outside of mineral-export-led activities is a common structural weakness and remains a key vulnerability.

Latin America and the Caribbean

Recent developments

Thanks to sound macroeconomic fundamentals in place before the onset of the crisis, the Latin America and Caribbean region has been able to weather the global financial crisis much better than previous external shocks. Nevertheless, economic activity in the region decelerated sharply in the aftermath of the crisis. For the 2009 calendar year, GDP is estimated to have fallen 2.6 percent, following an expansion of 3.9 percent in 2008 (table A5). This aggregate result masks a high degree of heterogeneity among countries in the region with respect to the timing and magnitude of the contraction in domestic output. Central American economies (including Mexico) were the worst affected, with output contracting a sharp 6.4 percent, while growth in the Caribbean economies stagnated.

In the immediate aftermath of the crisis, the region was hit by a sharp slowdown in private capital inflows, while increased uncertainty and credit tightening led to a marked contraction in private consumption and private investment. The capital outflows induced a sharp depreciation of currencies in the region, a decline in equity markets, and much higher borrowing costs. Nevertheless, the region managed to avoid falling into a balance of payments and/or financial crisis.

Private consumption contracted by nearly 2 percent, while fixed investment declined sharply by 13.6 percent, after growing at double-digit rates in the previous years. The region was also affected by the collapse in external demand for commodity exports, falling

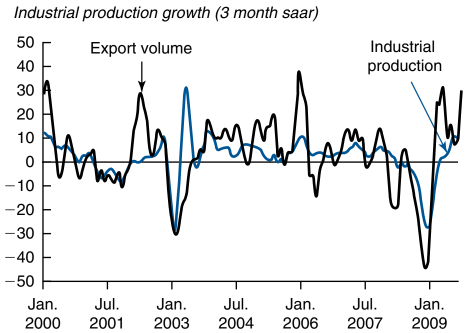
Table A5 Latin America and the Caribbean forecast summary
(annual percent change unless indicated otherwise)

	1995–2005[a]	2006	2007	2008	2009[e]	2010[f]	2011[f]
GDP at market prices (2005 US$)[b]	2.9	5.4	5.5	3.9	−2.6	3.1	3.6
GDP per capita (units in US$)	1.4	4.0	4.1	2.6	−3.8	1.8	2.3
PPP GDP[c]	2.9	5.5	5.7	4.2	−2.3	3.0	3.5
Private consumption	3.4	6.1	3.5	4.2	−1.9	3.2	3.4
Public consumption	2.2	2.8	2.9	4.1	2.9	2.8	2.6
Fixed investment	3.3	13.4	20.7	11.7	−13.6	6.1	5.8
Exports, GNFS[d]	6.0	6.7	4.9	1.6	−11.2	7.8	5.0
Imports, GNFS[d]	6.2	14.0	11.9	9.2	−15.8	10.3	5.6
Net exports, contribution to growth	0.2	−1.5	−1.7	−2.0	1.6	−0.7	−0.3
Current account balance/GDP (%)	−1.6	1.4	0.4	−0.6	−0.9	−1.0	−1.0
GDP deflator (median, LCU)	7.1	7.2	5.4	8.4	7.2	3.0	4.0
Fiscal balance/GDP (%)	−3.5	−1.1	−1.1	−0.9	−3.3	−2.8	−2.5
Memo items: GDP							
Latin America excluding Argentina	3.0	5.2	5.2	3.7	−2.6	3.2	3.7
Central America	3.6	5.0	3.7	1.7	−6.4	3.3	3.6
Caribbean	4.2	9.0	6.1	3.6	−0.1	2.3	3.3
Brazil	2.4	4.0	5.7	5.1	0.1	3.6	3.9
Mexico	3.6	4.8	3.3	1.4	−7.1	3.5	3.6
Argentina	2.3	8.5	8.7	6.8	−2.2	2.3	2.4

Source: World Bank.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and nonfactor services.
e. Estimate.
f. Forecast.

Figure A12 Industrial production and trade volumes are gaining momentum in Latin America and the Caribbean



Source: World Bank.

commodity prices, lower remittance inflows, and declining tourism activity. The decline in domestic demand translated into a sharp 15.8 percent contraction in import volumes. As a result, and despite an 11.2 percent contraction in export volumes, net trade contributed 1.6 percent to growth. Reflecting these developments industrial activity fell rapidly, plunging at a 20 percent saar rate in the last quarter of 2008 and at 16 percent in the first quarter of 2009 (figure A12).

Countries that rely heavily on trade with the United States were especially hard hit by the crisis. Mexico's economy suffered the steepest contraction in the region (7.1 percent) and its worst economic performance in seven and a half decades, both because of its close economic ties with the United States in the sectors most affected by the crisis (construction, automotive, and electrical appliances) and because of the AH1N1 flu outbreak in the second quarter of 2009. The flu outbreak hit the tourism sector especially hard and is estimated to have reduced overall GDP by 0.5 percent. Furthermore Mexican firms suffered foreign derivatives losses in December 2008 after the global crisis drove the peso to record lows. Exports collapsed in the first half of the year, dragging output down 7 percentage points, while the collapse in import volumes boosted growth by close to 9 percentage points. In 2009 private consumption is estimated to have contracted by 6.9 percent, as the labor market was severely affected by the economic slowdown, with formal unemployment almost doubling to 6.4 percent by September, and as remittances fell 13.4 percent in the first nine months of the year.

In Argentina, the global recession in conjunction with policy-related uncertainty took a toll on investment and trade. Collapsing imports and declining fiscal revenues point to weak domestic demand and relatively poor output performance in the first half of 2009, while a severe drought added to the economy's weak performance.

In República Bolivariana de Venezuela, GDP is estimated to have declined 2.4 percent as a result of the collapse in external demand, weak private consumption, and lower investment spending. Manufacturing and retail sales plunged owing to weak domestic demand, and output fell at a 4.5 percent annualized pace in the third quarter of 2009. The oil sector is becoming increasingly dominant in the economy. Supply bottlenecks, a difficult business environment, and a lack of private investor confidence are undermining new investment, impairing much-needed economic diversification.

Strong retrenchment in private investment spending and a steep drawdown in stocks (close to 1 percent of GDP) caused Chile's output to decline 4.7 percent year-on-year in the second quarter of 2009. Marked weakness in domestic demand resulted in a sharp contraction in imports that exceeded the plunge in exports.

Peru's economic growth decelerated from a double-digit pace in the first half of 2008 to a standstill in the first half of 2009, with the sharp contraction in investment spending leading to a 5.4 percent contraction in domestic demand. Weak external demand resulted in a 6.3 percent decline in exports, although imports contracted more sharply on account of weak domestic demand.

Countries in Central America and the Caribbean were afflicted by the recession in the United States and major economic partners in the European Union, particularly Spain, which has resulted in a contraction in trade, tourism, FDI, and remittances. The Caribbean economies contracted only 0.1 percent in 2009, down from the 3.6 percent growth recorded in 2008. Jamaica recorded one of the sharpest declines in GDP in the subregion, attributable to its heavy dependence on the U.S. economy (remittances declined 17 percent in the first half of 2009), and to sharp cuts in mining production. In the Dominican Republic, economic performance deteriorated sharply, with output down by 0.1 percent after 5 percent growth in 2008, reflecting developments in the U.S. economy that affected remittances, FDI, and tourism. The improvement in the terms of trade, as the oil price declined, has had a positive impact on economic performance, however. Caribbean economies benefited somewhat from the AH1N1 outbreak in Mexico as visitors shifted holiday destinations from Mexico to the Caribbean islands, and consequently in the early stages of the crisis, tourism and offshore financial services proved somewhat resilient.

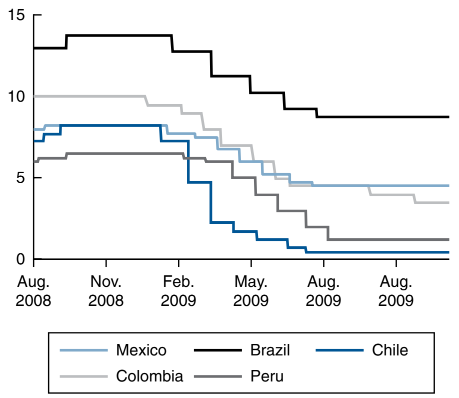
The Central American economies, excluding Mexico, contracted by 1.0 percent in 2009. External demand for their exports was hit by the global economic crisis, while remittances and tourism revenues also declined. Costa Rica's economy was afflicted by a 10.3 percent decline in U.S. tourist arrivals in the first nine months of 2009, but investment in the services sector continued and back-office services were resilient. The decline in tourist arrivals has prompted large price cuts for tourism packages as countries competed for a declining number of tourists. Remittances have also suffered because of weak labor markets in high-income countries. Compared with a year earlier, remittances to Guatemala and El Salvador were down by 9.5 and 10.3 percent, respectively, during the first half of 2009. In the first quarter of 2009, FDI inflows to Costa Rica fell by 19 percent (year-on-year), and by 41 percent to the Dominican Republic.

In response to the crisis, many governments in the region implemented countercyclical macroeconomic policies in an effort to support domestic demand, with government spending being the only demand component that registered growth during 2009. The aggressiveness of the fiscal policies implemented depended on the fiscal space available in each country and the extent to which they had access to financial markets. That said, the region entered the crisis much better prepared with respect to both the fiscal and external accounts. In Mexico, the declining oil revenues constrained the countercyclical response. In Chile, fiscal stimulus has helped limit the output contraction, and the government also provided credit support to SMEs through the development bank Banco Estado. The implementation of the fiscal stimulus in Peru was to some extent hindered as budget appropriation and distribution rules limited the increase in government spending, even as procurement rules have become more lax. Furthermore the government provided credit support to SMEs through the development bank Banco de la Nacion to help ease the impact of the credit crunch.

To support domestic demand at the time that external demand was collapsing, countries more integrated in the global economy lowered interest rates aggressively and allowed real exchange rates to depreciate (figure A13, figure A14). During the monetary-easing cycle, the central bank of Colombia cut rates by a cumulative 6.5 percentage points. Chile cut rates by 7.75 percentage points since the beginning of 2009, while Peru also eased monetary policy substantially. Brazil cut the SELIC[12] rate by an unprecedented 500 basis points to 8.75 percent.

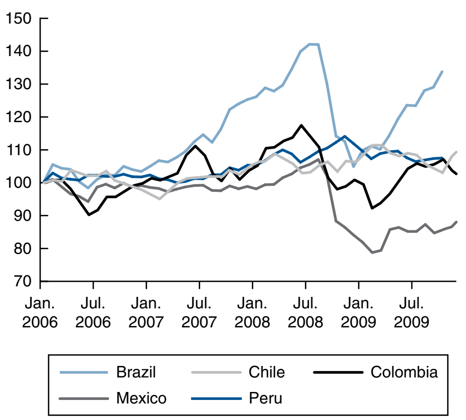
As elsewhere, many economies in the region showed signs that the recession bottomed out in the second half of 2009, with external demand rebounding faster and more strongly than initially anticipated (figure A15).

Figure A13 Central banks across Latin America eased monetary policy aggressively



Sources: Central banks; Datastream; Thomson Financial.

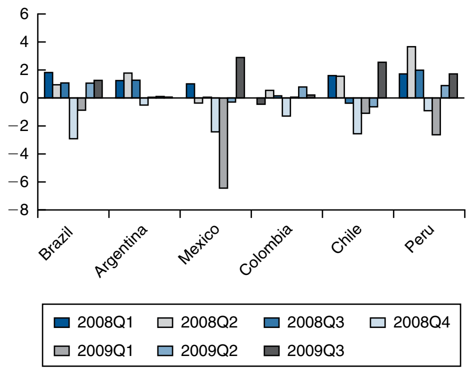
Figure A14 Real effective exchange rates depreciated in more integrated economies



Source: JPMorgan.

In Brazil, a swift rebound in domestic demand was boosted by expansionary monetary policy and countercyclical fiscal policy. These steps pulled the economy out of recession in the second quarter of 2009. Brazil's economy is also benefiting from the shift in the inventory cycle. This in conjunction with the stimulus for the automotive sector has set the stage

Figure A15 Quarterly GDP points to output stabilization in Latin America



Source: Haver Analytics.

Note: Data represent the seasonally adjusted change quarter over quarter except for Mexico, which are seasonally adjusted annual rates.

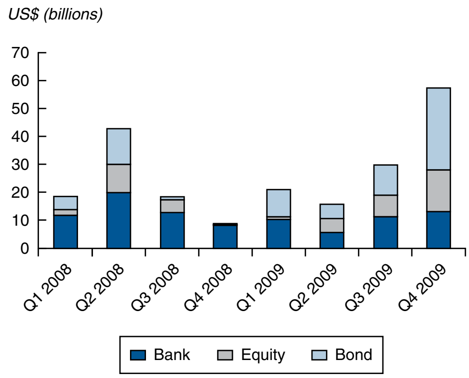
for a sharp recovery in industrial production, which increased by an annualized 17.6 percent in the second quarter and by 20.5 percent in the third quarter. However, because of base effects and a rather moderate recovery in external demand, as Chinese restocking tailed off, output is estimated to have remained relatively flat in 2009, implying the worst economic performance since the early 1990s.

In Mexico, the rate of contraction moderated in the second and third quarters, supported by less dramatic output declines in the manufacturing and service industries. In Argentina, an improved external environment has ignited a modest recovery and led to improvements in external balances, as commodity prices firmed and demand for exports increased, in particular from its main trading partner Brazil. In Chile significant fiscal and monetary stimulus contributed to the moderation in output contraction to 1.7 percent year-on-year in the third quarter, bringing the decline in GDP over the first three quarters of the year to 2.7 percent. In Colombia the improved external environment and the lagged effect of aggressive monetary easing helped the economy recover in early 2009. Output growth in the first two quarters of 2009 was also boosted by strong growth in public investment spending, even though private consumption and investment remained weak. In Peru a significant rebuilding of inadequate stocks is projected to contribute to growth in the second half of 2009. Uruguay's economy expanded by 0.5 percent in the second quarter of 2009 relative to the previous quarter, bolstered by growth in construction and transportation, reflecting the impact of several megaprojects, which offset output declines elsewhere, particularly in energy, agriculture, and manufacturing.

Corporate and sovereign spreads have retreated to pre-crisis levels in countries more integrated into the global financial system—demonstrative of a return of investors' confidence, while access to the international debt market has also improved. Lower-rated countries in the region continue to be perceived as risky by investors and this is reflected in spreads remaining above pre-crisis levels.

Overall, capital inflows to the region have returned, especially in economies that proved resilient to the crisis, such as Brazil, with total capital inflows rising to $57.4 billion in the fourth quarter of 2009, up from $15.7 billion in the second quarter. Bond issuance increased almost sixfold, nearing $30 billion, while equity inflows more than tripled to $14.8 billion. Bank lending recovered modestly, totaling $13.2 billion, down 33 percent compared with the second quarter of 2008 (figure A16).

Figure A16 Capital flows return to Latin America



Sources: Haver Analytics; World Bank.

Medium-term outlook

Fiscal stimulus, lagged impacts of accommodative monetary policy, the shift in the inventory cycle, improvements in the terms of trade, rising consumer and business confidence, stronger demand from high-income countries, and an easing of external financing conditions are all expected to support growth in the region over the next few quarters. GDP growth in the region is projected to accelerate to 3.1 percent in 2010, following an estimated 2.6 percent contraction in 2009, but growth will not regain the growth rates recorded during the boom years, in part because of weaker investment growth. The shape of the recovery will, to a large extent, be determined by the growth path of the United States and other major economic partners of the region. Growth is expected to remain strong for the next couple of quarters but to weaken in the second half of 2010, as the impact of stimulus measures and the rebuilding of depleted inventories cease to bolster growth. A double dip or a more buoyant growth scenario is also possible as a result of close linkages with high-income countries.

Economies more integrated through trade and financial linkages with the global economy, which have been the worst affected by the global downturn are expected to benefit most from the global economic recovery. The region's exports are projected to rebound strongly, expanding by 7.8 percent in 2010 as demand from major trading partners recovers. Higher commodity prices will also benefit commodity exporters in the region, easing pressures on external balances and in some cases fiscal balances. A weakening of growth momentum or even a double dip in high-income countries (see chapter 1) could lead to a deceleration in export growth in the second half of 2010 and into 2011.

Private consumption in the region is projected to bounce back strongly, rising 3.2 percent in 2010, partly because of a low base effect (it contracted by an estimated 1.9 percent in 2009) but also owing to improvements in labor markets throughout the region and in migrant-destination countries. Domestic demand growth may be supported by a pronounced bounce back in fixed investment as confidence returns and financing constraints ease (see chapter 1 regarding a more buoyant private sector reaction scenario). Less restrictive financing conditions compared with the crisis period and a return of investor confidence together with resumptions in delayed investment, are projected to boost fixed investment by 6.1 percent in 2010. However, investment growth will remain below the double-digit pace recorded in the boom years, as excess capacity lingers. Large output gaps, weak international financing conditions, and weak public sector investment will all weigh on prospects. The lagged impact of the substantial monetary easing in some countries, along with stronger fiscal stimulus, and a one-off benefit from inventories accumulation will bolster growth into 2010. In other countries, such as Chile, there will be fiscal consolidation in 2010, which will moderate the contribution of government spending to growth.

The tourism sectors in many countries in the region are expected to stage a recovery after a sharp decline in tourist arrivals in 2009, although a recovery in Mexico's tourism sector may weaken the recovery in some of the Caribbean countries that had seen a lower-than-expected decline in tourist arrivals in 2009, as they managed to attract tourists by offering discounted packages.

Remittances are expected to recover only modestly in the 2010–11 period, undermined by weak labor market conditions in the United States and other high-income countries, although the bottoming out of the housing sector in the United States bodes well for countries receiving remittances from the construction sector. The weak recovery in remittances will limit the strength of the recovery in private consumption in many countries in the Caribbean and Central America.

The recovery in the United States will help Mexico exit the deep recession it entered following the collapse in U.S. demand. Mexico's economy is forecast to expand by 3.5 percent in 2010 and growth will accelerate marginally to 3.6 percent in 2011 (table A6). Government spending is not expected to grow as it implements fiscal adjustments to compensate for lower oil revenues associated with declining oil production. Both exports and imports are projected to rebound strongly in 2010, as external and domestic demand strengthen, but net trade will be a drag to growth, as the acceleration in imports due to stronger domestic demand will outpace export growth. A strong rebound in the service sector is projected, after a subdued performance in 2009 on account of the negative impact of the AH1N1 flu. Mexico's growth outlook is clouded, however, by concerns about the long-term sustainability of fiscal accounts. The fiscal shortfall over the 2009–10 period is estimated at a cumulative 6.6 percent of GDP, with almost half of the deterioration related to lower oil prices and production. The expected fiscal reform should reduce government discretionary spending, which may have a negative impact on growth over the short(er) term.

Domestic demand in Brazil should benefit from strong fiscal and monetary stimuli, while exports are projected to rise in response to strong external demand from China. Overall, the economy is projected to stage a comeback in 2010, with growth accelerating to 3.6 percent. Economic growth will be largely driven by the recovery in private consumption and investment, as well as stronger external demand.

Recovery in external demand will help Argentina's economic recovery strengthen into 2010 as job creation in export-oriented industries will underpin a mild recovery in private consumption. The expected recovery in the agriculture sector will boost economic activity, as will less restrictive external financing conditions. The recovery will be fragile, however, with investment remaining a drag on growth

Table A6 Latin America and the Caribbean country forecasts
(annual percent change unless indicated otherwise)

	1995–2005[a]	2006	2007	2008	2009[c]	2010[d]	2011[d]
Argentina							
GDP at market prices (2005 US$)[b]	2.3	8.5	8.7	6.8	−2.2	2.3	2.4
Current account balance/GDP (%)	−0.2	3.6	2.8	2.2	2.3	2.2	2.2
Belize							
GDP at market prices (2005 US$)[b]	5.6	4.7	1.2	3.8	−0.1	1.7	2.3
Current account balance/GDP (%)	−12.1	−2.1	−4.0	−10.8	−7.7	−7.7	−7.6
Bolivia							
GDP at market prices (2005 US$)[b]	3.8	4.6	4.6	6.1	2.6	3.2	3.8
Current account balance/GDP (%)	−3.0	11.5	12.5	12.0	2.6	1.8	2.9
Brazil							
GDP at market prices (2005 US$)[b]	2.4	4.0	5.7	5.1	0.1	3.6	3.9
Current account balance/GDP (%)	−2.0	1.3	0.1	−1.7	−1.1	−1.6	−1.8
Chile							
GDP at market prices (2005 US$)[b]	4.2	4.6	4.7	3.2	−1.8	4.7	4.5
Current account balance/GDP (%)	−1.5	4.9	4.4	−2.0	1.5	1.1	1.4
Colombia							
GDP at market prices (2005 US$)[b]	2.4	6.9	7.5	2.5	−0.1	2.6	3.9
Current account balance/GDP (%)	−2.2	−1.8	−2.9	−2.7	−2.9	−2.6	−2.3
Costa Rica							
GDP at market prices (2005 US$)[b]	4.5	8.8	7.8	2.6	−1.8	2.1	2.9
Current account balance/GDP (%)	−4.0	−4.5	−6.3	−9.2	−4.2	−5.1	−6.3
Dominica							
GDP at market prices (2005 US$)[b]	1.4	3.2	0.9	3.1	−1.7	1.4	3.0
Current account balance/GDP (%)	−19.8	−17.3	−28.5	−36.5	−24.2	−24.1	−23.8
Dominican Republic							
GDP at market prices (2005 US$)[b]	5.2	10.7	8.5	5.0	−0.1	2.4	2.6
Current account balance/GDP (%)	−0.8	−3.6	−5.1	−10.1	−6.8	−7.2	−6.7
Ecuador							
GDP at market prices (2005 US$)[b]	3.2	3.9	2.5	6.5	−2.2	1.7	3.0
Current account balance/GDP (%)	−1.4	3.9	3.6	2.2	−3.0	−3.3	−3.4
El Salvador							
GDP at market prices (2005 US$)[b]	2.7	4.2	4.7	2.5	−2.1	0.8	2.3
Current account balance/GDP (%)	−2.5	−3.6	−5.4	−7.2	−2.6	−3.5	−4.7
Guatemala							
GDP at market prices (2005 US$)[b]	3.5	5.4	6.3	3.8	−0.4	1.6	3.0
Current account balance/GDP (%)	−4.9	−5.2	−5.4	−4.8	−2.8	−4.1	−4.4
Guyana							
GDP at market prices (2005 US$)[b]	1.7	−2.4	5.4	3.2	1.1	2.5	3.0
Current account balance/GDP (%)	−9.4	−19.8	−17.8	−20.2	−12.6	−18.1	−18.2
Haiti							
GDP at market prices (2005 US$)[b]	0.9	2.3	3.2	1.4	−0.3	1.9	2.1
Current account balance/GDP (%)	−4.0	−9.0	−5.7	−8.2	−7.9	−9.1	−10.6
Honduras							
GDP at market prices (2005 US$)[b]	3.8	6.3	6.3	4.0	−2.5	1.8	2.8
Current account balance/GDP (%)	−6.7	−4.7	−9.8	−14.3	−8.7	−10.9	−9.3
Jamaica							
GDP at market prices (2005 US$)[b]	0.8	2.7	1.5	−1.0	−3.7	0.3	2.2
Current account balance/GDP (%)	−5.5	−9.9	−15.3	−19.8	−14.3	−12.6	−9.9
Mexico							
GDP at market prices (2005 US$)[b]	3.6	4.8	3.3	1.4	−7.1	3.5	3.6
Current account balance/GDP (%)	−1.9	−0.5	−0.8	−1.5	−1.4	−1.7	−1.9

(*continued*)

Table A6 (*continued*)
(annual percent change unless indicated otherwise)

	1995–2005[a]	2006	2007	2008	2009[c]	2010[d]	2011[d]
Nicaragua							
GDP at market prices (2005 US$)[b]	4.1	3.7	3.2	3.2	−2.5	1.7	1.7
Current account balance/GDP (%)	−20.2	−13.4	−17.6	−23.8	−15.2	−19.8	−21.7
Panama							
GDP at market prices (2005 US$)[b]	4.5	8.5	11.5	9.2	1.2	2.7	3.8
Current account balance/GDP (%)	−5.3	−3.1	−7.3	−12.3	−7.4	−10.1	−10.0
Paraguay							
GDP at market prices (2005 US$)[b]	1.2	4.3	6.8	5.8	−3.8	2.6	3.7
Current account balance/GDP (%)	−1.5	1.4	0.8	−2.1	−0.3	−1.5	−1.9
Peru							
GDP at market prices (2005 US$)[b]	3.3	7.7	9.0	9.8	1.2	3.9	5.2
Current account balance/GDP (%)	−3.3	3.0	1.6	−3.4	−2.4	−2.5	−2.3
St. Lucia							
GDP at market prices (2005 US$)[b]	2.9	2.2	1.7	0.7	−1.4	1.5	2.7
Current account balance/GDP (%)	−13.8	−33.1	−32.6	−33.6	−26.5	−27.9	−29.0
St. Vincent and the Grenadines							
GDP at market prices (2005 US$)[b]	4.2	10.8	6.7	2.3	−1.0	1.2	1.8
Current account balance/GDP (%)	−18.3	−24.1	−26.3	−27.8	−20.1	−21.4	−21.8
Uruguay							
GDP at market prices (2005 US$)[b]	1.5	4.6	7.6	8.9	1.3	3.2	3.4
Current account balance/GDP (%)	−0.9	−2.0	−0.9	−3.8	−1.4	−2.4	−2.5
Venezuela, R. B. de							
GDP at market prices (2005 US$)[b]	1.6	10.3	8.4	4.8	−2.4	−0.2	1.4
Current account balance/GDP (%)	7.5	14.3	8.7	12.4	2.2	3.5	2.5

Source: World Bank.

Note: World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

Barbados, Cuba, Grenada, and Suriname are not forecast owing to data limitations.

a. Growth rates over intervals are compound average; growth contributions, ratios, and the GDP deflator are averages.
b. GDP measured in constant 2000 U.S. dollars.
c. Estimate.
d. Forecast.

owing to policy uncertainty. Furthermore, the unsustainable fiscal stimulus implemented ahead of the presidential elections will likely fade in the second half of the year, weakening one of the growth engines.

República Bolivariana de Venezuela is expected to buck the regional trend of economic recovery and is likely to continue to contract for a second consecutive year in 2010, as private consumption, investment, and exports continue to shrink. Macroeconomic imbalances—the result of inadequate macroeconomic policies and high inflation (notwithstanding economic contraction)—will undermine investment. Also, the strong growth of government spending, funded by an increasing public debt issuance as well as price and exchange controls, is undermining growth. Inflationary pressures are likely to continue to be fueled by currency mismanagement as well as rising import costs, partly stemming from the government's decision to import through Argentina instead of Colombia. Furthermore, inadequate investments will exacerbate domestic shortages, thereby exerting further upward pressure on prices.

Small open economies like Chile are likely to benefit most from the global economic recovery as their business cycles are highly correlated with the global economy. Chile's recovery will also be supported by domestic factors because aggressive and front-loaded countercyclical policies are boosting domestic demand. Improved terms of trade as well as rising consumer and business confidence should also bolster the recovery, bringing growth closer to potential.

Peru's recovery will benefit from stronger demand for commodity exports, particularly from Asia. Furthermore, the Free Trade Agreement with China, which comes into operation in January 2010, will further boost exports, in particular those of fishmeal and minerals. Government consumption and investment should be firm in 2010 as the government maintains efforts to support economic growth through new spending on public works and social programs, and it should remain a high priority ahead of the April 2011 presidential and congressional elections.

Growth in Central America is expected to bounce back in 2010 in line with developments in the United States and other major economic partners. Recovery in the region is highly dependent on workers' remittances from the United States and Europe (El Salvador, Guatemala, Honduras, and Nicaragua), and is projected to be more gradual, as the expected jobless recovery in high-income countries will put pressure on remittances, thereby delaying the recovery in private consumption in these countries. Similarly, tourism in the region (of particular importance for the Caribbean) is expected to recover only moderately as labor markets in client countries recover only gradually. FDI, which was a major source of growth over the 2003–08 period, is unlikely to return to pre-crisis levels while excess capacity lingers. The recovery in most countries in Central America will thus be anemic at best. In Jamaica, low alumina and bauxite production and export prices will constrain the recovery. Growth in these regions will continue to be undermined further by crime, corruption, weak democratic institutions, and a lack of competitiveness.

Risks

In countries where domestic demand is strengthening rapidly, delays in withdrawing policy stimulus represent an upside risk to growth and inflation. In such cases, output gaps could close faster than anticipated, leading to an inflationary environment. In particular, the risks for Brazil have shifted to the upside as domestic demand is rebounding strongly, while the effects of already enacted monetary loosening and countercyclical fiscal policy easing have not yet run their course. Another upside risk emanates from commodity prices, should the world economy (particularly in resource-intensive economies such as China) stage a stronger-than-expected rebound.

The recent run-up in equity markets and stronger capital inflows in general, stemming in part from still large interest rate differentials, have put upward pressure on real effective exchange rates in some countries. The surge in capital inflows to the region, which reached \$87.2 billion in the second half of 2009 (of which \$34.3 billion came in December), compared with \$36.8 billion in the first half of the year, has prompted the Brazilian government to impose a 2 percent financial transaction tax on foreign portfolio inflows. However, this measure has been ineffective in preventing capital inflows and real currency appreciation. Should such flows persist, this may lead to renewed asset price bubbles. Also, some economies may lose external competitiveness because of real currency appreciation at a time when external demand recovery remains fragile.

Middle East and North Africa

Recent developments

The impact of the global financial crisis for the developing economies of the Middle East and North Africa region varied across oil exporters and importers of the region.[13] Initially, the decline in regional equity markets was sharper than the average for emerging markets (figure A17). Since then, recovery in these markets has been hesitant owing to the unfolding of the Dubai World debt problems in the United Arab Emirates as well as concerns regarding growth prospects for the broader region.

Conditions at the outset of the financial crisis were less than propitious for the Middle East and North Africa. The "food-fuel" crisis