

# Executive Summary

*The global economy is emerging from recession, but its recovery will be gradual, with only modest growth in coming years.* Financial stabilization has greatly reduced the possibility of a systemic collapse, though there are still downside risks. So far, the recovery in advanced economies is dependent on massive policy stimulus. Growth in the United States and most advanced economies will remain sluggish, and employment conditions will likely get worse before they start to improve. A permanent loss in potential output, weak private consumption, and much higher debt levels in the United States will be negative legacies of the crisis that could adversely affect the Latin America and Caribbean (LAC) region.

*The impact of the crisis on the LAC region was substantial, but the worst is over for most countries.* The crisis shocked the region with more expensive external financing and lower exports, workers' remittances, and tourism receipts. A wave of uncertainty dented confidence, and the private sector cut back spending. But following a sizable contraction through the first half of 2009, the LAC region is recovering and moderate growth is expected for 2010.

*Still, the outlook varies considerably within the region.* Recovery prospects are stronger for countries that had the most room for policy maneuver, which are also benefiting in 2009 from much improved financial conditions and commodity export prices. Countries more reliant on tourism and remittances were not hit as forcefully on impact, but their recovery will be slower because their outlook depends significantly on lagging employment and consumption in the United States. Some of these countries also have less room for policy stimulus.

*Policies will have to strike difficult balances, according to country circumstances.* For better-prepared countries, which were able to apply monetary and fiscal stimulus, the issue will be when to begin, and how fast to proceed with, the withdrawal of stimulus. In general, it will be appropriate to begin the withdrawal on the fiscal before the monetary side. There are risks from removing stimulus too quickly, given that the global recovery is still not well entrenched, but also to withdrawing too slowly. A few countries may soon be facing strong capital inflows, and at some point could experience stronger currencies and even overheating—this would speed up the need to remove stimulus and is another reason for reversing fiscal easing earlier than monetary easing. For other countries, the room for stimulus has been almost depleted and should prudently be saved for downside risk scenarios. Countries with the least fiscal room will need stronger efforts to rebalance expenditure to protect vulnerable groups.

*In the medium term, policies will need to adjust to a new global environment of lower growth.* A return to precrisis rates of growth of output, and of commodity export prices, is unlikely. With government revenue therefore growing more slowly, public spending will need to be more focused, particularly in countries with higher debt. More broadly, policies will need to work

harder to provide conditions for growth and poverty alleviation. Finally, financial supervision and regulatory policies will need to continually develop to ensure stability, with broad coverage of systemic financial institutions and risks.

*A further policy agenda relates to building the region's resilience, and developing room for policy maneuver, in preparation for future shocks.* The recent experience has proven the value of steps taken in this direction by many countries during this decade. Against severe global shocks, the region avoided falling into its own financial and balance of payments crisis. In fact, in terms of maintaining economic activity, the region did as well as, or better than, many other countries, and much better than in the past. Countries with stronger policies prior to the crisis were most able to respond to cushion the blow. Other countries' crisis responses were constrained, and will benefit from developing policy frameworks to improve predictability and limit existing procyclical biases.

*This Regional Economic Outlook explores the consequences and policy implications of the recent global crisis and recession for the LAC region.* Chapter 1 sets the global stage, emphasizing how developments in the United States and advanced economies will affect recovery in the region. Chapter 2 reviews the current state of regional economies and their outlook for 2009–10 and through the medium term, setting out key policy issues and general recommendations. Chapter 3 then steps back to evaluate how well the region performed recently, from an international perspective, and compared with its performance in past episodes of global turmoil: together, these experiences point to an agenda for the region to further develop its policy frameworks and resilience to external shocks. Finally, Chapter 4 focuses on fiscal policy responses of LAC countries to the recent crisis, linking these to their precrisis conditions and policies and identifying priorities for developing fiscal policy frameworks in the years ahead.