Regional Economic Outlook: Western Hemisphere October 2008

Executive Summary

The world economy continues to be buffeted by the burgeoning downdraft of the financial crisis and volatile commodity prices. As such, the outlook points to a major downturn for the global economy, with growth falling to its slowest pace since the 2001–02 recession. However, authorities around the world have taken further, massive, and increasingly coordinated corrective actions. The central scenario in the *World Economic Outlook* anticipates that these will be successful in stabilizing financial conditions. However, it will take time, under any rescue plan, to restore the proper functioning of credit markets. For the United States, our baseline projection is that recovery will begin in the second half of 2009, and will be more gradual than previous recoveries, because of the exceptional nature of the asset price adjustments taking place. Overall, growth in the advanced economies as a whole will also be close to zero at least until the middle of 2009.

For Latin America and the Caribbean (LAC), the ongoing global turmoil represents a confluence of negative shocks: the freeze in global credit markets, weaker external demand, and lower commodity prices. These shocks can have strong negative feedback loops, particularly for financing conditions. A similar scenario, when stress-tested in the April 2008 *Regional Economic Outlook: Western Hemisphere,* risked near-recessionary conditions for the LAC region. But the region is not at that point and our central scenario points to growth of around 3 percent next year, close to the average for emerging market countries. The LAC region is expected to deal with the current global shocks better than in previous crises. This reflects the progress many countries in the region have made in improving their macroeconomic fundamentals over the past decade.

However, there are still a number of downside risks for the region. Foremost among these is the outlook for commodity prices. Prices remain elevated but could fall further, in line with the experience in previous global downturns. Of course, lower food and fuel prices would bring welcome relief for some countries, in particular low-income commodity importers in Central America and many Caribbean countries. But for the region as a whole, strong commodity prices have been a major factor in bolstering fiscal and external positions and driving growth in recent years. A further sharp fall would have considerable adverse implications for the region's fiscal and external positions. Policymakers remain on high alert to deal with the current shocks and these additional risks.

Against this background, several essential priorities arise for the region in the period ahead. First, it is key to preserve the proper and efficient functioning of financial systems by preemptively addressing risks from liquidity and asset quality, and some countries have already taken steps in this regard. Many countries have built up considerable foreign exchange buffers that could be used to deal with exceptional and temporary shocks. Second, it remains important to preserve the hard-won gains on inflation. Central banks will need to maintain an active communication with markets on policy challenges and measures, especially on the future course of inflation, to keep expectations well anchored. This is especially important for countries where domestic demand has been growing well above trend and inflation remains above target. Third, fiscal situations will likely come under stress at a time when there will be increased need to maintain a robust safety net for those low-income households that would be affected by the slowdown. This will require a much more targeted strategy for fiscal spending to ensure that essential needs can be met while containing any additional financing requirements.