

THE INTERNATIONAL FINANCIAL CRISIS: IMPLICATIONS FOR LATIN AMERICA AND THE CARIBBEAN

BACKGROUND

As the financial crisis has spread beyond East Asia, world GDP growth has been affected. Growth in 1998 was 2 percent according to the IMF, down from 4.3 percent per year in 1996 and 4.2 in 1997. This slowdown in economic growth was more marked in developing countries than in advanced economies. Indeed, the rate of growth of the former in 1998 was half what was achieved in 1997. Growth in the developing countries of the Western Hemisphere also fell to half its 1997 rate.

IMPACT OF FINANCIAL CRISIS ON CENTRAL AMERICA

So far, the Asian crisis has had relatively little effect on Central America because: 1) its most important export market, North America, is still healthy; 2) trade with countries affected by the crisis is marginal; 3) goods from C.A. are still competitive because they benefit from trade preferences (e.g. U.S. Caribbean Basin Initiative); 4) As net importers, C.A. countries have benefited from the lower price of commodities.

Central American countries have not introduced protectionist trade policy measures (e.g. raising tariffs) to avoid deterioration of their trade and current account balances. In fact, C.A. countries are participating fully in the FTAA process, have concluded an FTA with the Dominican Republic and are scheduling additional trade liberalization measures.

In the short term, it will be difficult to attract foreign investments (with the exception maybe of investments in infrastructure projects, part of the reconstruction effort in the aftermath of Hurricane Mitch).

In the short/medium term, the growing current account deficit in the US could become a catalyst for increased protectionist pressures, that would in turn affect negatively economies in the region.

IMPACT ON TRADE IN LATIN AMERICA AND THE CARIBBEAN (LAC)

The Asian crisis continues to have an impact on Latin American and Caribbean (LAC) economies in several ways. The first one is the direct effect on trade. LAC exports to East Asia are negatively affected by the economic contraction in those economies and also by the price competitiveness that has resulted from exchange rate devaluations in Asia. The second one is through commodity prices. Many countries of LAC are important exporters of primary and manufactured commodities. The global economic slowdown has driven down the prices of major commodities. On the other hand, net importers of affected commodities, such as minerals and petroleum products, have benefited from this fall in prices. This is the case with most Central American and Caribbean economies. A third effect is through the displacement of LAC exports in markets such as those of the OECD, or the LAC regional market itself, where they compete with East Asian products that are cheaper. However, this effect may be smaller than it appears.