4%, while for emerging and developing economies, the projection is 8.1%. Even though these rates are almost 3 and 2 percentage points lower, respectively, than in 2022, they are still much higher than the average rates for the decade prior to the pandemic (2010–2019): 2.0% in advanced economies and 5.1% in emerging and developing economies.

Global financial conditions have tightened, financial volatility has increased in both emerging and advanced economies, equity markets in much of the world have fallen sharply, risk appetite has declined, capital outflows from emerging markets have intensified, and the dollar has appreciated significantly worldwide.

On fixed-income markets, yields for the long-term bonds of countries considered risk-free benchmarks —such as the United States and Germany— have climbed sharply in response to inflationary pressures and the resulting tightening of monetary policy. Higher bond yields for these countries, together with diminished risk appetite, have pushed up the cost of financing for other economies. As a result of these higher financing costs, cross-border lending and debt issuance have been in decline since the fourth quarter of 2021. In fact, between December 2021 and June 2022, global growth in cross-border lending slowed from 6.8% to 1.2%, while in developing and emerging economies it slowed from 7.4% to 3.8%. Over the same period, growth in international debt issuance at the global level declined from 5.5% to 1.2%, and for the developing world from 9.0% to 5.5%.

Rising global borrowing costs are also increasing the risk of financial stress among some emerging market and developing economies, which over the past decade have accumulated debt at the fastest pace in more than half a century.

In 2022, the balance of payments current account deficit is expected to expand for the region as a whole to 1.9% of GDP, continuing the upward trend seen over the past three years. This larger deficit is primarily explained by a slight deficit in the goods balance.

The value of Latin America's goods exports will climb by 20% in 2022, less than the 28% recorded in 2021. Most of this growth —14 percentage points— will come from rises in export prices, while volume growth will be more modest, at 6%, given the weaker economic growth in the region's key trading partners.

The situation is similar for goods imports, which are set to increase in value by 24% in 2022. Of this rise, 18 percentage points are expected to come from higher prices of imports and the remaining 6 percentage points from larger volumes.

In 2022, terms of trade in the region are expected to fall by an average of 3.4%, reflecting a rise of 14% in export prices and 18% in import prices. However, patterns differ among the subregions. For example, a rise of 5.9% is projected for the Caribbean, and of 5.2% for the Andean Community countries, driven by higher prices for hydrocarbons, of which several members are net exporters. At the other extreme, the largest fall is expected for Central America, -8.9% with respect to 2021, mainly because the subregion's countries are net importers of energy and in several cases also of foodstuffs.

The deficit on the services balance is expected to narrow slightly in 2022, closing at -0.9% of GDP (compared to -1.0% of GDP recorded in 2021). The income deficit, meanwhile, is projected to be larger in 2022, at -3.3% of GDP, due to increased repatriation of investment earnings and larger interest payments on debt. Lastly, the transfer surplus is expected to continue to expand in 2022, mainly owing to further growth in migrant remittances to the region, which constitute the main item in this account.

In line with patterns in other emerging economies, financial flows to Latin America have declined in recent quarters. As global financing conditions continued to tighten, Latin American and Caribbean debt issuance on international markets reached US$ 58.5 billion in the first 10 months of 2022, down 58% from the same period in 2021, and at an average rate almost 1.5 percentage points higher.

Latin America's sovereign risk has increased over the course of 2022, reflecting rising global financing costs and heightened risk aversion. The J. P. Morgan EMBI Global Diversified Index, which measures the difference between the interest rate on debt commitments arising from bonds issued by emerging countries relative to the rate on United States bonds, which are considered the safest, reached an annual high of 525 basis points in September and subsequently eased to 447 basis points in mid-November. This is still 66 basis points above the 381 points recorded at the end of 2021 and 112 points above the level in January 2020 before the start of the pandemic.

The Economic Commission for Latin America and the Caribbean (ECLAC) estimates that the region's overall external financing needs for 2023 will be around US$ 571 billion. This amount reflects the countries needing to meet around US$ 462 billion in external debt repayments over the year and to finance a balance-of-payments current account deficit estimated at some US$ 109 billion.

In 2022, the region's economies continued to grow (an estimated 3.7% for the year overall), albeit at a lower rate than in 2021 (6.7%), and all indications are that they will start to trend towards pre-pandemic growth rates in 2023. Accordingly, year-on-year growth rates have been gradually slowing since the second quarter of 2021 and average economic growth is projected to slow for the countries of the region from the second half of 2022 onward, reflecting both the end of the rebound effect seen in the 2021 recovery and the impact of restrictive monetary policies, greater fiscal spending constraints, lower consumption and investment and a deterioration of global conditions.

In 2022, growth in public consumption slowed compared to previous quarters. The net external sector made a negative contribution to GDP growth, which appeared to be linked to a faster recovery of imports and weaker external demand.

After being the main driver of economic growth in the second quarter of 2022, with annual growth of 6.7%, private consumption is expected to slow in the third and fourth quarters, owing to the high level reached in the second quarter and the growing effects of inflation on households' purchasing power, the depletion of their savings surpluses and the rise in the cost of borrowing. Investment also contributed to GDP

growth in the first half of 2022, especially in the second quarter. This trend is primarily a reflection of the rise in investment in machinery and equipment, which offset a drop in gross fixed capital formation in construction.

The slowdown is expected to continue and steepen in 2023. GDP growth is therefore projected significantly slower than in 2022, at an average rate of 1.3% for the region.

Labour markets in the region continued to recover in 2022, maintaining a trend that had begun in 2021 with the acceleration of growth and the easing of the health measures adopted to address the pandemic. The labour force participation rate recovered to reach 62.9% by the end of the second quarter of 2022, 0.3 percentage points higher than in December 2021. The number of employed was also up in the first half of 2022. The unemployment rate fell from a third quarter high in 2020 of 11.5% to 7.0% in the second quarter of 2022, on the back of an increase in the number of employed and a recovery of the workforce absorption capacity.

Growth in the number of employed has been reflected in substantial rises in different sectors, with two-digit year-on-year percentage increases in activities such as commerce, restaurants and hotels (13.2%) and in the manufacturing industry (11.2%). More than half of the jobs created in the second quarter of 2022 were in commerce, restaurants and hotels and in community, social and personal services, while 17.4% were in manufacturing.

The labour market recovery has not been robust enough to bridge the persistent gender gaps in indicators such as the labour force participation and unemployment rates. By the end of the second quarter of 2022, the participation rate for women (52.1%) was 22.5 percentage points lower than for men (74.6%). That same gap was 22.3 percentage points in the fourth quarter of 2019.

The labour market recovery has been accompanied by higher informality. At the close of the first quarter of 2022, the average informality rate for the region was 48.8%, topping the 2021 rate by 0.3 percentage points (48.5%) and the 2020 rate by 2.1 percentage points (46.7%). After rising for six consecutive quarters, real wages began trending downward, with the regional median falling by 0.6% in the second quarter of 2022.

The performance of the labour market in the region will depend largely on economic activity and inflation, as well as the limited space to adopt policies to drive aggregate demand. The slowdown in GDP growth since the second quarter of 2022, which is expected to continue into 2023, is casting doubt on the possibility that labour indicators will continue improving in the region.

On the fiscal front, central government public revenues as a percentage of GDP are expected to increase in Latin America in 2022, contrary to previous projections. Tax revenue posted strong growth, driven by income tax collection, which has offset slow expansion of revenue from goods and services consumption tax. Weak growth in indirect taxes stems from dampened economic activity in the second half of the year and tax relief measures to address high inflation (such as exemptions for basic food basket items and fuels), which have depressed tax revenues. In the Caribbean, growth in public revenues is expected to slow, although performance will be uneven across countries.

Central government public spending in Latin America is expected to continue declining in 2022 in line with fiscal deficit reduction directives in annual budgets. Lower public spending is mainly the result of a reduction in current subsidies and transfers. Although countries have taken steps to counter inflation which have affected public spending (food and energy subsidies), in most cases this has been offset by the progressive withdrawal of pandemic-related emergency programmes. While a slight decrease in the level of capital expenditure is expected —relative to GDP— the implementation

of adjustments towards the end of the year could lead to a sharper fall as countries seek to meet their fiscal balance targets. Interest payments are being driven up by higher debt levels and deteriorating macrofinancial conditions. The same trends are observed in the Caribbean, although capital expenditure is expected to rise in several countries of the subregion.

In keeping with these trends, the region is expected to post smaller fiscal deficits. In Latin America, the overall deficit is expected to be -3.1% of GDP in 2022 compared to -4.2% in 2021. The primary deficit is forecast to return to pre-pandemic levels, at -0.5% of GDP in 2022 compared to the previous year's -1.7%. Deficit reduction in Latin America has been possible thanks to higher public revenue, which has also enabled countries to cut total spending by less than would otherwise have been required. In the Caribbean, fiscal deficits will continue to shrink, but will remain larger than before 2020. The overall deficit for the subregion is expected to be -3.1% of GDP in 2022, compared to -3.6% of GDP in 2021. The primary balance could remain in deficit throughout the year, contrasting with the surpluses recorded over the past decade.

Gross public debt in Latin America fell over the first nine months of 2022. Central government debt in Latin America averaged 51.2% of GDP in September 2022, compared to 53.1% of GDP at 2021 year-end. In the Caribbean, it sat at 77.8% of GDP in June 2022, compared to 85.8% of GDP in December 2021. The main driver of the improved debt-to-GDP ratio was growth in nominal GDP, since the nominal values of debt stocks were relatively stable through the year in several countries. This could change by the end of the year as budget execution concludes in the fourth quarter. In addition to concerns related to debt levels in the region, countries are facing less favourable macrofinancial conditions for refinancing public debt. Rising interest rates, currency depreciations and heightened sovereign risk are expected to complicate the financing of government operations in 2023, which could hurt public spending.

The region is at a development crossroads that calls for a fundamental change in the fiscal policy paradigm. The current macroeconomic foundations, which are characterized by slow growth and low levels of investment and productivity, are too weak to drive sustained, sustainable and inclusive growth. Meanwhile, persistent structural development gaps —inequality, poverty, informality, and weak social protection, health and education systems, among others— are increasingly limiting the economic and social potential of Latin America and the Caribbean. At the same time, the region, already highly vulnerable, is facing the existential threat posed by climate change. Active fiscal policy will be needed to confront these challenges, in order to create the conditions to boost growth and investment, guarantee social welfare and build resilience to climate change. However, given the intensive investment required to realize this agenda, it is crucial to implement measures to strengthen the fiscal capacity of the State and to incentivize private sector participation in development.

In turn, a stronger fiscal sustainability framework will be essential to ensure the viability of the public spending required to promote structural change in development patterns. The framework should prioritize domestic resource mobilization, in particular through public revenues, which have historically been insufficient to meet the demands of public spending. Tax collection in the region is low compared with that of the countries that are members of the Organisation for Economic Co-operation and Development (OECD) and with that of other countries with a similar level of development. Direct tax collection is low, in particular for personal income tax, which limits not only resource mobilization but also the redistributive power of the tax system as a whole. However, this framework must include and streamline efforts to encourage private investment, creating an institutional framework to adequately regulate tax incentives for investments that support emissions reduction, and to foster private green and social investment from national and international financial markets.

In a context of high demand and limited resources, it is important to take a strategic approach to public spending. Priority should be given to investments in programmes and projects with strong economic, social and environmental returns that create high-quality jobs, promote gender equality and drive transformation of the production structure. ECLAC has therefore proposed a set of possible development drivers for the region: the energy transition, e-mobility, the circular economy, the bioeconomy, the health-care manufacturing industry, the digital transformation, the care economy and sustainable tourism. Investments related to climate change adaptation and mitigation have particularly high development potential. Proactive investments in these areas will produce considerable economic and social dividends, driving creation of dynamic and competitive economies and fostering long-term social well-being.

The pattern of rising inflation that began in mid-2020 in the region seems to be easing. In fact, in recent months there have been signs of a slowdown in regional inflation, even though it is expected to remain relatively high.

In the first half of 2022, consumer price inflation at the regional level continued to accelerate, hitting 8.4% in June, the highest figure since 2005. Once again, higher food and oil prices and heightened exchange-rate volatility drove these price trends in Latin American and Caribbean economies. However, some changes in the direction of these variables in the second half of 2022, coupled with a sharp slowdown in economic activity, have brought average regional inflation down by 1.6 percentage points, to 6.8% in October, 0.2 percentage points higher than in December 2021. At the subregional level, in October 2022, average inflation for the economies of South America was 8.7%, for Central America and Mexico 7.7%, and for the Caribbean 7.4%.

Inflation of tradable goods prices was a significant 3.6 percentage points higher than in December 2021, while inflation of non-tradable goods was 1.5 percentage points lower.

Trends in the prices of energy and food, which in many countries of the region are imported goods, have been key to the pattern in the general consumer price index. Although food inflation has been accelerating since late 2018, the pace been quicker since the second half of 2020. Energy inflation, meanwhile, has been on the rise since March 2021. At the end of October 2022, food inflation was 11.6%, up 4.2 percentage points from December 2021 and 6.4 percentage points from May 2020. Notably, in July 2022, food inflation was 12.5%, the highest rate since the global financial crisis. Energy inflation, meanwhile, peaked in November 2021 (17.6%) and since then has tended to slow; in October 2022, it was 9.7 percentage points lower than in December 2021 (17.2%).

Future inflation patterns in the region will be intricately linked to inflation in the rest of the world, as the determinants are very similar. Based on an easing of food and energy prices and less tension in global supply chains, estimates suggest lower inflation in 2023. In addition, the measures adopted by central banks and their impact on aggregate demand should also lead to lower inflation in the future, in keeping with the slowdown in the second half of 2022.

Despite all of this, inflation is forecast to remain above pre-pandemic levels in 2023. Several central banks in the region have also indicated that they expect inflation to be close to the ranges set in their monetary programmes by mid-2024.

In 2022, monetary authorities' actions have been driven by rising inflation. Through to November, most of the central banks that use the monetary policy rate as their main instrument raised it substantially, to levels near those seen during the global financial crisis. The policy rate hikes were accompanied by declines in base money growth. As a result, lending rates have risen, while real domestic credit to the private sector has maintained the low growth registered since the pandemic.

Because of the deterioration in conditions —slower GDP growth, falling real wages, rising inflation and higher interest rates— credit quality worsened and, between December 2021 and the third quarter of 2022, 17 of the 32 economies analysed reported increases in the delinquency rate.

Monetary authorities have also faced greater financial volatility over first 11 months of 2022 as a result of the change in the monetary policy stances of developed economies, the resulting tightening of international financial conditions, a stronger dollar, and capital movements in and out of the region's economies. This heightened financial volatility and currency depreciation have been particularly significant since the second quarter of 2022 for the economies of the region with floating exchange rates that use the monetary policy rate as their main instrument.

As a result of efforts to stabilize exchange rates and reduce the impact of their volatility on macrofinancial stability, including the knock-on effect on inflation, some central banks in the region have made active use of international reserves, which shrank by 7.2% overall in the region. However, the current level of international reserves remains higher than the average registered between January 2010 and December 2019.

The prospect of lower inflation in 2023 —owing to slower rises in the prices of food and energy, the easing of certain global supply problems and lower demand— should reduce the pressure for monetary authorities to raise monetary policy rates further. However, because the abatement in inflation will be gradual and prices will remain high in historical terms, no major changes to monetary policy are expected. Nevertheless, other factors, such as the pace of the economic slowdown, international financial market volatility and the resulting exchange-rate fluctuations, will shape monetary policy and extent to which macroprudential tools —including international reserves— are used to preserve macrofinancial stability. Once again, monetary authorities will face the challenge of maintaining the policy space to mitigate damage to variables such as investment, which would hurt GDP trajectories over the medium and long terms, and to prevent higher inflation and disproportionate exchange-rate fluctuations from further eroding purchasing power and accentuating inequalities.

Monetary authorities should continue to pursue their agendas to lessen the financial risks linked to climate change, because the effects of various climate events on the financial system —due to resulting costs and economic losses (physical risks) and the preferential allocation of resources to low-carbon economies (transition risks)— tend to translate into traditional credit, market and liquidity risks, as well as operational risks. The climate change dimension should therefore be included in macroprudential regulatory frameworks and in the design of available instruments in the region, to fine-tune the targeting of sectors, agents or activities that may be more exposed, to address the systemic aspect of the risk posed by climate change, and to maintain financial stability.

In a complex macroeconomic context of mounting uncertainties, the countries of Latin America and the Caribbean are on course to grow by 3.7% in 2022, almost half the 6.7% recorded in 2021. Economic growth is expected to slow further in 2023, to 1.3%, less than 40% of the 2022 rate. This slowdown in growth reflects a tapering off of the rebound effect seen in 2021, a weaker global economy, greater uncertainty on international financial markets, a downturn in aggregate demand in the countries of the region and tighter macroeconomic policy.

All the subregions will post lower growth in 2023: South America is set to grow by 1.0% (3.7% in 2022); the group comprising Central America and Mexico by 1.6% (3.3% in 2022); and the Caribbean (excluding Guyana) by 3.3% (4.5% in 2022). With these growth estimates for 2022 and 2023, the region would complete the decade 2014–2023 with average growth of 0.9%, which is below —less than half, in fact— even that of the "lost decade" of the 1980s during the external debt crisis.

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