Executive Summary

The broad-based acceleration of global growth in 2017 is reflected in the solid gains posted by the economies of the United States and Canada, both of which are expected to grow above potential in the near term. More broadly, growth in both advanced and emerging market and developing economies is expected to gain further momentum in 2018 and 2019, reflecting the effects of expansionary US fiscal policy, favorable global financial conditions, and improved prospects for external demand. Risks to the outlook are broadly balanced in the near term. Over the medium term, however, global growth is expected to soften, and risks are tilted to the downside, owing to the possibility of a sharp tightening of financial conditions, escalating trade tensions and risks of a further shift toward protectionist policies, and geopolitical strains.

In this global setting, economic recovery in Latin America and the Caribbean is gaining strength. Following a contraction in 2016, growth moved solidly into positive territory in 2017 and is expected to accelerate further in the near term, underpinned by the pickup in global demand and trade, accommodative global financial conditions, an uptick in commodity prices, and a cyclical recovery of domestic private investment.

Despite the improved near-term outlook, significant risks remain. In addition to the risks of tightening global financial conditions and populist changes in key economic partners, domestic elections and rising populist sentiment at home, as well as corruption scandals, could generate economic and policy uncertainty and derail the implementation of much-needed reforms.

Moreover, medium-term growth prospects for the region remain weak, with potential growth reverting to its subdued long-run average. With projected GDP per capita growth rates substantially below most other emerging market regions and just modestly above advanced economies, prospects for income convergence look dismal.

The sharp fall in commodity revenues following the end of the commodity super-cycle and widening fiscal deficits led to a deterioration in debt dynamics. With commodity prices expected to remain low for long and the need for countries in the region to build fiscal buffers and restore sustainability, fiscal adjustment remains an imperative, but the pace and composition of such adjustment should be tuned to support and protect inclusive growth and productivity-enhancing spending. Inflation has continued to decline in most countries, because of which monetary policy can remain accommodative, provided inflation expectations remain anchored. Exchange rate flexibility should remain the first line of defense against external shocks. The need to boost potential growth and productivity calls for a deep and comprehensive structural reform agenda.

In South America, growth resumed in 2017, supported by a favorable external environment, a cyclical recovery in domestic demand, and the end of recession in larger economies, notably Argentina and Brazil. Activity is expected to accelerate further in both 2018 and 2019. Policymakers should strive to place public debt on a sustainable footing, while minimizing the adverse impact on short- and medium-term growth. Where fiscal sustainability or credibility might be at risk, policymakers should address these concerns by front-loading the adjustment and pushing through fiscal reform.

The outlook for Mexico, Central America, and the Caribbean is shaped in large part by developments in the United States, owing to important trade, financial, and migration linkages. In the near term, the region will benefit from higher growth in the United States, but in the longer term uncertainties stemming from US policies will cast a shadow on prospects. Policies should be geared toward preserving macroeconomic stability in the context of a complex external environment—and domestic policy uncertainty because of coming elections in Costa Rica and Mexico—while setting the stage for stronger, sustainable, and inclusive growth. Tackling corruption and improving law enforcement and security to address high levels of crime in some countries remain imperative for a durable rise in investment and private sector participation.

This issue of the *Regional Economic Outlook* features three analytical chapters, assessing the role of central bank communication and transparency, the impact on growth from fiscal adjustment, and strategies for maintaining past gains in poverty and inequality reduction. Key findings include the following:

- Procyclical monetary policy tightening by Latin America's central banks in the wake of external supply shocks has prompted some reexamination of policy and the public communication of decisions. This chapter argues that central bank credibility—reflected in the degree of anchoring in inflation expectations—has bearing on policy decisions in response to these shocks and is positively related to central bank transparency. Stronger transparency frameworks and communication strategies are associated with higher policy predictability and a better anchoring of inflation expectations, thus providing greater room to maneuver in the face of transitory shocks.

- Rising public debt in many countries in Latin America and the Caribbean has underscored the need for fiscal consolidation. But will this policy hinder the region's nascent recovery? Using a new database of fiscal policy actions, estimated fiscal multipliers suggest that consolidation in the region will be more contractionary than previously thought. Nevertheless, multipliers are small enough to suggest that consolidations will improve the region's debt dynamics, even in the short run. Since expenditure multipliers vary by type of instrument, consolidation plans should preserve public investment to support growth and employment.

- Latin America has made impressive progress in reducing inequality and poverty since the turn of the century, but remains the most unequal region in the world. The gains were particularly pronounced for commodity exporters during the commodity boom. Much of the progress reflected real labor income gains for lower-skilled workers, especially in services, with a smaller but positive role for government transfers. With the end of the commodity boom, a tighter fiscal envelope, and poverty rates already edging up in some countries, policies will have to be carefully calibrated to sustain social progress. Increasing personal income tax revenues while rebalancing spending can help maintain key social transfers and infrastructure spending.