



OECD Economic Outlook: Projections for Latin American countries

June 2015



OECD Economic Outlook: Projections for Latin American countries* JUNE 2015

* This publication presents projections for 7 Latin American countries

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FOREWORD

The relationship between the OECD and Latin America is growing along with the importance of the region in the international economy. The participation of Latin American countries in our committees, working groups, instruments and initiatives is stronger than ever: Chile and Mexico are two of our most active members; Colombia and Costa Rica are currently in a process of accession; Brazil is a Key Partner of the Organisation; we just initiated a country programme with Peru; and many other Latin American and Caribbean countries are actively engaged in several of our sectorial activities.

This growing collaboration of the OECD with Latin America is no coincidence. The region faces a decisive moment: the end of the commodity super-cycle has generated a significant slowdown in growth in recent years, and today Latin America's outlook contains opportunities but also risks. On the positive side, lower oil prices and stronger than expected global growth will boost activity in countries that import energy and have strong trade links with the United States and Europe. On the negative side, the expectation that commodity prices will remain at current levels in the medium term has affected business confidence and investment in the main exporters of raw materials in the region.

This document, which draws on the OECD's most recent semi-annual Economic Outlook, presented by the Organisation in June 2015 but with a more targeted view for the region, shows that although Latin America is better positioned than in the past to deal with external shocks, there are important heterogeneities across countries. In particular, it shows that countries with stronger fundamentals and improved macroeconomic policies have been able to counteract the effects of the external shock and therefore they are expected to rebound faster. We underline the need for all countries in the region to boost productivity and potential growth, with recommendations to promote a more dynamic and more inclusive growth through structural policies that are essential to consolidate and enhance the significant progress made over the past ten years in reducing poverty and inequality.

I hope this joint effort by the OECD Economic Department and the OECD Development Centre will contribute to discussions on how to promote better policies to consolidate a more socially inclusive development strategy in the region. Latin America can seize the current context to promote a regional wave of major reforms, and the OECD is ready to help.

Angel Gurría

Secretary-General



3rd June 2015

EDITORIAL I

THE B-MINUS WORLD ECONOMY: INVESTMENT IS KEY TO GETTING A BETTER GRADE

The economic recovery from the global financial and economic crisis that broke out in 2008 has been unusually weak. Global growth has consistently been slower than the average pace during the dozen or so years before the global financial crisis. The failure to achieve a stronger cyclical upswing has had very real costs in terms of foregone employment, stagnant living standards in advanced economies, less vigorous development in some emerging economies, and rising inequality nearly everywhere.

In this Economic Outlook we project that global growth will strengthen gradually to approach its past average pace by late 2016. Growth is expected to be shared more evenly across regions of the world, with external imbalances generally smaller than they were in the run-up to the global crisis. Labour markets are gradually healing in the advanced economies. Risks of deflation have receded. Yet, we give the global economy only the barely passing grade of B-.

Why the dissatisfaction? To begin with, our starting point is inauspicious. The first quarter of 2015 saw the weakest global growth since the crisis. The United States experienced a particularly sharp dip, but a number of other advanced economies shrank during the quarter, and growth in China slowed down more than expected. We see this weakness at the beginning of the year as largely the result of temporary factors. The boost to consumption from lower oil prices is still expected to come through in oil-importing countries, where demand will also be spurred by the widespread monetary easing (often accompanied by currency depreciation) in countries accounting for more than 50% of world GDP. A generally neutral fiscal stance in most large economies will not be a drag on growth, unlike in the previous few years.

But even if we are right about the transitory nature of the latest bout of weak growth, the outlook is not satisfactory. Despite tailwinds and policy actions, real investment has been tepid and productivity growth disappointing. By and large, firms have been unwilling to spend on plant, equipment, technology and services as vigorously as they have done in previous cyclical recoveries. Moreover, many governments postponed infrastructure investments as part of fiscal consolidation.

This Outlook takes a detailed look at investment, concluding that the slow rate of private investment is largely explained by subdued (actual and expected) demand, both at home and globally. This demand weakness has hindered investment growth, which in turn has held back employment, wages, and consumption. On the supply side, sluggish investment has undermined the rate of growth of potential output – the capacity of economies to increase living standards, make good on future obligations to citizens, and repay debt – via a slower rate of increase of the capital stock and a slowdown in the diffusion and embodiment of technical change. The world economy remains stuck in a low-level supply-demand equilibrium environment.

Boosting the performance of the global economy requires jumping to a higher growth equilibrium with more investment, that creates more employment, jobs, and consumption demand, which ratifies the higher rate of investment, leading to the beneficial supply-side outcome. At least some of what we see as needed for such a jump to a high-level equilibrium is in prospect, given macro-policies and global demand balance. In our projections, fixed investment growth in the OECD region picks up to 4% next year, the highest rate since the crisis. But whether investment accelerates in line with our projections is a key question hanging over the improving outlook that we depict. Moreover, even if it does, this would still be insufficient to deliver the strong global growth in the near term needed to increase employment and reduce inequality; potential output growth would still look anaemic compared to past decades.

So, more than demand-oriented macro policies are needed to generate a strong and durable boost to investment. Reducing policy uncertainty would help, such as a tone-down of fiscal brinksmanship in the United States, favourable resolution of Greece's status vis-à-vis the euro area, realistic medium-term fiscal path in Japan, and greater transparency of financial systems in emerging economies. Progress on reducing financing constraints in the euro area through attention to non-performing loans could cement more positive business sentiment there. Clear signals this year at COP21 on coordinated international action to combat climate change could be an important incentive to underpin a surge in investment, with benefits for demand, innovation and environmental sustainability.

Structural policies have a central role to play to achieve more satisfactory and sustained investment growth. Restrictive product market regulation impedes the growth of the capital stock in OECD economies. FDI restrictiveness (and corruption) affect quantity and quality of cross-border investment. In the European Union, attention to disparities and complexities in regulation of network services industries, as proposed in the Investment Plan for Europe, would support investment to complete the Single Market. In some emerging markets cost-benefit analysis would improve the returns to investment, making it a more sustainable underpinning for growth

The Economic Outlook calls on countries to adopt balanced policy packages with mutually reinforcing monetary, fiscal and structural policies. Collective action with positive spillovers can boost the global economy to the higher-growth equilibrium with stronger investment, more employment, and a greater capacity to improve living standards for all. More robust global growth will make countries and the global economy more resilient to salient risks such as financial instability. Expanding employment and strengthening public finances are pathways to equality of opportunity. The world economy is muddling through with a B-minus average, but if homework is not done and with less than average luck, a failing grade is all too possible. On the other hand, how to get the A is known and within reach.

Catherine L. Mann
OECD Chief Economist



3rd June 2015

EDITORIAL II

FROM A SHORT-TERM ECONOMIC SLOWDOWN TO REFORMS IN THE LONG RUN?

The economic slowdown that began in Latin America in 2010 continues. The region will continue to grow, casting aside fears of a crisis that arose two years ago. The pace of growth, however, will continue to be slow. According to ECLAC forecasts, the region's economy will grow by 1.0% in 2015 (compared with 1.1% in 2014, 2.5% in 2013 and 2.9% in 2012), again less than the OECD average after a decade of economic convergence. In 2016, growth is expected to pick up slightly. These developments are driven by the less favourable international conditions, due to lower commodity prices, and the economic slowdown in the People's Republic of China. Also of note is the rising cost of external financing and more restrained capital inflow prospects due to the tightening of US monetary policy.

The differences in economic growth across countries could increase due to the uneven impact of the external context as well as domestic factors. By sub-regions, in 2015 South America is expected to exhibit growth rates close to zero, while Central America and Mexico could exceed 3% and the Caribbean close to 2%. The fastest growing economies in Latin America are expected to be Panama (6%) and the Plurinational State of Bolivia, Dominican Republic and Nicaragua (5%). These differences in growth rates can be attributed to both the varying impact of the international context (changes in commodity prices and the corresponding trade impacts, and the different levels of integration with China and the US) as well as internal factors related to economic management.

The frequent short-term commodity and capital booms have made economic activity in Latin America more volatile, without boosting sustained growth. Almost all Latin American and Caribbean countries have experienced periods with large inflows of foreign currency in the form of exports of natural resources (food, minerals and fuels), remittances, short-term capital flows or foreign direct investment. As analysed in Latin American Economic Outlook 2015, jointly elaborated by the OECD, ECLAC and CAF, these periods of high resources have been particularly frequent in South America. Each boom contributed 6 percentage points to GDP over the course of nearly three years. Over the past five decades, the output gap increased during the booms and turned negative afterwards, thus increasing the volatility of economic growth. This was particularly true of booms in short-term capital flows, food and minerals, which have shaped the external environments during the past decade. Moreover, in the countries that experienced the booms, no positive impact on the growth trend was observed either during or after them.

The main concern is that the low growth rates of around 3% for Latin America over the next few years are not indicative of a temporary slowdown but rather signal lower potential growth. Potential growth in Latin America has been estimated at between 3% and 4% a year over the past ten years, which is slightly below the growth recorded during the most recent period of expansion, from 2004 to 2008. However, in light of the deteriorating international context which has hampered growth since 2010, the "new normal" for the region may well be lower than previously expected.

In the short run, Latin American countries should rebuild their monetary and fiscal response capacities. Countries in the region need to strengthen their financial and fiscal framework by expanding their fiscal space. They also need to maintain the credibility of their central banks in running a countercyclical monetary policy, which has tended to be accommodating in the face of weak growth. The measures required to expand their fiscal space will vary from country to country. Some, such as the Central American, Andean countries and Mexico, where tax revenues are significantly lower than 20% of GDP as shown in Revenue Statistics in Latin America and the Caribbean 1990-2013 (OECD, CIAT, ECLAC and IDB, 2015) will need to expand their bases, while others, especially in South America, will need to change the composition of their public spending. In the Caribbean, governments need to continue their efforts to ensure that fiscal policy remains sustainable, especially government debt. It is important that all countries

set up automatic stabilisers (for their expenditure, but also for their revenues) and have access to macro-prudential frameworks and stabilising tools, with the clearly defined conditions for their use.

In the long term, the region needs to move forward with implementing structural reforms to boost potential growth and equality. Key reforms include strengthening education, skills and innovation. Latin America's productivity in recent years has been disappointing compared with that of both OECD countries and emerging economies. Stronger productivity would lead to more inclusive growth and would reduce the already high inequality and poverty rates. Education and innovation reforms must ensure equal opportunities of access to a complete, high-quality cycle of education in order to foster an adequately skilled workforce whose skills are closely matched with the needs of the labour market (Latin American Economic Outlook 2015). There must also be measures to promote formal employment. The region's well-being, especially in the long run, will depend on whether governments make the most of this opportunity..

Mario Pezzini

Director Development Centre



3rd June 2015

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OVERVIEW FOR LATIN AMERICAN COUNTRIES

Latin American economic growth is set to recover during the second half of 2015 and gain further speed towards potential growth in 2016, though with notable differences across countries. The rebound reflects developments in the global economy, where activity is expected to improve gradually. More dynamic world trade flows, together with more competitive effective exchange rates, will boost exports and support activity. In countries where business and consumer confidence will improve, aggregate domestic demand will also contribute to the uplift.

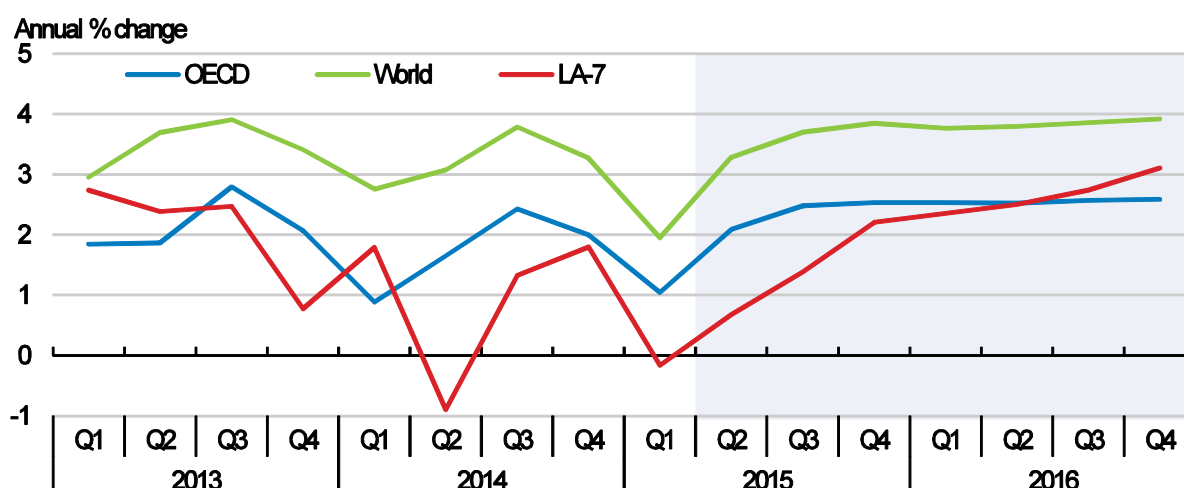
With its predominance of large commodity exporters, Latin America has been hit by the sharp fall of oil, mineral and food prices, which has deteriorated their terms of trade. In addition, the region has been affected by higher volatility of capital flows and currency depreciations. However, countries have shown a high degree of resilience in the face of these shocks. This has been especially the case in countries with sound macroeconomic policy fundamentals. Countries with strong budgetary positions required less fiscal consolidation despite the loss of tax revenue linked to commodity exports. As well, where price expectations were anchored and monetary policy was credible, central banks could tolerate the temporary increase of inflation following currency realignments. These successes demonstrate the importance of continued commitment to sound macroeconomic policies.

Further structural policies in Latin America would make an important contribution to medium-term economic prospects and strengthen the social progress achieved during the past decade. Broad-based reforms should focus on four priorities: increasing productivity, reducing inequality, strengthening institutions and improving sustainability. Continued commitment to such policy priorities would not only contribute to further economic growth, but would also bolster resilience in the face of shocks and reduce the risks of sharp slowdowns that may result from extraordinary developments in the global economy.

Latin American will benefit from a world economy that is starting to move at a faster pace

After two years of slowing down, economic growth in Latin America as a whole is expected to accelerate in the course of 2015 and gain further speed in 2016. This pick-up in activity will be driven by stronger external demand as global growth is projected to strengthen in the course of 2015 and 2016. The recovery in advanced economies will be driven by improvements in consumer and investor confidence, as well as by supportive monetary conditions, a slower pace of fiscal consolidation, and lower energy prices. These developments have different implications across Latin American economies, but with a positive effect overall.

Figure 1. Growth is set to gradually recover



Source: OECD Economic Outlook.

Table 1. Latin American economies are projected to recover, with differences across countries

| | Average 2002-2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|------------------------------------|----------------------|------------|------------|------------|------------|------------|
| Percent | | | | | | |
| Real GDP growth¹ | | | | | | |
| World ² | 3.9 | 3.3 | 3.3 | 3.4 | 3.2 | 3.8 |
| OECD ² | 1.7 | 1.3 | 1.4 | 1.8 | 1.9 | 2.5 |
| United States | 1.7 | 2.3 | 2.2 | 2.4 | 2.0 | 2.8 |
| Euro Area ² | 1.1 | -0.8 | -0.4 | 0.9 | 1.4 | 2.1 |
| Japan | 0.7 | 1.8 | 1.6 | 0 | 0.7 | 1.4 |
| China | 10.6 | 7.7 | 7.7 | 7.4 | 6.8 | 6.7 |
| LA-7³ | 3.9 | 2.6 | 2.7 | 1.2 | 0.9 | 2.2 |
| Argentina | 5.4 | 0.8 | 2.9 | 0.5 | -0.1 | 2.0 |
| Brazil | 3.9 | 1.8 | 2.7 | 0.2 | -0.8 | 1.1 |
| Chile | 4.3 | 5.5 | 4.3 | 1.8 | 2.9 | 3.7 |
| Colombia | 4.6 | 4.0 | 4.9 | 4.6 | 3.3 | 3.7 |
| Costa Rica | 4.7 | 5.2 | 3.4 | 3.5 | 3.4 | 4.3 |
| Mexico | 2.3 | 3.8 | 1.7 | 2.1 | 2.9 | 3.5 |
| Peru | 6.2 | 6.0 | 5.8 | 2.4 | 3.6 | 4.3 |

1. Year-on-year increase

2. Moving nominal GDP weights, using purchasing power parities

3. The LA-7 aggregate is estimated using a moving nominal GDP weights, using purchasing power parities.

Source: OECD Economic Outlook and OECD Secretariat projections.

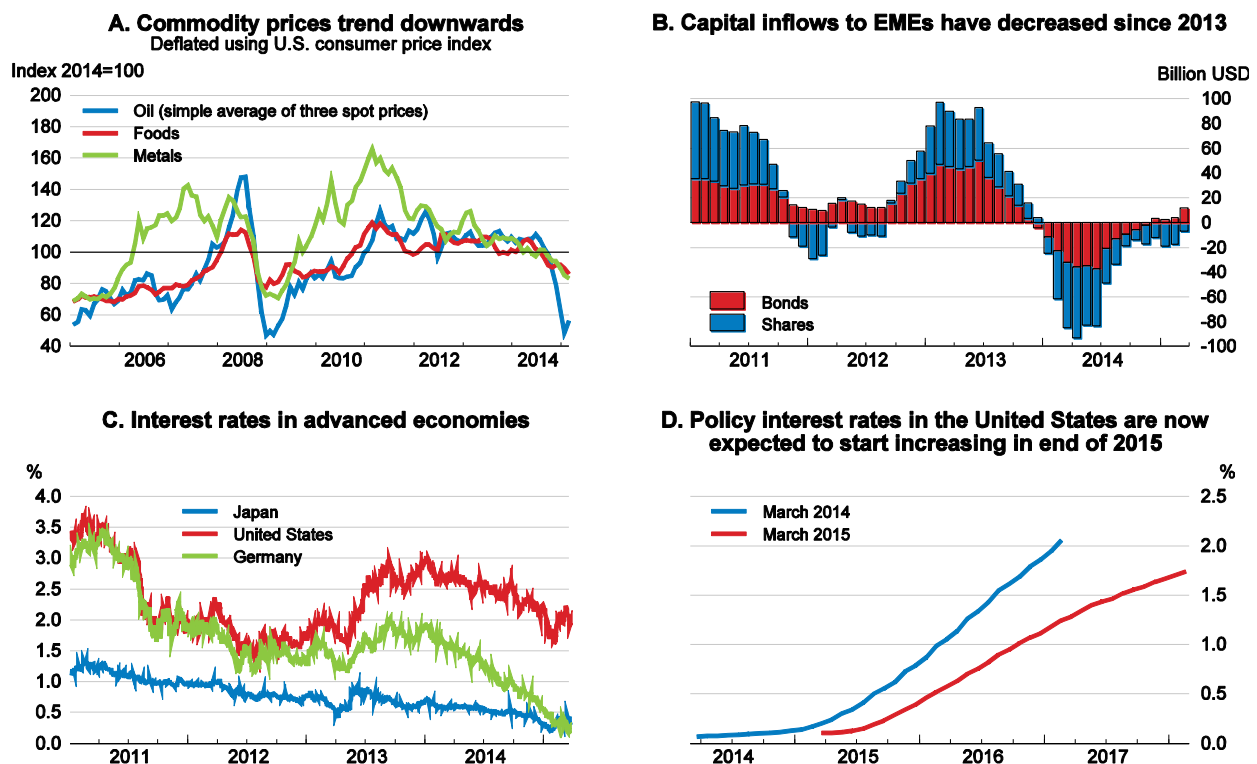
The strengthening of the US economy is expected to increase demand for goods from most countries in Latin America, with a stronger impact on major trading partners, notably Mexico and Costa Rica. In the United States, growth will recover thanks to supportive monetary conditions, less fiscal consolidation, lower energy prices and an increase in household wealth. Similarly, the recovery of growth in Europe and Japan will be supported by lower oil prices, currency depreciation and monetary policy stimulus, and will likely increase the demand of industrial goods from Latin American countries. In China, growth is projected to edge down as the economy transitions from being led by investment to consumption of services, and imports are thus expected to weaken.

The implications of the sharp fall in oil prices will differ from country to country, but the overall effect will be positive in Latin America. Lower prices will have an adverse effect on the trade and fiscal balances of countries with high oil exports, such as Colombia and Mexico. However, it will benefit the rest of the countries in the region by boosting real incomes of households, reducing the need for energy subsidies, and improving external balances.

The expected tightening of monetary policy in the United States, where the Federal Reserve is assumed to raise interest rates by the end-2015 and beginning of 2016, has contributed to higher financial volatility in Latin America. Stock-market prices have weakened and capital flow reversal has led to exchange-rate depreciation in some countries, increasing the cost of servicing sovereign debt denominated in foreign currencies. In addition, spreads on Latin American sovereign debt has increased faster than in other emerging economies despite still low debt-to-GDP ratios.

In addition to external developments, country-specific factors also contribute to the diversity of short-term outlooks. In particular, falling private sector confidence in Brazil, and remaining macroeconomic imbalances and regulatory restrictions in Argentina, are expected to restrain growth this year. On the other hand, the stronger capacity to act counter-cyclically in the Andean economies (Chile and Peru) enables them to provide a fiscal stimulus that will contribute to growth in 2015.

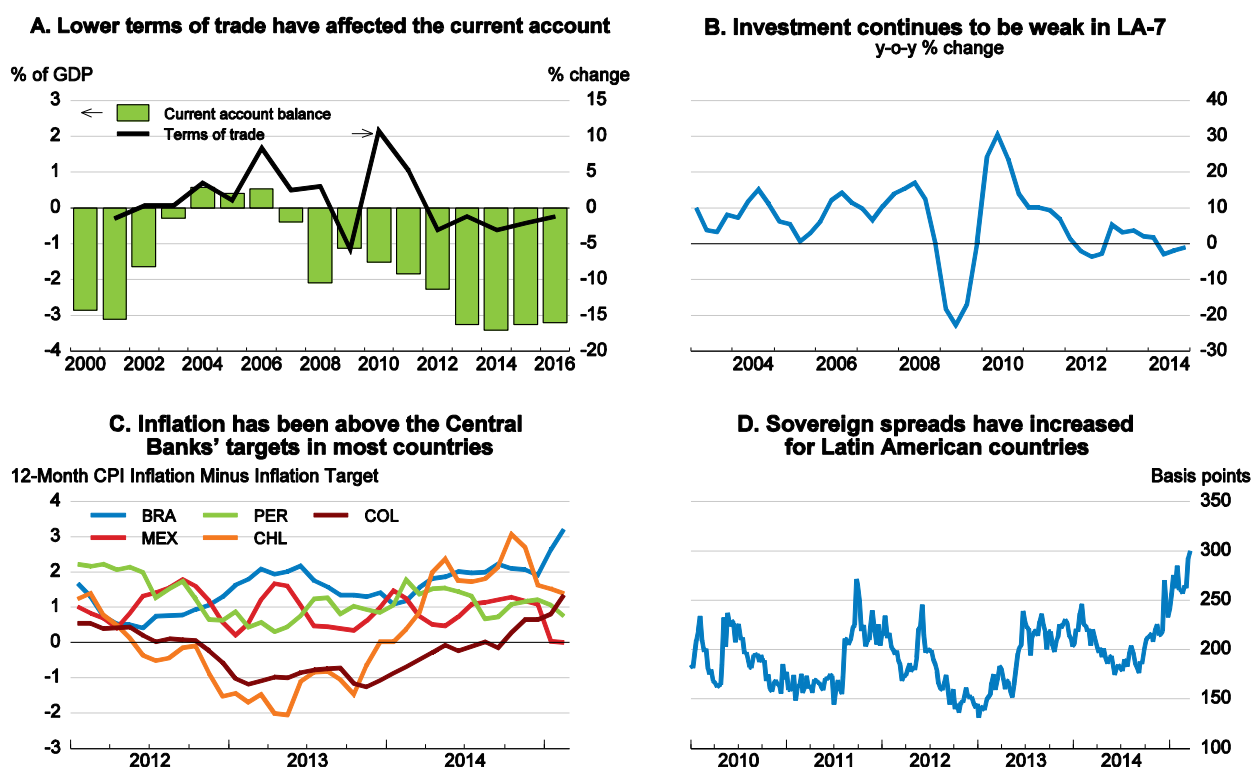
Figure 2. The external environment presents lower commodity prices, capital flows reversals and tighter expected financial conditions



Note: Figure C shows long-term interest rates for 10-year government bonds.

Source: OECD Economic Outlook, Datastream and IMF.

Figure 3. Lower terms of trade have affected Latin American countries by increasing the current account deficits, reducing investment, depreciating currencies and increasing inflation and sovereign spreads



Source: OECD Economic Outlook; Datastream and IMF.

Risks to the outlook are balanced

Sudden changes in expectations regarding the tightening of monetary policy in the United States risk triggering renewed financial volatility. Some economies have increased their exposure to short term capital flows earlier in the decade, which makes them more vulnerable to changes of sentiment in international financial markets (OECD Economic Outlook, 2015). In addition, corporations in several Latin American countries have intensified foreign-currency borrowing in recent years. Further appreciation of the US dollar and higher interest rates could increase the cost of funding for Latin American companies, damaging investment even further.

Non-economic developments are also a source of risk. In several countries, credibility and confidence in governments and institutions has weakened, which could increase political instability. Although so far most countries have maintained some degree of fiscal discipline, in others structural deficits have grown and debt is increasing. In these economies, political support for necessary fiscal adjustment may weaken, thus increasing risk of unstable debt dynamics. Political developments could also result in new measures that would increase distortions in the economy. Finally, reports of a strengthening El Niño raise the prospects of unusual or extreme weather events in certain parts of the world, which can have significant economic impacts in Latin America.

The short-term outlook is also subject to upside risks. World trade flows could be more dynamic than expected if consumer demand rebounds more strongly in the United States and Europe. This would not benefit all countries alike in the region, but would nonetheless provide overall support. As well, structural reforms recently approved in Mexico and Chile could also impact productivity sooner than expected. In particular, tangible progress in policies to foster competition, reduce skill mismatches and raise female labour force participation could boost economic potential more strongly and earlier than assumed.

Countries with sound macroeconomic fundamentals have some space for counter-cyclical policies

Many countries in Latin America have developed sound macroeconomic frameworks over the past decade, thus providing room for monetary and fiscal policies to react to external shocks. However, the space is smaller than it was during the crisis of 2008-2009. While Chile and Peru have a more robust fiscal situation that allows them to offer some fiscal stimulus, in Mexico and Colombia the fiscal rule does not allow much room for manoeuvre. The situation is more difficult in Argentina and Costa Rica, and Brazil has already initiated a fiscal adjustment.

Similarly, the possibility of additional monetary stimulus is limited in countries where inflation is above the target of the Central Bank and there is no clear evidence of economic slack. However, in economies where inflation expectations remain low and well-anchored, there is still room to decrease policy rates further if it were needed. Most countries face modest inflation pressures, despite low unemployment, in part thanks to the contribution of lower commodity prices. Thus, monetary policy is assumed to remain accommodative in most countries, except in Brazil.

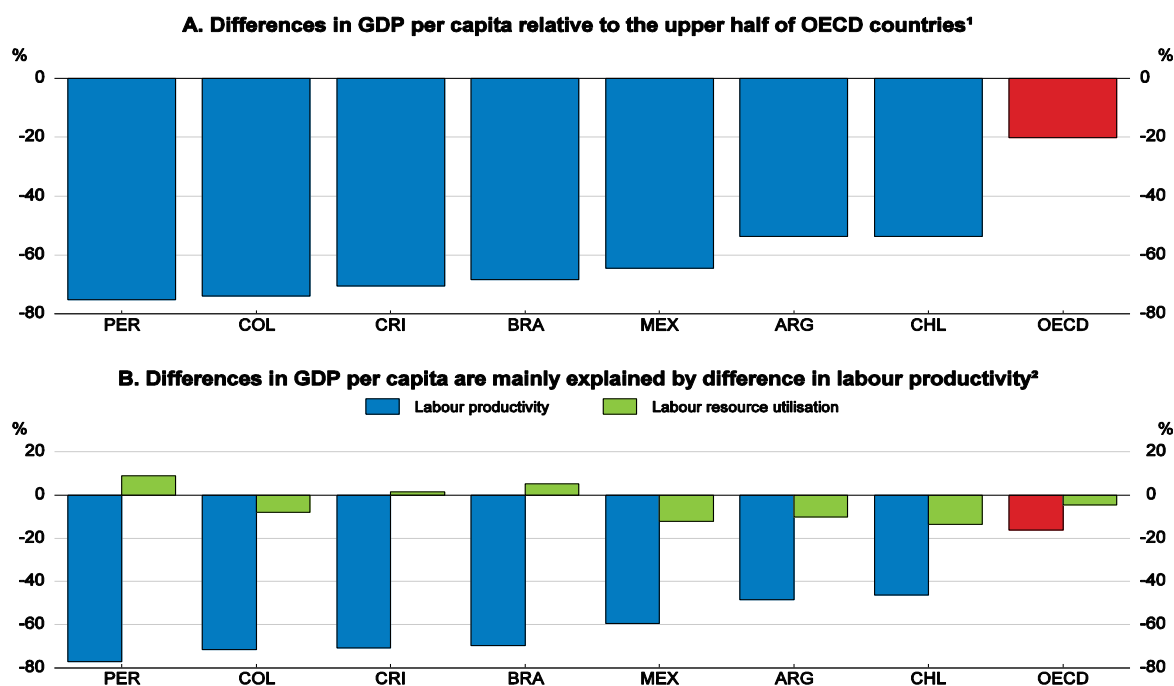
Countries also need to prepare for the risk of more volatile times by reinforcing their macro-prudential frameworks and prudential supervision. To prepare for the eventuality of renewed financial tensions and exchange rate volatility, the region should continue to establish strong macro-prudential policies and financial regulations and to reinforce supervision, including ensuring sufficient capital and liquidity buffers and reducing currency mismatches.

Time for a new growth engine based on productivity

Strengthening economic growth and catching up towards income in OECD countries will require foremost the implementation of policy measures to raise productivity growth. Common challenges to do so are combating informality, addressing bottlenecks in human and physical capital, and improving the infrastructure. Other important priorities to boost growth and make it more inclusive are enhancing skills and the quality of education, as well as reducing gender gaps in the labour market. Policies for learning should be at the top of the agenda in the coming years in Latin America.

During recent decades, major social reforms have significantly reduced poverty levels in many countries. This achievement must be safeguarded, built upon and extended. To sustain and deepen this economic and social transformation, Latin American economies should respond to the new global environment by pursuing sound macroeconomic policies and implementing structural reforms. From the fiscal side, the lower oil price is an excellent opportunity for several countries to eliminate subsidies to energy and transport, to free up resources for those people most in need and fight poverty and inequality more effectively.

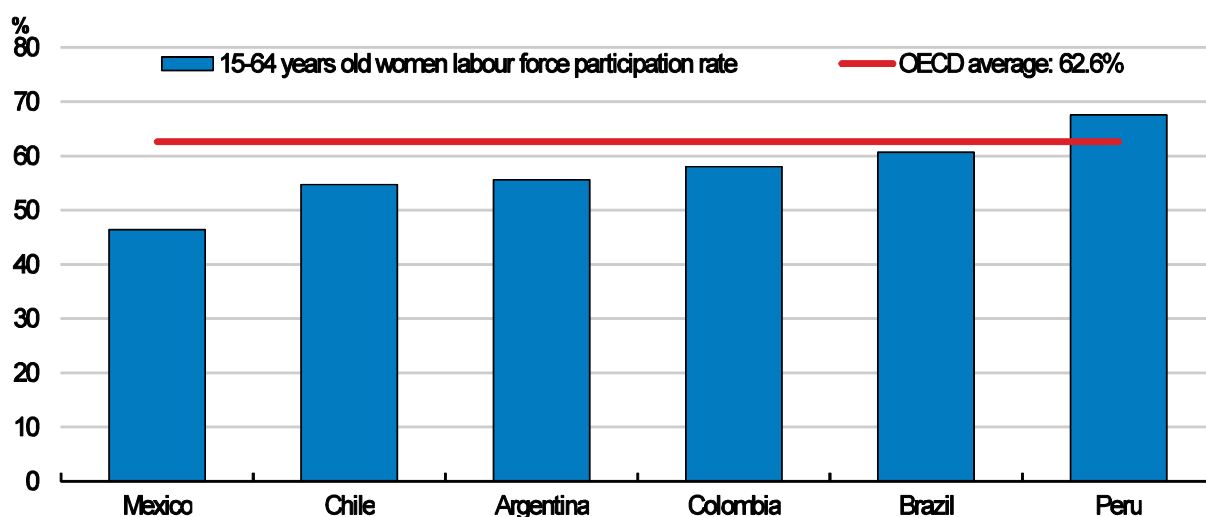
Figure 4. Latin America has an opportunity to increase productivity and catch up with OECD countries



1. Compared to the simple average of the 17 OECD countries with highest GDP per capita in 2013 based on 2013 purchasing power parities (PPPs). The sum of the percentage difference in labour resource utilisation and labour productivity do not add up exactly to the GDP per capita difference since the decomposition is multiplicative.
2. Labour productivity is measured as GDP per employee. Labour resource utilisation is measured as employment as a share of population.

Source: OECD, National Accounts Database; World Bank, World Development Indicators (WDI) Database; ILO (International Labour Organization).

Figure 5. Female labour force participation is relatively low in Latin American countries



Note: The labour force participation rate is the labour force as a percent of the working age population.

Source: OECD and ILOSTAT.

ARGENTINA

After a weak outturn in 2015, Argentina's economy will recover in 2016, led by a stronger demand from trading partners and an improvement in investors' confidence. The current slowdown of activity reflects the decline in exports, as traditional trading partners, notably Brazil, are negatively affected by lower terms of trade. By the end of 2015 and in 2016, activity is expected to rebound thanks to higher growth of foreign demand and a rise in business confidence, which will boost investment.

Inflation has moderated, although it is still high. To reduce it, it is necessary to decrease monetization of the fiscal deficit in the short term, and gradually eliminate the deficit in the medium term. In this regard, the drop in oil prices, which will mitigate external and fiscal vulnerabilities, offers an excellent opportunity to progressively reduce subsidies to energy and transport. Without fiscal measures, the deficit is expected to continue increasing.

One of the biggest medium-term challenges is to achieve higher investment rates, so as to achieve robust and sustainable growth. Investment grew strongly over the past decade, but during the last four years it has shown a declining trend due to the drop in terms of trade and policy uncertainties which affected business confidence.

Economic activity remains weak

Activity has decelerated in 2014 and the economy is currently stagnating. This is the result of the worsening of external demand, particularly from Brazil, and lower domestic expenditure, which in part was affected by tighter controls on trade. The most affected sectors are manufacturing industry and retail trade, which jointly fell by around 1%. The lower dynamism of economic activity has affected the labor market – with a slight increase in the unemployment rate – and households' consumption.

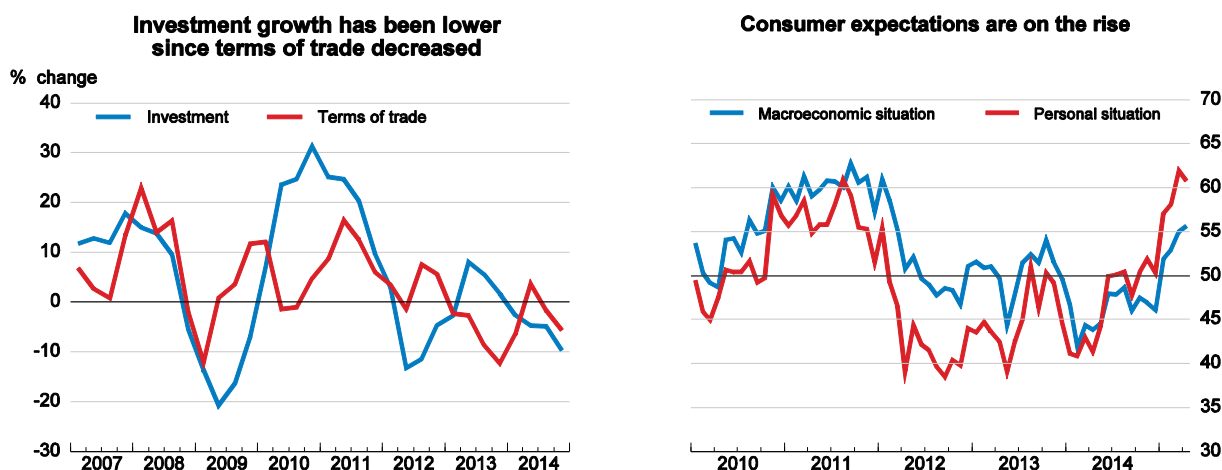
Investment growth has turned negative. After growing by an average of 10.4% a year between 2002 and 2011, which brought it from about 11% of GDP to a maximum of 24%, investment has decelerated since mid-2011. This raises important concerns not only because weak investment played a major role in the slowdown, but also because increasing it is necessary to correct structural bottlenecks, including the large needs in infrastructure.

Inflation has decreased but will remain high

Inflation has decreased recently and, although still high, it is expected to fall further in 2016. Lower inflation will result from: a more gradual depreciation of the exchange rate and a slower growth of monetary aggregates; weaker economic activity and therefore less pressure on prices; and falling energy prices passing through to domestic prices. Additionally, the gap between the formal and informal exchange rate – originated from the restrictions on currency markets – has stabilized between 40 and 50 percent since the end of 2014, and it is expected to continue moderating throughout the year due to the lower external vulnerabilities.

Fiscal policy continues to provide a strong stimulus, and the budget deficit has widened. Further deterioration in fiscal balances is projected, despite lower oil prices offering an opportunity to reduce the subsidies to energy and transport. The budget deficit is projected to deteriorate from 2.7% of GDP in 2014 to 4.1% in 2015 and 4% in 2016. Hence, macroeconomic imbalances will remain important, hindering the effectiveness of measures to reduce inflation.

Argentina



Source: INDEC and Universidad Torcuato Di Tella.

A normalization of macroeconomic policies is required to recover stability and boost growth

Investors' confidence is recovering thanks to recent legal changes that have improved the investment climate for international oil companies, expanding the possibility of exploiting the large energy potential of the country. This provides an opportunity to improve the business climate and facilitate investment, thus contributing to stronger medium-term growth.

A resolution of debt legal challenges would also help Argentina return to sustainable growth. This would make it possible to regain access to international capital markets and help to reestablish normal financial conditions. After normalizing relations with creditors, Argentina could dismantle existing restrictions on capital flows, thus eliminating the gap between the official and informal foreign exchange market. Although the recent issuance of 10-year government bonds denominated in foreign currency shows an initial improvement in relations with financial markets, solving the debt legal challenges remains necessary to obtain external financing at lower rates.

To improve growth prospects and social outcomes, it will be necessary to increase productivity growth. Reducing the barriers to international trade would contribute to stronger productivity because competition with foreign supplies would encourage firms to become more efficient. The reduction of product market regulations would also go in this direction, by lowering barriers to market entry and enhancing domestic competition over time. Finally, there is a strong need to improve the quality of education to boost the skills of the labour force.

Argentina: Demand, output and prices

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--------------------------------------|--|---------------------------------------|------|-------|------|------|
| | Current prices in billions of AR pesos | Percentage change, volume (prices) | | | | |
| GDP at market prices | 2 312.0 | 0.8 | 2.9 | 0.5 | -0.1 | 2.0 |
| Private consumption | 1 496.3 | 4.3 | 4.3 | -0.5 | 0.0 | 2.0 |
| Government consumption | 323.4 | 5.9 | 4.2 | 2.8 | 1.5 | 1.0 |
| Gross fixed capital formation | 426.9 | -7.0 | 3.1 | -5.6 | -3.3 | 2.0 |
| Final domestic demand | 2 246.6 | 2.4 | 4.1 | -0.9 | -0.3 | 1.8 |
| Stockbuilding ¹ | 29.5 | 0.1 | 0.1 | -0.4 | -0.1 | 0.0 |
| Total domestic demand | 2 276.0 | 0.5 | 4.2 | -1.2 | -0.3 | 1.8 |
| Exports of goods and services | 406.1 | -5.6 | -4.0 | -8.1 | -3.0 | 5.0 |
| Imports of goods and services | 370.1 | -6.1 | 3.6 | -12.6 | -5.1 | 4.1 |
| Net exports ¹ | 36.0 | 0.3 | -1.5 | 1.4 | 1.2 | 1.4 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | — | 18.7 | 19.7 | 28.7 | 24.1 | 17.1 |
| Current account balance ² | — | -0.2 | -0.8 | -0.9 | -1.9 | -1.5 |

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP at market value.

Source: INDEC and OECD projections.

BRAZIL

Economic growth is projected to contract this year, but a slow recovery is expected to unfold gradually from the end of 2015, driven initially by strengthening exports, which will be boosted by the depreciation of the real.

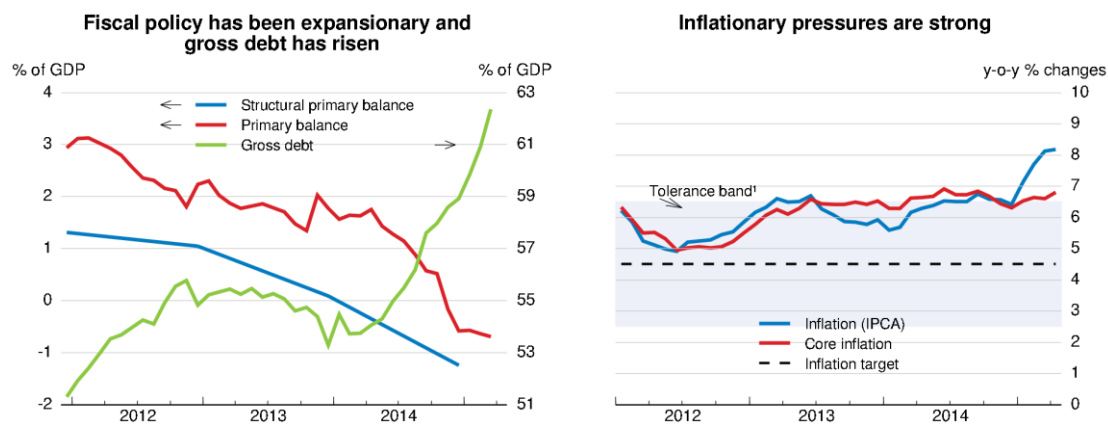
Fiscal performance has deteriorated and inflation has risen significantly. Consequently, rebuilding confidence in macroeconomic policies remains the priority. Continuous vigilance to ensure a return of inflation to the target is warranted. Recent government commitments for fiscal adjustment are welcome and also lay the grounds for stronger growth. More specifically, recent adjustments of social benefits, lower support to public banks and cost-covering electricity prices are correcting past distortions and are important initiatives on the supply side. The planned launch of a new round of concessions, especially in transportation, is fundamental to addressing bottlenecks and promoting higher growth. The recent decision to restart trade negotiations with the EU and the start of a wide-ranging free-trade agreement with Mexico are welcome. Progress on a comprehensive reform of indirect taxes, lowering trade barriers and reducing administrative burdens could spur competition and accelerate the recovery significantly. The commitment to inclusive growth, including through further improvements in education and well-targeted social transfers, should be maintained.

At less than 20% of GDP, Brazil's level of investment has traditionally been low by international and Latin American standards. This partly reflects Brazil's relatively low domestic saving. Over the past 4 years, however, investment has been trending down due to policy uncertainties and lack of confidence. These factors have recently been compounded by corruption allegations surrounding the national oil company, Petrobras. Business investment is projected to pick up in 2016 as activity accelerates and some of the previous risks are being addressed.

Growth has stalled and confidence has declined

The economy came to a standstill in 2014 against the background of deteriorating terms of trade, domestic bottlenecks and policy uncertainty. While monetary policy tightened, fiscal policy delivered a sizeable stimulus. In practice, several of the fiscal measures failed to support growth effectively and further added to existing distortions. Fiscal accounts deteriorated and the primary balance, which had been in surplus since 1999 to keep public debt on a declining path, turned into a deficit. As a result, gross debt increased by almost 7 percentage points of GDP since 2013. Headline and core inflation have been significantly above the 4.5% inflation target, and have risen above the ceiling of the tolerance band in early 2015 due to adjustments in administrative prices. Short-term indicators including business conditions and retail sales are consistent with a contraction of activity in early 2015.

Brazil



1. The inflation target is met whenever the accumulated inflation during the period January-December of each year falls within the tolerance band.

Source: Central Bank of Brazil; and IBGE.

Brazil: Demand, output and prices

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|--|---|------|------|------|------|
| | Current prices Brazilian Real billions | Percentage changes, volume (2000 prices) | | | | |
| GDP at market prices | 4 374.8 | 1.8 | 2.7 | 0.2 | -0.8 | 1.1 |
| Private consumption | 2 637.0 | 3.9 | 2.9 | 0.9 | 0.6 | 1.2 |
| Government consumption | 817.4 | 3.2 | 2.2 | 1.4 | -1.5 | -0.5 |
| Gross fixed capital formation | 902.9 | -0.6 | 6.0 | -4.3 | -3.7 | 0.9 |
| Final domestic demand | 4 357.3 | 2.9 | 3.4 | -0.1 | -0.7 | 0.8 |
| Stockbuilding ¹ | 51.2 | -1.1 | 0.2 | 0.2 | 0.0 | 0.0 |
| Total domestic demand | 4 408.4 | 1.8 | 3.5 | 0.1 | -0.7 | 0.8 |
| Exports of goods and services | 501.8 | 0.1 | 2.2 | -1.0 | -6.3 | 5.9 |
| Imports of goods and services | 535.5 | 0.2 | 7.2 | -1.0 | -3.3 | 2.4 |
| Net exports ¹ | - 33.7 | 0.0 | -0.7 | 0.0 | -0.3 | 0.3 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | — | 5.9 | 6.5 | 6.9 | 7.1 | 5.9 |
| Consumer price index | — | 5.4 | 6.2 | 6.3 | 8.3 | 5.2 |
| Private consumption deflator | — | 6.1 | 7.0 | 6.8 | 8.1 | 6.3 |
| General government financial balance ² | — | -2.3 | -3.1 | -6.2 | -4.9 | -4.1 |
| Current account balance ² | — | -2.3 | -3.4 | -3.9 | -3.6 | -3.1 |

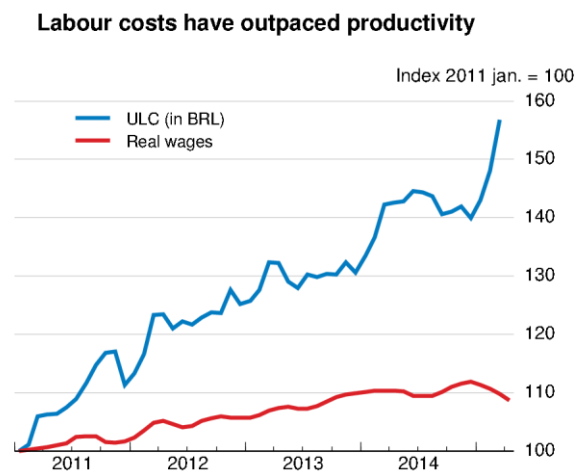
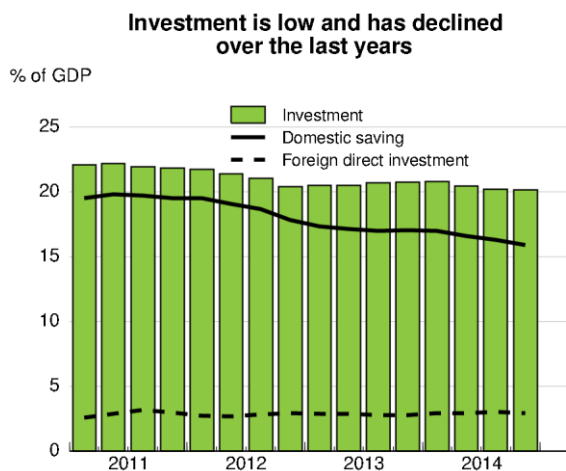
1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP at market value.

Source: OECD Economic Outlook 97 database.

Business and consumer confidence has deteriorated sharply owing to a combination of low growth and high inflation, the corruption investigations and discussions about possible sovereign rating downgrades. Deteriorating international competitiveness and substantial policy uncertainties resulting from a series of ad-hoc policy changes that affected the conditions of doing business added to the decline of confidence among investors, and thus to a contraction of investment.

Brazil



Source: Central Bank of Brazil; and IBGE.

Macroeconomic policy space is limited but structural reforms can boost growth

Macroeconomic policy space is severely limited by the need to restore confidence and preserve Brazil's investment grade rating. In January 2015, the new government announced a significant fiscal

adjustment, with primary surplus targets of 1.2% and 2% of GDP for 2015 and 2016. The new targets are backed by concrete measures to reduce expenditures and – to a lesser extent – raise revenues. This has lent credibility to the consolidation plans. At the same time, the central bank adopted a more ambitious strategy of bringing inflation back to the 4.5% target by end-2016 and, accordingly, has raised the policy rate further. Despite hikes in administrative prices and a depreciated currency, which have pushed year-on-year headline inflation significantly above the target range in early 2015, inflation expectations have declined, probably as a result of these stronger fiscal and monetary policies. Also, price realignments, as in the energy sector, are aimed at ensuring the right signals are in place for markets to work well.

Structural reforms have a significant potential to boost growth. Reducing the compliance costs and distortions imposed by Brazil's fragmented system of indirect taxes could provide an almost immediate cost reduction for firms, and could be achieved by consolidating indirect taxes into a single, broad-based value-added tax with full deductibility for inputs and an exemption for exports. This would improve competitiveness, adding to the effects of the depreciated exchange rate. In addition, reducing barriers to international trade would reduce the costs of imported inputs and strengthen incentives to enhance productivity by exposing Brazilian firms to more international competition. Lowering domestic entry barriers could reinforce the limited exposure of Brazilian firms to competitive pressures, eventually raising productivity. Improvements in infrastructure could also reduce transport costs, particularly for exporters. Although concessions already play an important role in infrastructure in Brazil, improvements in the regulatory environment could enhance predictability and boost new and sizeable investments by the private sector. PPPs are to play a much larger role in the upcoming concessions, in line with less participation by public banks, in particular BNDES.

Brazil has achieved substantial reductions of poverty and inequality and has seen the emergence of a new middle class. Policy efforts, including in education and social transfers, have played a crucial role in this process and this momentum should be maintained to make growth more inclusive.

The economy will contract in 2015, followed by a gradual recovery in 2016

The economy will be negatively affected in 2015 by low levels of confidence, lower investment in the oil sector and the headwinds from macroeconomic policy tightening. Over the course of the year, however, improved macroeconomic policies and a few announced structural policy reforms are assumed to raise confidence. Private consumption, and with some delay also investment, are projected to rebound and lead the recovery of growth. Exports will be supported by a more competitive exchange rate, which will reduce the current account deficit.

Unemployment, which has so far been isolated from low activity levels due to declining labour participation among young cohorts, is expected to rise during 2015, before beginning to fall again slowly as of 2016. As the effects of administrative price hikes and currency depreciation taper off, inflation is projected to decline over the projection period and converge to the inflation target by the end of 2016.

Risks to the outlook include a failure to achieve the announced fiscal adjustment, which will be seen as a litmus test for improved macroeconomic policies. Besides reducing investment, this could trigger a loss of Brazil's investment grade rating. Fallout from the events unfolding at Petrobras could be stronger than expected, particularly if the investigations lead to more bankruptcies in upstream activities. Although water reservoir levels have recently risen following a prolonged drought, the possibility of energy or water rationing remains. Such rationing significantly dented growth in the early 2000s. A principal upside risk is related to the structural reform agenda. Given the significant scope to improve the business climate, a few key reforms could make a significant difference for productivity and boost growth.

CHILE

After a sharp slowdown in 2014 the economy is projected to gradually recover in 2015 and 2016. The pick-up in activity will initially be driven by higher public spending, but will increasingly be supported by stronger external demand for industrial goods from the United States and Europe.

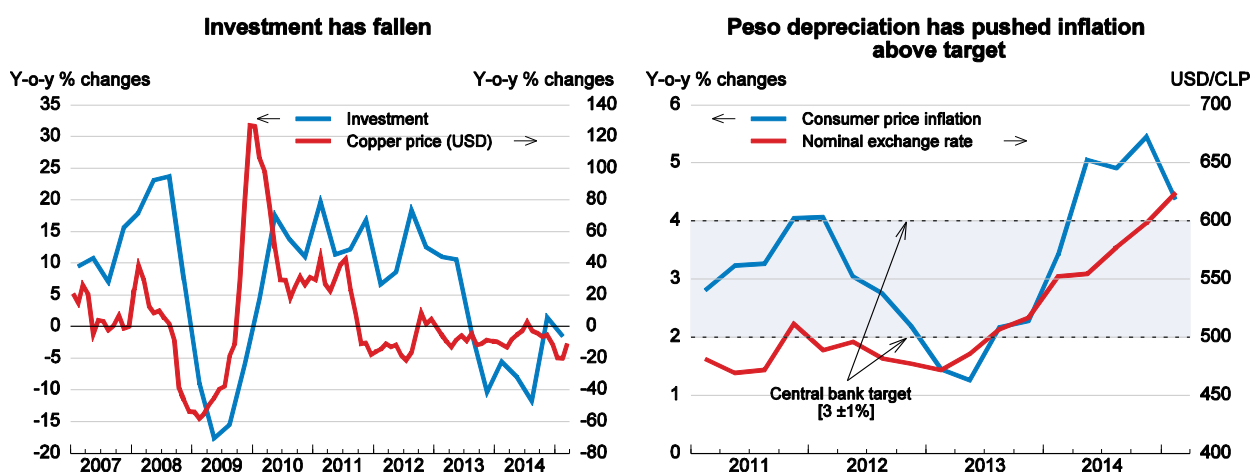
As the exchange rate has stabilised, inflation is moderating, although it remains above the central bank's target band. Since inflation expectations remain well anchored, monetary policy can continue to support growth in the near term, before moving to a more neutral stance as growth strengthens. The underlying stance of fiscal policy is expected to be expansionary in 2015, but then to become neutral in 2016 as the government remains committed to achieve a zero structural balance by 2018.

The large decline in copper prices in the aftermath of the commodity super-cycle has affected the investment plans of mining companies, which have significantly reduced investment since 2012. This decline is perceived to be to a large extent permanent, and mining investment is therefore not expected to recover very strongly, even in the medium term. Therefore, advancing the *Productivity Agenda*, which is meant to broaden the base of the economy, is essential. Structural reforms to open market further to competition will be particularly important to boost investment outside the mining sectors, increasing and making growth more inclusive.

The economy is in transition

The long phase of strong economic growth driven by the booming mining sector has come to an end. Declining copper prices and lower demand from China have reduced the terms of trade, business confidence and investment. The mining sector over-invested during the commodity super-cycle – when mining investment grew from approximately 2% to almost 7% of GDP – creating a lot of spare capacity. As a result, mining investment has declined by a third since 2012, and is expected to remain weak in the medium term. Lower terms of trade have also cut household incomes and private consumption.

Chile



Source: OECD 97 database; Datastream; and Central Bank of Chile.

Chile: Demand, output and prices.

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|-------------------------------|--|------|------|------|------|
| | Current prices CLP billion | Percentage changes, volume (prices) | | | | |
| GDP at market prices | 121 319.5 | 5.5 | 4.3 | 1.8 | 2.9 | 3.7 |
| Private consumption | 74 017.8 | 6.1 | 5.9 | 2.2 | 2.2 | 3.3 |
| Government consumption | 14 690.6 | 3.5 | 3.4 | 4.4 | 7.0 | 5.1 |
| Gross fixed capital formation | 27 132.0 | 11.6 | 2.1 | -6.1 | 1.2 | 1.2 |
| Final domestic demand | 115 840.4 | 7.0 | 4.6 | 0.5 | 2.6 | 3.1 |
| Stockbuilding ¹ | 1 652.6 | 0.4 | -0.9 | -1.1 | 2.0 | 0.0 |
| Total domestic demand | 117 493.0 | 7.5 | 3.8 | -0.5 | 4.8 | 3.1 |
| Exports of goods and services | 46 162.8 | 0.1 | 3.4 | 0.7 | 3.0 | 6.1 |
| Imports of goods and services | 42 336.3 | 4.8 | 1.7 | -7.0 | 1.9 | 4.3 |
| Net exports ¹ | 3 826.5 | -1.6 | 0.6 | 2.5 | 0.4 | 0.7 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | — | 0.8 | 1.8 | 5.5 | 4.9 | 3.3 |
| Consumer price index | — | 3.0 | 1.8 | 4.7 | 3.3 | 2.6 |
| Private consumption deflator | — | 2.7 | 2.5 | 5.6 | 4.7 | 3.5 |
| Unemployment rate | — | 6.4 | 6.0 | 6.3 | 6.2 | 6.3 |
| Central government financial balance ² | — | 0.6 | -0.6 | -1.8 | -2.4 | -1.7 |
| Current account balance ² | — | -3.6 | -3.6 | -1.1 | -0.8 | 0.0 |

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP at market value

Source: OECD Economic outlook 97 database

Monetary and fiscal policies are supporting the recovery

To support domestic demand, the central bank decreased policy interest rates by 200 basis points and has kept them close to historical lows since October 2014. This monetary support resulted in an exchange rate depreciation of around 15% in real terms since early 2013, cushioning the economy from the falling terms of trade by boosting exports and investment in non-mining sectors. The current account deficit has already fallen from 3½ per cent of GDP in 2013 to projected ½ per cent in 2015.

Fiscal policy is also supporting activity. Taking advantage of a robust fiscal situation – with a near absence of net debt – the government has responded to the slowdown in activity with a strong fiscal impulse to the economy in 2015. Government expenditures will grow by around 10% in 2015, part of which will however be offset by tax increases. Because most of the increase in spending is in public investment and infrastructure investment, the fiscal stimulus can remain temporary, leaving the government in a position to achieve its goal of zero structural balance by 2018.

The economy is projected to rebound, but structural reforms are essential for sustained growth

Economic activity posted a moderate recovery during the first months of the year, and the exchange rate depreciation and stronger growth of trading partners in the second half of 2015 and in 2016 are expected to boost industrial exports. Similarly, private consumption will increasingly add to growth as lower prices of oil contribute to improve the income of families.

The economic consequences of the large drop in copper prices have shown how much Chile is affected by external shocks. Growth, however, will depend on implementing the government's ambitious reform agenda. Uncertainties on this point, or about the effects of reform, could depress confidence and therefore the speed of the investment recovery. By contrast, tangible progress in reform — particularly policies to foster competition, reduce skill mismatches, increase economic diversification and raise female labour force participation — could boost economic potential more than assumed and will help to reduce inequalities.

COLOMBIA

Economic growth will slow down in 2015 as weaker commodity prices reduce investment and exports, and public spending slows due to lower oil and mining revenues. Tighter household balance sheets and weaker employment growth will also slow domestic demand growth. Currency depreciation will temporarily raise headline inflation, but also contribute to growth by gradually boosting non-commodity exports. Stronger foreign demand and the easing of infrastructure bottlenecks will also contribute to an export-led recovery in 2016.

Monetary policy should be neutral to keep inflation expectations anchored. Fiscal consolidation consistent with the fiscal rule should continue, but in the longer term more tax revenues are required to finance needed social expenditures and infrastructure investments. Structural reforms are needed to make growth more inclusive and to facilitate the economic rebalancing process.

Investment will weaken due to less resource-related investment. Reducing the tax burden on business investment would boost investment outside oil and mining. More competition in banking would lower the cost of financing investment. Infrastructure investment has increased, but there are still large gaps to fill. Swift implementation of the ambitious private-public partnership programme in transport infrastructure is crucial.

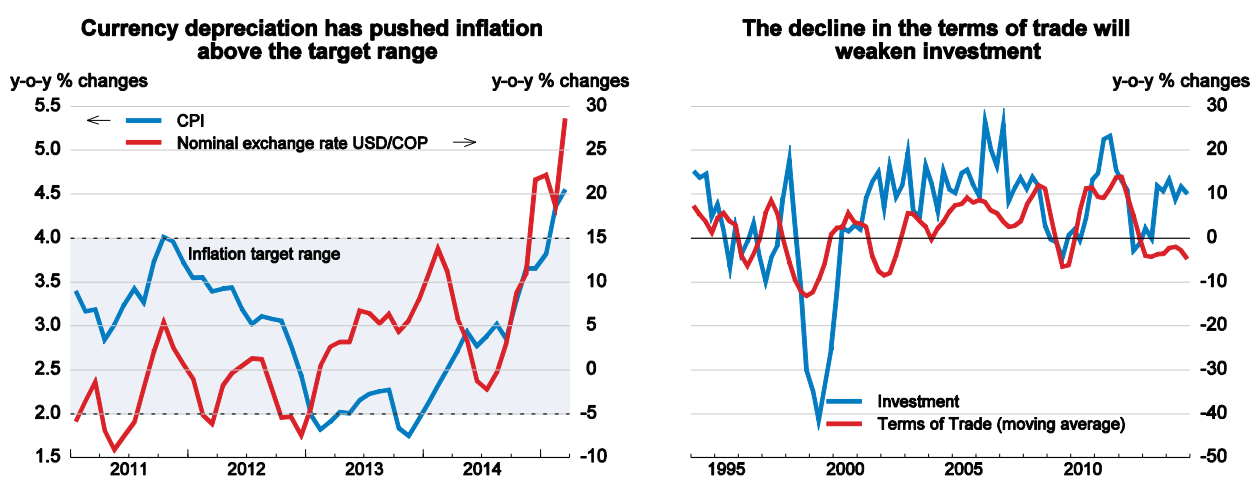
Growth is moderating due to lower commodity prices

Lower global commodity prices and declining resource-sector investment have resulted in reduced output and widened the current account deficit. Inflation has edged above the target zone, driven mainly by increased food prices, due to adverse weather conditions, a recent trucker strike, and the depreciation of the peso. Private consumption growth has slowed as employment growth moderated and consumer confidence weakened.

Monetary policy is supportive but public spending growth is slowing

The monetary policy rate has remained at 4.5% since September 2014, despite the recent surge in inflation. This monetary support is appropriate given economic uncertainties, since the increase in inflation is mainly due to transitory factors and inflation expectations remain close to the 3% target. Reducing agricultural trade barriers would curb the impact of local weather conditions on food prices.

Colombia



Source: OECD Economic Outlook 97 database; and OECD National Account Database.

Colombia: Demand, output and prices

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--------------------------------------|---|--|------|------|------|------|
| | Current prices Colombian Peso trillions | Percentage changes, volume (prices) | | | | |
| GDP at market prices | 619.9 | 4.0 | 4.9 | 4.6 | 3.3 | 3.7 |
| Private consumption | 381.3 | 4.4 | 3.8 | 4.3 | 3.6 | 3.2 |
| Government consumption | 98.0 | 6.4 | 9.3 | 6.2 | 1.9 | 2.2 |
| Gross fixed capital formation | 146.3 | 4.7 | 6.0 | 10.9 | 3.0 | 3.6 |
| Final domestic demand | 625.6 | 4.8 | 5.3 | 6.2 | 3.2 | 3.1 |
| Stockbuilding ¹ | 1.7 | -0.1 | -0.1 | 0.2 | -0.1 | 0.0 |
| Total domestic demand | 627.3 | 4.9 | 5.2 | 6.7 | 3.3 | 3.1 |
| Exports of goods and services | 116.1 | 6.0 | 5.3 | -1.7 | 3.6 | 5.0 |
| Imports of goods and services | 123.6 | 9.1 | 6.4 | 9.2 | 3.4 | 2.0 |
| Net exports ¹ | -7.4 | -0.7 | -0.3 | -2.1 | -0.2 | 0.3 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | — | 3.0 | 1.9 | 1.8 | 2.6 | 3.3 |
| Consumer price index | — | 3.2 | 2.0 | 2.9 | 4.3 | 3.3 |
| Private consumption deflator | — | 2.7 | 2.1 | 2.9 | 4.0 | 3.4 |
| Unemployment rate | — | 10.4 | 9.6 | 9.1 | 9.0 | 9.0 |
| Current account balance ² | — | -3.1 | -3.2 | -5.3 | -6.0 | -5.3 |

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP at market value

Source: OECD Economic outlook 87 database

As resource-related revenues fall, public spending will be reduced to achieve budget balance targets in 2015 and 2016. Colombia's fiscal rule allows for automatic stabilisers, but as the decline in oil and coal prices might be permanent adjusting spending is appropriate. However, public investment in transport infrastructure needed to remove bottlenecks should not be cut. A structural tax reform is needed to raise more revenues, reduce the tax burden on investment to support growth outside the commodity sector, and decrease informality and inequalities.

Structural reforms would facilitate the adjustment process and would make growth more inclusive. Fostering competition in product markets such as telecommunications, food and the retail sectors will boost productivity. More competition in banking would reduce financing costs. Reforming the minimum wage, reducing non-wage labour costs and more skills investment are needed to curb labour informality and reduce inequality. A structural pension reform to increase pension coverage is needed to reduce still high old-age poverty.

Growth will weaken as structural constraints slow adjustment

Growth will be reduced by the gradual rebalancing of investment and employment towards non-commodity exports and tradables that compete with imports. This will reduce the dominance of oil and mining exports, now 70% of total exports, in a healthy adjustment. Investment is projected to gain some momentum towards the second half of 2016 and lower employment growth will contain private consumption growth. The current account deficit will widen in 2015 but then gradually narrow again as competitiveness improves and external demand from neighbouring oil-exporting countries picks up. Inflation is projected to move closer to the target due to increased economic slack and the fading effects of the weaker currency and food-price shocks related in part to the drought caused by the "El Niño" phenomenon. The drought will also affect output negatively by reducing agricultural production and energy supply.

The evolution of global oil and coal prices, and of external demand from the United States and China, could significantly alter short-term prospects. The large current account is a vulnerability, but this is mitigated by good capital market access, the flexible exchange rate regime, a prudent debt composition and contingent credit lines. Successful execution of the transport infrastructure programme is key to the economic rebalancing. Better climate conditions should the drought ease would raise growth and lower inflation.

COSTA RICA

Growth will slow down slightly in 2015. Interest rate cuts will support private consumption and investment. Growth will pick up in 2016, driven by the recovery in the economies of the main trading partners, particularly the United States. Unemployment will decrease slightly.

Inflation has steadily decreased from a peak of 5.9% in November 2014 and in January 2015 returned to the target range of the Central Bank. The adoption of a flexible exchange rate regime in February 2015 has established inflation as the sole objective of monetary policy and is contributing to the convergence of inflation expectations to the target range.

In order to maintain the macroeconomic stability achieved in recent years, it is urgent to adopt concrete actions of fiscal reform, both in revenue and in expenditure control. The country must also undertake structural reforms, increasing competition and improving the efficiency of the educational system. An improvement of infrastructure, through participation from the public and private sectors, would also help to ensure a sustained growth of the potential of the economy.

Growth has temporarily slowed down

Growth has slowed down since mid-2014, which is partially explained by the withdrawal from the country of the manufacture activity of the electronics company Intel, which has readjusted its operations to the changes in the market of microprocessors. This withdrawal will slow down growth by 0.6 percent points, mostly in 2015. Other industries have also shown a deceleration this year, even in the dynamic services sector.

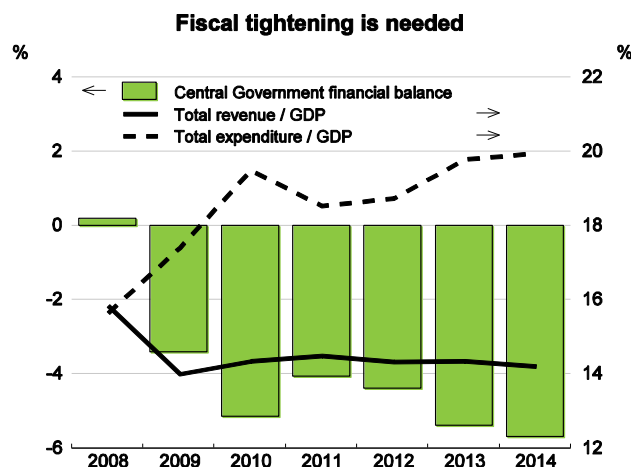
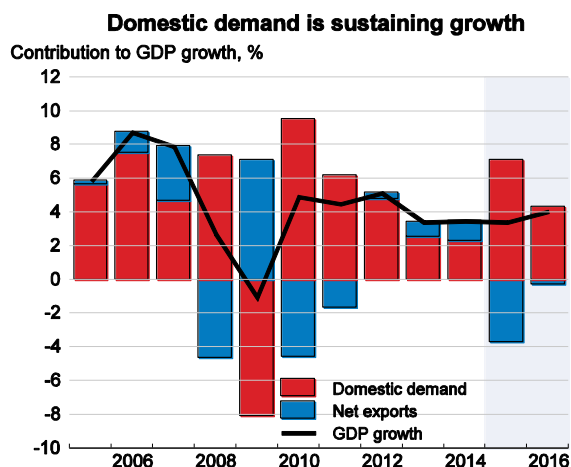
Inflation returned in January to the target range of the Central Bank, after some months of acceleration due to the colón depreciation in early 2014. The Central Government finished 2014 with a budget deficit of 5.7% of GDP, a figure expected to be reached again in 2015. It is expected that in 2016 the deficit will increase in 0.8 percentage points, while debt will remain on a growing trend.

Monetary policy framework has been strengthened

The adoption in January of a flexible exchange rate regime made inflation the only goal of monetary policy. The Central Bank kept its target range for inflation in 3% - 5%, taking into account the absence of demand pressures, the expected exchange rate stability and the favourable conditions in oil prices. It is expected that the new regime will help inflation expectations to converge to the target range and will reduce the high financial dollarization in households and firms, which undermines the effectiveness of monetary policy, as agents internalize in their economic decision the higher exchange rate risk.

Amid decreasing inflation and a slowdown in growth, the Central Banks has cut its policy rate from 5.25% to 3.75%, which will support domestic demand, particularly private consumption and construction.

Costa Rica



Source: Banco Central de Costa Rica.

Costa Rica: Demand, output and prices

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|-------------------------------|--|------|------|------|------|
| | Current prices CRC billion | Percentage changes, volume (prices) | | | | |
| GDP at market prices | 20 852.2 | 5.2 | 3.4 | 3.5 | 3.4 | 4.3 |
| Private consumption | 13 596.3 | 4.2 | 3.3 | 3.9 | 5.0 | 4.8 |
| Government consumption | 3 730.9 | 1.0 | 2.8 | 3.5 | 3.2 | 2.8 |
| Gross fixed capital formation | 4 167.8 | 8.0 | 12.3 | 4.5 | 7.7 | 4.6 |
| Final domestic demand | 21 495.1 | 4.8 | 5.5 | 4.0 | 5.5 | 4.6 |
| Stockbuilding ¹ | 395.7 | 0.1 | -2.7 | -1.7 | 1.6 | -0.1 |
| Total domestic demand | 21 890.8 | 4.8 | 2.6 | 2.4 | 7.3 | 4.5 |
| Exports of goods and services | 7 759.5 | 9.3 | 3.6 | -1.7 | -7.4 | 4.3 |
| Imports of goods and services | 8 798.0 | 8.7 | 2.1 | -4.0 | -0.4 | 4.8 |
| Net exports ¹ | -1 038.6 | 0.4 | 0.9 | 1.2 | -3.7 | -0.3 |
| Memorandum items | | | | | | |
| GDP deflator | — | 3.9 | 4.4 | 4.7 | 4.3 | 4.2 |
| Consumer price index | — | 4.6 | 3.7 | 5.1 | 4.3 | 4.0 |
| Private consumption deflator | — | 4.5 | 5.0 | 4.1 | 2.6 | 4.3 |
| Unemployment rate | — | 9.8 | 8.3 | 9.7 | 9.5 | 9.2 |
| Central government financial balance ² | — | -4.4 | -5.4 | -5.7 | -5.7 | -6.5 |
| Current account balance ² | — | -5.3 | -5.0 | -4.9 | -4.0 | -4.4 |

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP at market value

Source: Banco Central de Costa Rica and OECD secretariat projections.

Improvement of public finances and structural reforms are urgent

The recovery of external demand will help growth to return to rates above 4% in 2016. An environment compatible with a stable inflation is expected, save for any increases in the exchange rate that might result from the rise in interest rates in the United States.

The lack of fiscal reforms is the main risk for the stability of public finances in the medium term, and there is agreement on the need of a reform that increases revenue and allows to control expenditure. In

March 2015, the Ministry of Finance submitted for public consultation its proposal of tax reform, which comprises the introduction of VAT with a wider base that includes most services, as well as several changes on the income tax. However, the legislative process is generating uncertainty as to whether the planned increase in taxes will happen during 2015.

Structural reforms in the goods and services markets are also needed to increase productivity, strengthen growth and make it more inclusive. In particular, it is necessary to promote more competition in several sectors and improve the efficiency of the educational system. Road infrastructure, ports and airport as well as the public transport system require special attention to increase competitiveness and the productive potential in the long run.

MEXICO

Mexico's economic recovery is strengthening, led by US import demand for manufactures and a weaker currency. Real GDP is projected to grow by 2.9% in 2015 and 3.5% in 2016. Firming exports have finally allowed the rebound to gain speed, and investment has begun to regain lost ground. Notwithstanding lower oil prices, new tenders are attracting considerable interest in the wake of the recent energy-sector reforms. Wide-ranging reforms to competition, energy and market regulation have helped boost confidence while monetary policy has been supportive.

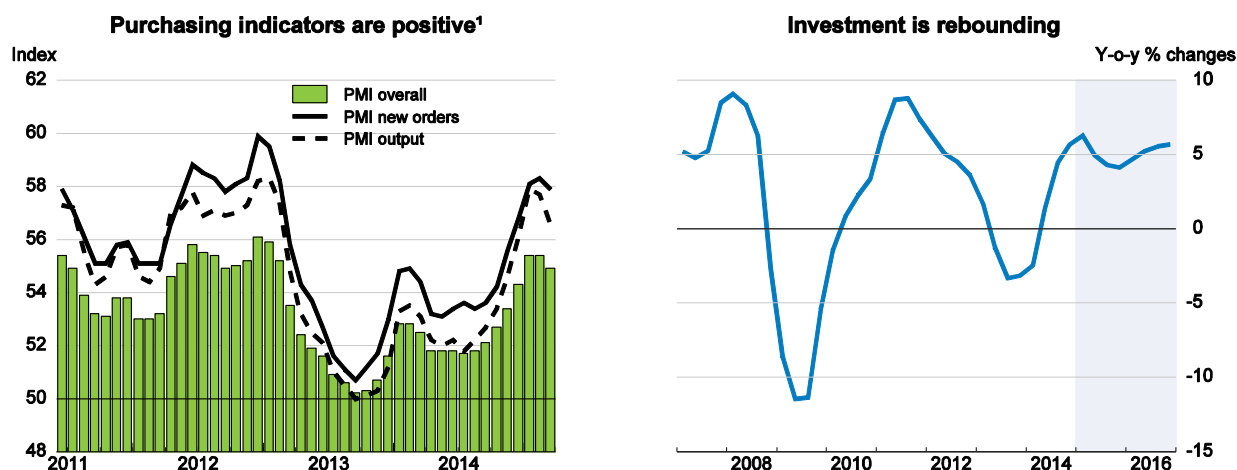
While monetary policy has remained on hold so far, interest rates will need to be raised once the US Federal Reserve raises its rates to forestall potential capital outflows. Spending was tightened early in 2015 and a balanced budget is still foreseen in 2017.

Overall investment spending has been picking up strongly, particularly for durable equipment, while residential construction is also picking up, albeit more gradually. Determined efforts to implement the wide-ranging recent structural reforms offer the best chance to boost investment and productivity, helping to ensure more rapid and sustainable gains in well-being going forward.

The rebound in activity is gaining momentum

The Mexican economy has faced repeated delayed recoveries over the past few years due to a combination of weak global demand, domestic financial problems in the construction sector and, until last year, insufficient structural reforms. The ongoing strengthening of the US economy, an easing of the construction sector's problems, and a recent comprehensive package of structural reforms are all improving the investment climate. Investment has picked up substantially, and manufacturing activity has been growing still faster, supporting a robust formal job market and boosting household incomes and consumption growth.

Mexico



1. Based on a 3-month moving average of the Markit Purchasing Managers' Index (PMI) for Mexico. Readings above 50.0 signal an improvement in business conditions on the previous month, while readings below 50.0 signal a deterioration.

Source: OECD 97 database; and Markit.

Mexico: Demand, output and prices

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|-------------------------------|-------------------------------------|------|------|------|------|
| | Current prices MXN billion | Percentage changes, volume (prices) | | | | |
| GDP at market prices | 14 544.4 | 3.8 | 1.7 | 2.1 | 2.9 | 3.5 |
| Private consumption | 9 658.3 | 4.7 | 2.5 | 2.0 | 2.7 | 3.1 |
| Government consumption | 1 683.0 | 3.3 | 1.6 | 2.5 | -0.3 | -0.2 |
| Gross fixed capital formation | 3 156.9 | 4.8 | -1.5 | 2.2 | 4.9 | 5.1 |
| Final domestic demand | 14 498.2 | 4.5 | 1.5 | 2.1 | 2.8 | 3.2 |
| Stockbuilding ¹ | 225.1 | 0.3 | -0.1 | 0.3 | -0.1 | 0.0 |
| Total domestic demand | 14 723.3 | 4.8 | 1.4 | 2.4 | 2.7 | 3.2 |
| Exports of goods and services | 4 543.3 | 5.9 | 2.1 | 7.3 | 8.5 | 7.6 |
| Imports of goods and services | 4 722.2 | 4.6 | 2.9 | 6.3 | 6.4 | 6.8 |
| Net exports ¹ | - 178.9 | 0.4 | -0.3 | 0.2 | 0.6 | 0.3 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | — | 3.6 | 1.5 | 3.6 | 3.1 | 3.0 |
| Consumer price index | — | 4.1 | 3.8 | 4.0 | 3.5 | 3.1 |
| Private consumption deflator | — | 3.9 | 2.7 | 3.6 | 3.1 | 2.9 |
| Unemployment rate ² | — | 4.9 | 4.9 | 4.8 | 4.7 | 4.6 |
| Public sector borrowing requirement ^{3,4} | — | -3.5 | -3.8 | -4.7 | -4.0 | -3.5 |
| Current account balance ⁴ | — | -1.3 | -2.4 | -2.1 | -2.0 | -2.1 |

1. Contributions to changes in real GDP, actual amount in the first column

2. Based on National Employment Survey.

3. Central government and public enterprises.

4. As a percentage of GDP at market value.

Source: OECD STEP 97 database

Monetary policy remains supportive

The central bank's target interest rate remains at an all-time low of 3%. Inflation has fallen closer to the centre of the Bank's target band, easing concerns that interest rates will need to be raised soon. Moreover, inflation expectations are well anchored. At the same time, the Mexican peso has depreciated by almost 20% in nominal effective terms in recent months, helping to boost external competitiveness.

Fiscal policy was accommodative until earlier this year, with the public sector borrowing requirement (PSBR) expanding by almost one percentage point of GDP from 2013 to 2014. However, following the collapse in oil prices, given the budget's heavy dependence on oil, the government announced measures to reduce 2015 expenditures by 0.7% of GDP, which will decrease the fiscal cliff associated with a return to "traditional" budget balance by 2017, defined as approximately 3% of GDP in terms of the PSBR.

Demand is strengthening

As US imports and domestic demand continue to grow, activity will gain further momentum and start absorbing excess capacity. The early implementation of structural reforms by the administration – most notably in the energy, financial and telecommunications sectors – is already helping business confidence and the climate for private sector investment, while public sector reforms are helping as well. These reforms should boost potential growth through increases in the capital stock and gains in productivity. Residential investment is picking up as the housing sector recovers. Capital investment should surge this year and next, boosting manufacturing activity.

The main downside risk to growth comes from possible volatility associated with the withdrawal of US monetary policy accommodation. Mexico has fared well so far, but a bout of emerging market gloom could trigger capital outflows that would drive up longer-term interest rates. Record-high foreign exchange reserves and the Flexible Credit Line offer important backstops against possible shocks. On the positive side, the major structural reforms that have passed could have effects on productivity and investment that occur earlier and are larger than assumed, helping to support gains in well-being.

PERU

After a considerable slowdown in 2014, a recovery in economic growth is projected for 2015 and 2016. This recovery will be driven by the reversal of the adverse supply shocks that affected the economy in 2014 – climate factors caused temporary disruptions in mining, fishing and agriculture – and by a fiscal stimulus. Meanwhile, it is expected that new mines become operational as well as new important infrastructure projects which will boost growth by the end of this year and the next one.

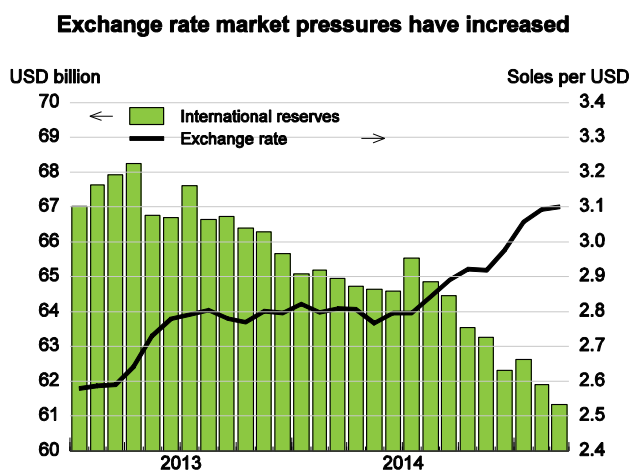
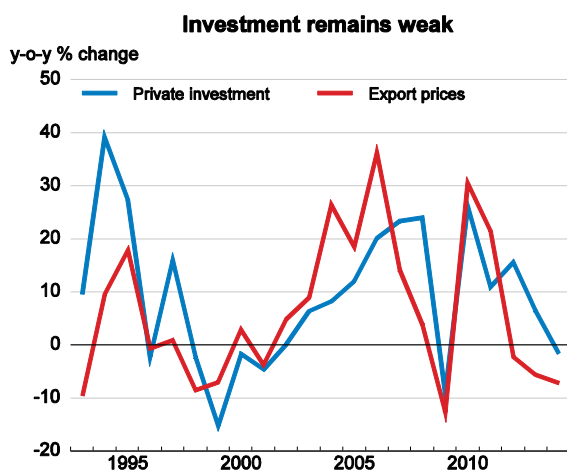
Inflation is currently at the upper bound of the target band (2% +/- 1%). However, the absence of demand pressures, a negative output gap and lower dynamism in the labor market will contribute to a gradual decline towards the midpoint target. The exchange rate pressures limit the scope for new reductions in the interest rate by the monetary authority. Contrary, fiscal policy is projected to be expansionary in 2015 supporting the recovery in activity.

The end of the commodities super-cycle poses the necessity to implement structural policies to diversify the economy, boost productivity, sustain potential growth and continue moving forward in social inclusion.

Growth will remain weak but a gradual recovery is expected

Economic activity has shown a poor performance mainly as a result of three factors. First, private consumption slowed down due to lower dynamism in the labor market which reduced job creation and increased the unemployment rate. Furthermore, food prices have risen and some surveys have revealed that more households face difficulties to pay their debts. Second, growth was adversely hit by the contraction in public investment, especially by the drop of approximately 50% of sub-national government investments, which implement more than half of all public investment. Finally, private investment also fell due to the worsening of business expectations. This suggests that investment will continue being sluggish in 2015.

Peru



Source: Central Bank of Peru.

Peru: Demand, output and prices

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|--------------------------------------|---|---------------------------------------|------|------|------|------|
| | Current prices in millions of Soles | Percentage change, volume (prices) | | | | |
| GDP at market prices | 469 854.8 | 6.0 | 5.8 | 2.4 | 3.6 | 4.3 |
| Private consumption | 281 718.0 | 6.1 | 5.3 | 4.1 | 4.2 | 4.5 |
| Government consumption | 48 111.0 | 8.1 | 6.7 | 6.4 | 7.0 | 6.0 |
| Gross fixed capital formation | 120 908.2 | 10.2 | 12.1 | -3.9 | 1.0 | 3.0 |
| Final domestic demand | 450 737.2 | 7.4 | 7.4 | 2.0 | 3.6 | 4.3 |
| Exports of goods and services | 139 336.6 | 5.8 | -2.3 | -0.3 | 3.0 | 5.0 |
| Imports of goods and services | 120 219.0 | 11.3 | 3.6 | -1.4 | 2.0 | 5.0 |
| Net exports ¹ | 19 117.6 | -1.2 | -1.7 | 0.3 | 0.3 | 0.1 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | — | 2.1 | 1.7 | 2.9 | 2.0 | 1.5 |
| Consumer price index | — | 2.6 | 2.9 | 3.2 | 2.5 | 2.0 |
| Unemployment rate | — | 6.8 | 7.5 | 6.0 | 6.2 | 6.0 |
| Current account balance ² | — | -2.7 | -4.4 | -4.1 | -4.3 | -4.5 |

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP at market value.

Source: Banco de la Reserva de Peru and OECD projections.

Fiscal and monetary policy support the recovery but structural policies can boost long run growth

Fiscal policy is expected to be expansionary in 2015 and neutral in 2016. Firstly, a drop in fiscal revenues is foreseen due to various tax measures announced at the end of last year to boost activity in the short and medium term. Among these measures are a reduction in corporate and personal income tax rates, a decrease in the Selective Tax on Fuel and the simplification of the VAT schemes. On the other hand, government expenditure in investment is projected to recover finance infrastructure projects. Specifically, it is estimated that the government will invest around 0.7% of GDP in new infrastructure projects. Therefore, prospects are that the fiscal deficit will be 2 % of GDP, consistent with a decreasing trend in the gross public debt to GDP ratio at levels that will not affect the sustainability of public accounts.

Inflation is currently at the upper bound of the target band. This year, the Central Bank has lowered the policy interest rate by 25 basis points and the domestic currency has depreciated by more than 5%, in spite of the of the large interventions in the markets to contain it. Given the high level of dollarization of credit (around 40%) and considerable currency mismatches, a sharp depreciation can have a systemic impact and harm significantly economic activity. The space for new cuts in the interest rate is limited because it could increase pressures in the exchange rates. While the Central Bank could continue relying on international reserves to delimit depreciation, exchange rate interventions would reduce liquidity in the system pushing upwards the interest rate and offsetting the effect of the initial cut. Therefore, if needed, the Central bank could continue reducing reserve requirements in domestic currency to expand credit.

In the coming years growth will gain momentum thanks to the increase in mining production, especially copper, as a result of the new mines beginning to operate, which will jointly produce the equivalent of 42% of total production in 2014. Therefore, mining contribution to GDP will be around 1% to GDP in the next two years. However in the long-run, lower levels of metal prices suggest that the mining sector may no longer be an engine of strong growth. Therefore, to boost productivity and growth of potential output, structural policies are required. In particular, policies to reduce the very high level of informality, improve access to quality education and reducing the large gaps in infrastructure are required to boost productivity and competitiveness in the country.

The risks to the outlook are external as well as internal

Two important external risks remain. First, there is the risk of a stronger than expected slowdown of growth in China that could reduce terms of trade even further. Second, higher volatility in financial markets triggered by faster than expected increase in U.S. interest rates could lead to a reversal of capital flows and stronger pressures to the exchange rate creating a high risk given the country's level of dollarization. On the domestic side, downside risks are related to a weaker than expected recovery in investment that could be affected by continuing social tensions in mining regions, or a stronger than expected impact from El Niño weather phenomenon.

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