Outlook for Latin America and the Caribbean: Pandemic Persistence Clouds the Recovery

The pandemic continues to spread in Latin America and the Caribbean (LAC), but economic activity is picking up. After a deep contraction in April, activity started recovering in May, as lockdowns were gradually eased, consumers and firms adapted to social distancing, some countries introduced sizable policy support, and global activity strengthened. Real GDP is projected to contract by 8.1 percent in 2020, followed by a mild recovery in 2021 reflecting persistent spread of the virus and associated social distancing and scarring. Risks to the outlook remain tilted to the downside, and uncertainty about the pandemic's evolution is a key source of risk. Containing the spread of the virus and addressing the health crisis remain the key policy priorities. In countries where lockdowns still hamper activity, policies should focus on ensuring that firms have sufficient liquidity, and on protecting employment and income, while developing medium-term fiscal consolidation plans to safeguard debt sustainability. In countries that are easing lockdowns, efforts should focus on supporting the recovery, including through structural reforms. Once the pandemic is under control, and the recovery is on a strong footing, fiscal policy will need to focus on rebuilding buffers. Monetary policy should remain accommodative as long as inflation stays within the target range and inflation expectations are well anchored.

An Unparalleled Health Crisis

The coronavirus disease (COVID-19) pandemic has hit LAC hard. With only 8.2 percent of the world population (640 million people), the region had 28 percent of all cases (9.3 million) and 34 percent of all deaths (341,000) by the end of September. The number of new cases continues to rise in some countries (Argentina, Costa Rica, Paraguay), while it has stabilized in others, though at relatively high levels (Brazil, Peru). The largest economies in the region (Brazil, Chile, Mexico, Peru) have some of the highest numbers of deaths per capita worldwide (Figure 1, panel 1), and official reports likely underestimate the tally. The pandemic's spread in the region has been uneven: in contrast to the largest economies, some Caribbean nations and Uruguay have been able to contain the outbreaks, and, within countries, large urban centers were hit harder than other areas (IMF 2020a).

LAC countries implemented strict lockdown measures early in the pandemic—when cases were still low (Figure 1, panels 2 and 3). The lockdowns initially slowed the epidemic as mobility plummeted (Annex 1). However, they were not able to contain the spread of the disease effectively as mobility started to rise. In fact, the pandemic evolved as a "slow burn"—a prolonged period of steady increase in new cases and deaths resulting in a high total death toll despite a notable initial decline in mobility. The prevalence of poverty, informality in labor markets, and the inability to practice social distancing in densely populated urban areas and crowded low-income neighborhoods contributed to the rising death toll. In addition, weak state capacity and the lack of fiscal buffers in many LAC countries hindered containment and mitigation efforts, including through the failure to strengthen testing and tracing capacities (Figure 1, panel 4). As outbreaks became more widespread, poorly prepared health systems in the region came under pressure and failed to contain the human costs (Figure 1, panel 4).

The slow-burn dynamics in the region means still high marginal contagion and death rates which persist even today and calls for a slow reopening process, because concerns over weak government capacity and the resilience of health systems persist. Many countries in LAC started easing restrictions later than other regions did and adopted a more gradual approach, keeping in place containment measures that are relatively stringent by international standards to date (Figure 1,

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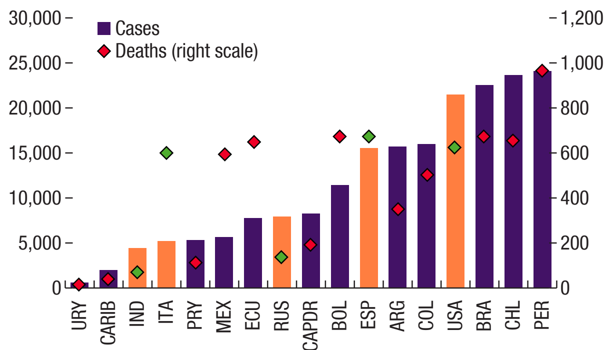
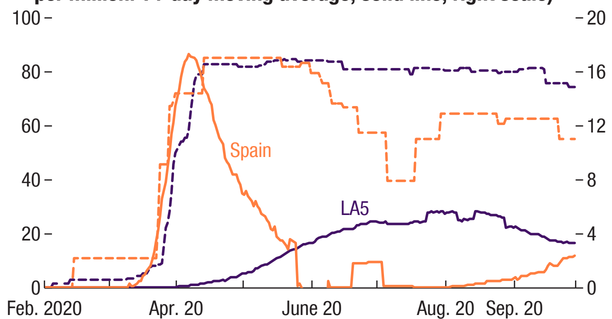
Figure 1. Recent Developments in the COVID-19 Pandemic

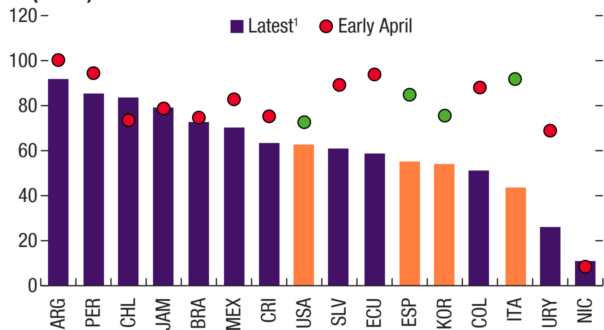
1. COVID-19 Confirmed Cases and Deaths
(Per million people)



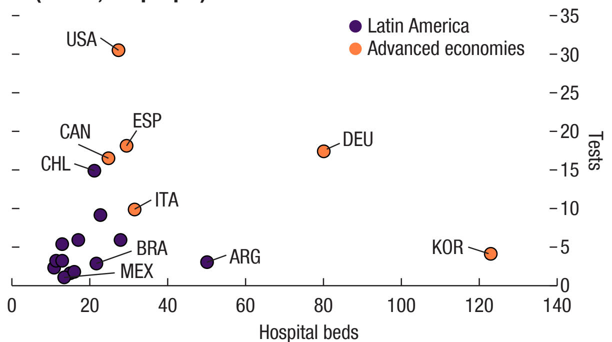
2. COVID-19 Deaths and Containment Stringency Index
(Stringency index: 14-day lagged, dashed line; new deaths per million: 14-day moving average, solid line, right scale)



3. Containment Stringency
(Index)



4. Hospital Beds and Tests[2]
(Per 10,000 people)



Sources: Hale and others (2020); Oxford University COVID-19 Government Response Tracker; Johns Hopkins University; Our World in Data database; and IMF staff calculations.
Note: Data are as of September 28, 2020. Data labels use International Organization for Standardization (ISO) country codes. For country group composition, see page 35. CAPDR = Central America, Panama, and the Dominican Republic; CARIB = Caribbean; COVID-19 = coronavirus disease; LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).
[1]Latest available data as of September 28, 2020.
[2]The series on hospital beds refers to latest available data as of September 28, 2020. The series on tests refers to the September 2020 average.

panel 2). However, measures of de facto mobility suggest that compliance with containment measures has weakened over time (Annex 1). In Brazil, for example, mobility has now reached European levels. Consequently, the pandemic witnessed a resurgence in many LAC countries starting around June.

A Historic Economic Contraction

The pandemic's global and synchronized nature led to national lockdowns, border closings, a collapse in economic activity and global trade, and a sharp tightening of financial conditions. Financial conditions have eased because of the prompt and forceful reaction of economic authorities in advanced economies, but the global contraction in trade took longer to revert.

High Economic Vulnerability to Lockdowns

Structural features of LAC economies made them particularly vulnerable to this unprecedented shock, more so than those outside the region. Border closings, regional lockdowns, and social distancing—essential to containing the virus—curtailed activity in contact-intensive sectors (such as hospitality, entertainment, and tourism; IMF 2020b).The share of workers employed

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in contact-intensive sectors was larger in the Caribbean islands and some Central American countries (Costa Rica, El Salvador) than elsewhere in the region, suggesting higher exposure, but all LAC countries were more exposed than the average advanced, emerging market, and low-income economies (Figure 2, panel 1). Furthermore, direct exposures to contact-intensive sectors were magnified through input-output links, leading to a significantly larger fraction of LAC economies being affected by the pandemic (Figure 2, panel 2). Beyond contact intensity, labor markets in LAC were vulnerable to the COVID-19 shock because of the low share of workers employed in occupations for which remote work is feasible (teleworkable occupations, Figure 2, panel 3).

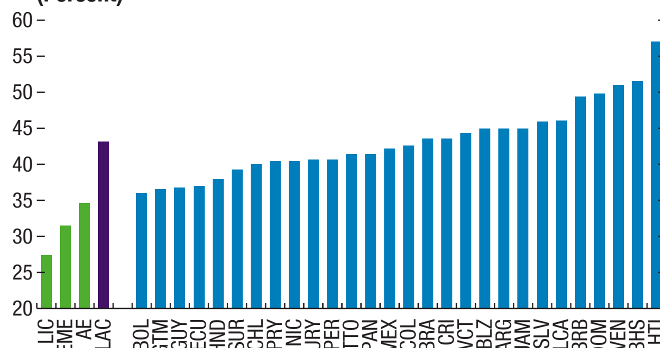
A Global Shock

The strong decline in global economic activity compounded the pandemic's domestic impact. Sharp contractions among LAC's trading partners contributed to a sudden decline in merchandise exports, which in most countries started to reverse gradually in July (Figure 3, panel 1). An enduring collapse in tourism affected several countries in the region severely, notably in the Caribbean (Figure 3, panels 2 and 3). However, remittances, which were expected to remain depressed for the year, have shown a surprising rebound in recent months in several countries, providing them with a respite (Figure 3, panel 4). Except for oil prices, commodity prices recovered to pre-COVID-19 levels after falling in March (Figure 3, panel 5). The stability of key agricultural and metal prices, coupled with a recovery of the Chinese economy in the second quarter, buffered the contraction in exports in the first half of 2020 (Figure 3, panel 6).

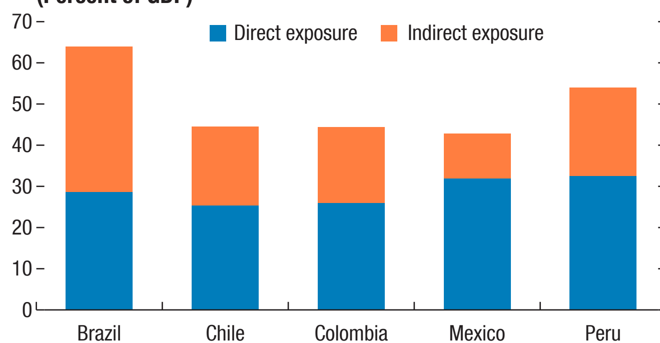
Financial conditions in LAC have eased recently but remain tight in some countries and segments (Figure 4). A global increase in risk aversion from mid-February to late March led to portfolio reallocations that are larger than in previous episodes of financial stress, with an abrupt increase in spreads and a steep fall in currencies and

Figure 2. Contact Intensity and Remote Work

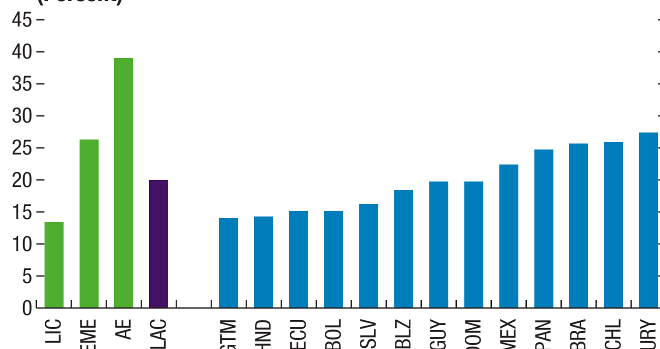
1. Share of Employment in Contact-Intensive Sectors[1] (Percent)



2. Exposure to Contact-Intensive Sectors[2] (Percent of GDP)



3. Share of Teleworkable Jobs (Percent)



Sources: Dingel and Neiman (2020); International Labour Organization ILOSTAT database; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. AE = advanced economies; EME = emerging market economies; LAC = Latin America and the Caribbean; LIC = low-income countries.
[1]Regional aggregates are simple averages.
[2]Contact-intensive sectors include wholesale and retail trade, transportation and storage, accommodation and food services, education, arts and entertainment, and domestic employment.

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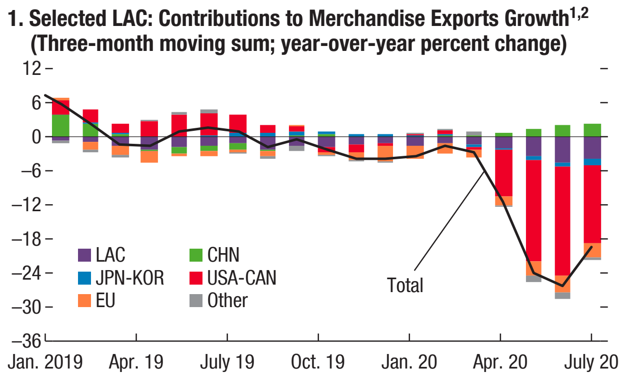
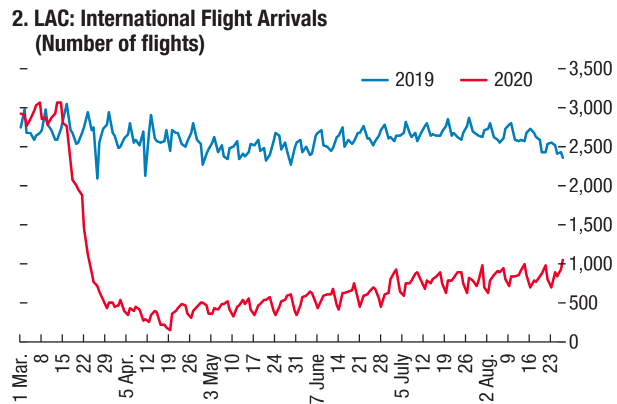
Figure 3. Global Economic Conditions

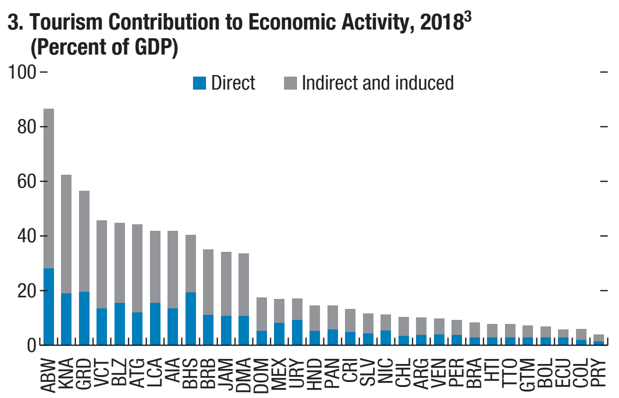
1. Selected LAC: Contributions to Merchandise Exports Growth[1,2]
(Three-month moving sum; year-over-year percent change)



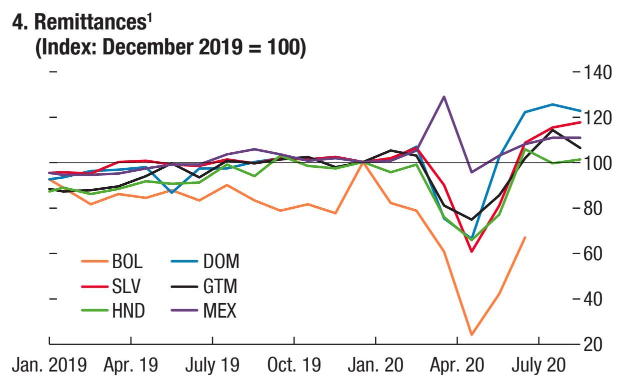
2. LAC: International Flight Arrivals
(Number of flights)



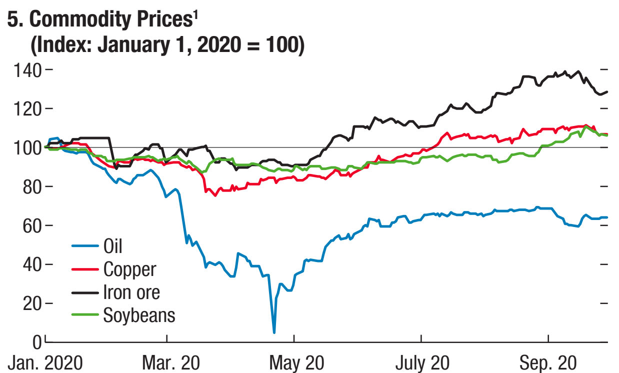
3. Tourism Contribution to Economic Activity, 2018[3]
(Percent of GDP)



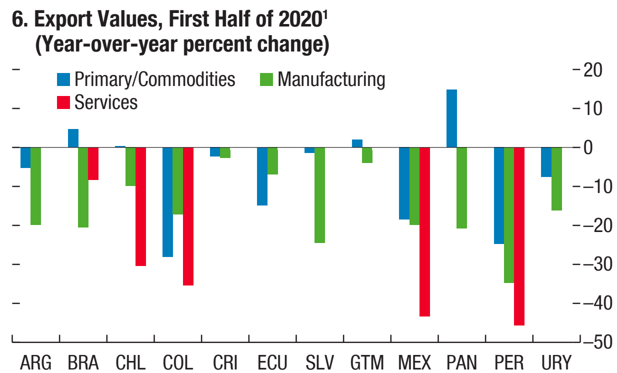
4. Remittances[1]
(Index: December 2019 = 100)



5. Commodity Prices[1]
(Index: January 1, 2020 = 100)



6. Export Values, First Half of 2020[1]
(Year-over-year percent change)



Sources: Bloomberg Finance L.P.; Caribbean Tourism Organization; Flightradar24; Haver Analytics; IMF, Balance of Payments Statistics database; national authorities; World Travel and Tourism Council database; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. EU = European Union; LAC = Latin America and the Caribbean.
[1]Values in US dollars.
[2]Includes Argentina, Brazil, Chile, Colombia, Mexico, and Uruguay.
[3]Direct contribution includes direct GDP impact of the most relevant sectors (catering, accommodation, entertainment, recreation, transportation, and other services related to travel and tourism). Indirect and induced contribution includes supply chain impact to the other sectors and the impacts of incomes earned directly and indirectly because they are spent in the local economy.

equity prices. Financial conditions stabilized and capital outflows moderated in April after the large monetary and fiscal support packages in advanced economies (October 2020 *Global Financial Stability Report* [GFSR]). Capital flows have stabilized, currencies have appreciated, and spreads

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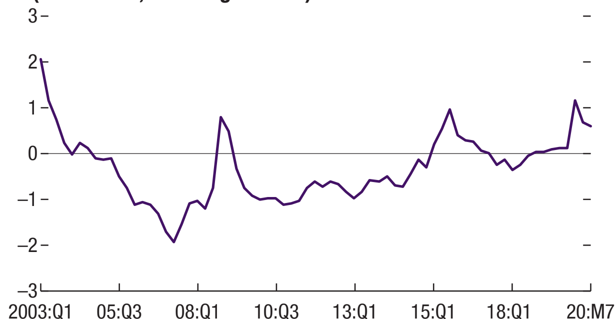
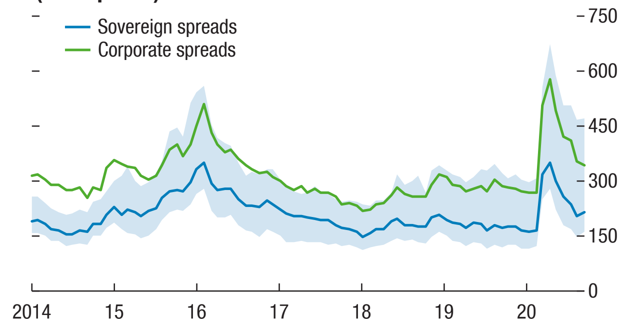
Figure 4. Financial Conditions and Capital Flows

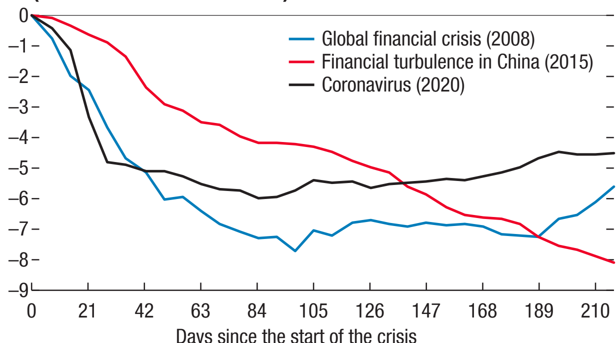
1. Latin America: Financial Conditions Index[1]
(0 = neutral; +/– = tight/loose)



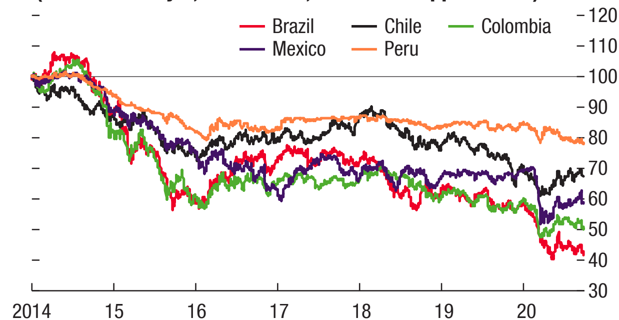
2. Sovereign and Corporate Spreads[2]
(Basis points)



3. Latin America: Cumulative EPFR Flows[3]
(Percent of initial allocation)



4. Exchange Rates against the US Dollar
(Index: January 1, 2014 = 100; increase = appreciation)



Sources: Bloomberg Finance L.P.; Emerging Portfolio Fund Research (EPFR) database; Haver Analytics; national authorities; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru); LA6 = Latin America 6 (Brazil, Chile, Colombia, Mexico, Peru, Uruguay).
[1]For methodology and variables included in the financial conditions index, refer to the online annex of the October 2018 *Global Financial Stability Report*.
[2]Sovereign spreads refer to the median of LA6 JP Morgan Emerging Market Bond Index Global spread, US-dollar-denominated sovereign bonds. Corporate spreads refer to the median of LA5 JP Morgan Corporate Emerging Market Bond Index spread, US-dollar-denominated corporate bonds. Shaded area refers to the minimum-maximum range of LA6 sovereign spreads.
[3]The start dates used for the shock events are September 10, 2008 (global financial crisis); July 15, 2015 (financial turbulence in China); and February 26, 2020 (coronavirus outbreak).

have decreased since May amid rising global risk appetite. However, valuations have generally not yet recovered to pre-COVID-19 levels. Financial conditions have loosened relative to April, particularly in selected segments of financial markets. Sovereign yields in the five largest economies in Latin America (LA5: Brazil, Chile, Colombia, Mexico, Peru) are close to historic lows. Also, the marked decline in interest rates in the United States has reduced financial stress in all countries. Financial conditions, however, remain tight on average (Figure 4, panel 1).

Capital outflows hit local currency bond markets particularly hard, prompting central banks to act and governments to modify their debt management strategies. Although domestic banks and institutional investors, to a lesser extent, bought the bonds that foreign investors sold (Figure 5), central banks intervened in bond and foreign exchange markets to prevent disorderly market conditions. Interventions peaked in March and were scaled back as volatility subsided. Sovereign issuances in local currency were reduced, and the duration was shortened (Brazil, Mexico). In turn, investment grade sovereigns in LAC (Colombia, Chile, Mexico, Panama, Peru, Trinidad and Tobago, Uruguay) issued hard currency debt in international markets, showing their ability to maintain access

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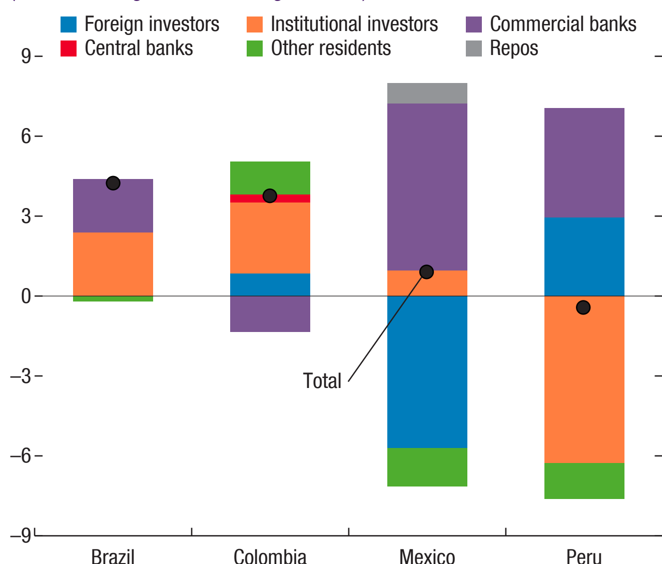
Figure 5. Changes in Holders of Public Debt Denominated in Local Currency

(Percent change; March to August 2020)



Sources: Bloomberg Finance L.P.; Haver Analytics; national authorities; and IMF staff calculations.

at reasonable yields.[1] Other countries[2] took advantage of improved global financial conditions and increased risk appetite and also issued in hard currency, while Argentina and Ecuador, which faced economic challenges before the pandemic, concluded debt restructurings of their external public debt (Box 1).

A Historic Collapse in Activity

The pandemic, lockdowns, and external forces contributed to a historic collapse in activity in the second quarter of 2020. The LA5 countries experienced larger quarterly GDP contractions than in any recession on record (Figure 6, panel 1). Monthly activity indicators show a similar picture for a broader set of countries (Figure 6, panel 2).

Lockdowns' disproportionate impact on contact-intensive sectors (mostly in services), coupled with a decline in demand in these sectors caused by fears of health risks, resulted in an abrupt fall in services value added in the LA5 in the second quarter (Figure 6, panels 3 and 4). Other sectors were also hit, but contractions were more in line with past recessions. On the demand side, private consumption—a relatively stable and resilient component—had an atypically large contraction compared with investment.

The COVID-19 crisis also stands out for its large impact on employment and uneven impacts across different types of workers. In previous recessions, employment in LAC barely fell as GDP contracted (Figure 6, panel 5). This time the decline in employment in the second quarter was larger than the decline in GDP (Figure 6, panel 6). Features of LAC labor markets, such as informality, concentration in small and medium enterprises (SMEs), and low ability to work from home, put a large fraction of LAC's employment at risk and are exacerbating the shock's impact. In fact, the COVID-19 shock severely affected informal employment, which in previous recessions acted as a buffer during downturns (October 2019 *Regional Economic Outlook: Western Hemisphere)*. Women, young, and low-skilled workers (who were ex ante vulnerable) experienced relatively large employment losses (IMF 2020b; Annex 2). Moreover, the shock's large impact on low-skilled workers, who typically come from low-income households, highlights its regressive nature.

High-frequency indicators point to an uneven recovery in economic activity since May. Monthly activity indicators and retail sales improved in most LAC countries after a sharp contraction in April (Figure 6, panel 2 and Figure 7, panel 1). Purchasing managers' indices and business confidence indicators also improved, with some countries already in expansionary territory (Figure 7, panels 2 and 3). However, economic activity remains depressed relative to pre-COVID-19 levels throughout the region, and there are clear differences across countries in the recovery's speed. Brazil, Costa Rica, and Uruguay experienced less pronounced collapses at the height of the crisis, and by July had a smaller gap in economic activity relative to January than

[1]Uruguay also issued local currency global bonds (indexed to inflation).

[2]Brazil, the Dominican Republic, El Salvador, Guatemala, Honduras, and Paraguay have issued since April.

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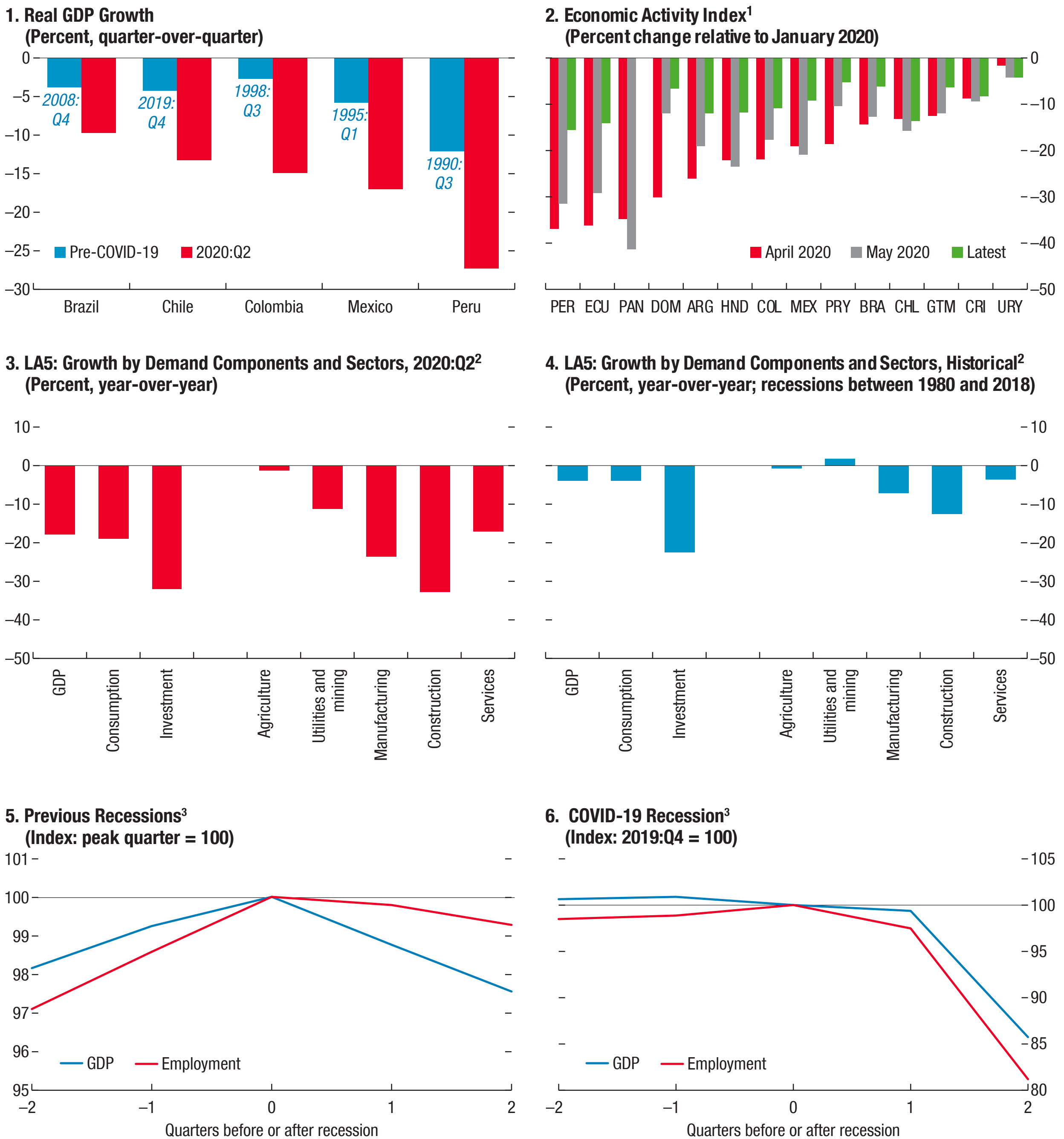
Figure 6. An Unusual Recession



Sources: Haver Analytics; national authorities; United Nations Statistics Division database; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. COVID-19 = coronavirus disease; LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).
[1]Latest refers to July 2020, except for the Dominican Republic and Paraguay, which show June 2020 data.
[2]Simple average of LA5 countries.
[3]Simple average of Brazil, Chile, Colombia, and Mexico.

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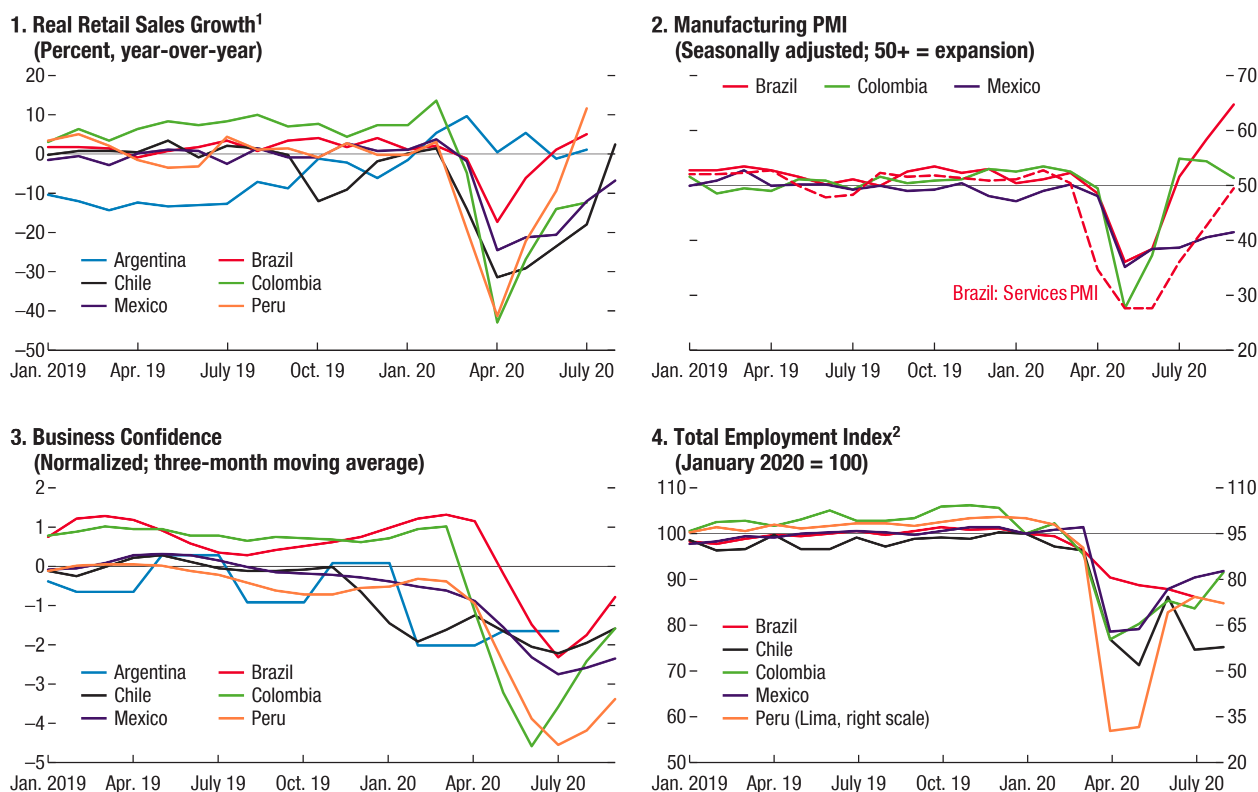
Figure 7. An Uneven Recovery since May



Sources: Haver Analytics; IHS Markit Ltd.; Asociación Nacional de Tiendas de Autoservicio y Departamentales (ANTAD, Mexico); national authorities; and IMF staff calculations.
Note: PMI = purchasing managers' index.
[1]Argentina refers to total supermarket sales. Mexico refers to total same-store sales from ANTAD.
[2]Data for Brazil, Chile, and Peru (Lima) are transformed to reflect monthly employment rather than three-month moving averages.

others did. By contrast, Ecuador and Peru suffered large contractions, and activity remained relatively subdued in July. Similarly, retail sales and business confidence in Brazil bounced back and reached pre-COVID-19 levels in June, but in Mexico, they recovered less strongly and remain depressed. Moreover, the recovery is subject to considerable uncertainty and possible setbacks. For example, after seeing labor market improvements in May and June, some countries experienced further reductions in employment in July that were associated with new outbreaks and containment measures (Figure 7, panel 4).

Bold Policy Actions to Cope with an Unprecedented Shock

Countries in LAC deployed a multipronged policy response to mitigate the immediate health and socioeconomic fallout of COVID-19. They announced fiscal support amounting to about 8 percent of GDP on average, which included a combination of above-the-line measures (additional expenditure and forgone revenue) and below-the-line and off-budget actions (including loans and guarantees) aimed at improving health care systems, supporting the incomes of households and firms, and avoiding a credit crunch (Figure 8, panel 1). Nonetheless, there has been significant variation in the size and composition of support packages across

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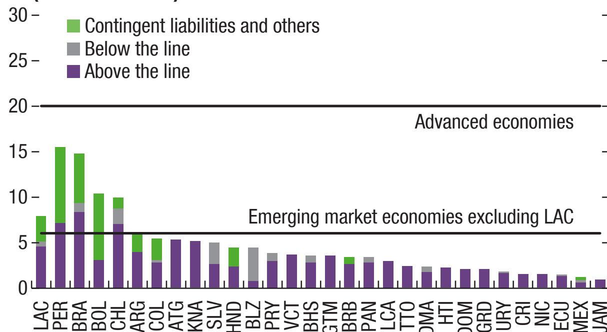
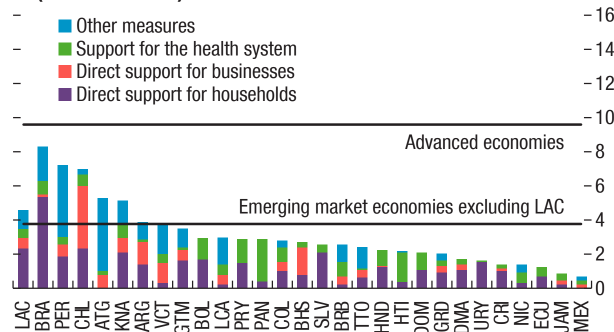
Figure 8. Fiscal and Monetary Developments

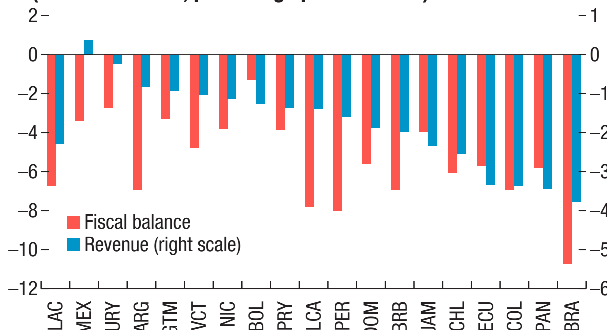
1. Discretionary Fiscal Measures[1,2]
(Percent of GDP)



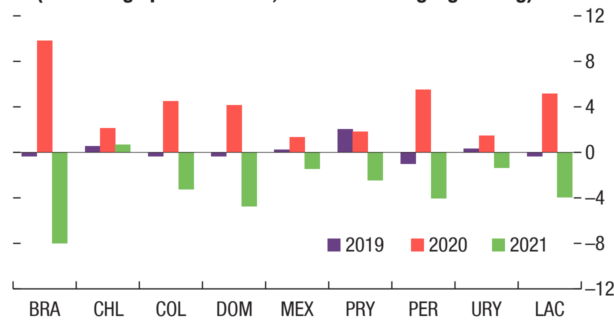
2. Above-the-Line Discretionary Fiscal Measures[1,3]
(Percent of GDP)



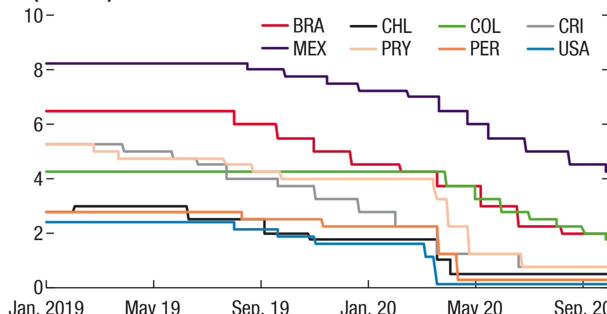
3. Change in Fiscal Balance and Revenue, 2020[4]
(Relative to 2019; percentage points of GDP)



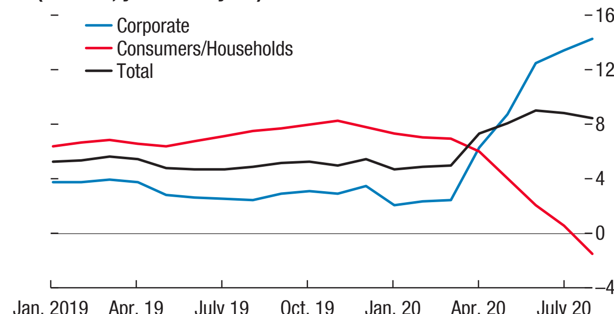
4. General Government Fiscal Impulse[4,5]
(Percentage points of GDP; +/– = loosening/tightening)



5. Policy Rates
(Percent)



6. LA5: Real Credit Growth[6]
(Percent, year-over-year)



Sources: Haver Analytics; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. LAC = Latin America and the Caribbean; LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).
[1]Advanced economies, emerging market economies excluding LAC, and LAC aggregates are fiscal year US dollar nominal GDP-weighted averages. LAC includes countries shown in the chart. Does not include tax deferrals and anticipation of benefits, which typically have small effects on an annual basis.
[2]For most countries, the loan guarantees include the total potential amount of loans covered by the guarantees; for Chile and Colombia, the amount corresponds to the capital committed for such purposes.
[3]In Peru, other measures include mostly capital spending; in Brazil, they mostly include support to local governments.
[4]LAC is fiscal year US dollar nominal GDP-weighted average.
[5]Defined as the change in structural primary balance. Chile refers to the change in structural non-mining primary balance. Colombia refers to the consolidated public sector's change in structural non-oil primary balance.
[6]Simple average of LA5. Nonfinancial corporations/commercial and household/consumer loans.

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Table 1. Central Bank Actions Aimed at Easing Stress in Funding and Securities Markets

Objective	Action	Countries
Easing stress in longer-term funding markets	Funding for lending	ARG, BRA, CHL, MEX, PER, PRY
Easing stress in securities markets	Private security purchase programs	BRA, CHL, COL
	Government bond purchase programs	COL, CRI, GTM, JAM

Sources: IMF, COVID-19 Central Bank Intervention Database; and IMF, COVID-19 Policy Tracker.
Note: Data labels use International Organization for Standardization (ISO) country codes.

countries in the region, reflecting in part fiscal space constraints. About half of above-the-line measures in LAC (approximately 2.5 percent of GDP) corresponds to increases in support for households, and the rest is split evenly between support to firms, support to the health system, and other measures. (Figure 8, panel 2). Most of the measures aimed at supporting households and firms have been fully implemented.[3] Amid sizable fiscal support and a sharp reduction in government revenue caused by the recession, fiscal deficits are expected to increase across the region in 2020 (Figure 8, panel 3).

These exceptional measures are playing a key role in supporting economic activity to avoid even more severe economic downturns and a larger social impact. IMF staff estimates suggest that the macroeconomic effect of the fiscal measures, if fully implemented, would be sizable, raising the region's level of real GDP by about 6–7 percent within a year compared with a counterfactual scenario with no fiscal measures (IMF 2020c; Annex 3). This is in line with the large fiscal impulse projected for 2020 (Figure 8, panel 4). Support measures have also mitigated the social impact of the crisis. In Brazil, for example, IMF staff estimates suggest that without the emergency aid program, the poverty headcount ratio would have increased from about 6.7 percent to 14.6 percent (per the national poverty line of 178 reais of per capita household income). However, once the emergency aid is taken into account, the poverty headcount ratio fell to 5.4 percent.

In addition to fiscal packages, countries also implemented other measures to boost activity and support households. Some countries, notably Chile and Peru, passed legislation that allowed withdrawals from individual pension fund accounts, and a large share of the eligible population has accessed these funds. Although such policies are achieving their objectives of alleviating individual liquidity constraints, they also created short-term pressures on pension funds to mobilize liquid assets and could generate fiscal liabilities over the medium to long term because governments may need to complement insufficient pensions in the future.

Most central banks in the region eased monetary policy and provided liquidity support to lower market stress and preserve credit flows to the economy. Policy rates were cut across the region, with Brazil, Colombia, Costa Rica, Mexico, and Peru cutting rates by more than 200 basis points. Chile and Peru are at the effective lower bound (Figure 8, panel 5). Liquidity support measures amount, in some cases (such as Brazil and Peru), to significant shares of GDP (about 16 and 8 percent, respectively). These measures, together with quasi-fiscal operations and financial policies to mitigate bank balance sheet stress (including using existing or enhanced flexibility of the regulatory framework to restructure loans, limits on dividend payouts, reduction in countercyclical or conservational capital buffers, and government guarantees), have contributed to corporate credit growth (Figure 8, panel 6). Some countries used asset purchase programs to improve bond market functioning (Colombia), attend to pressing social needs (Guatemala), and ease overall financial conditions (Chile, October 2020 GFSR and Table 1). These programs have been shown to reduce government bond yields and to gradually reduce market stress (October 2020 GFSR, Chapter 2).

[3]Some countries have experienced delays in the implementation of investment plans and in health expenditure.

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Table 2. Real GDP Growth
(Percent, year-over-year)

			Projections	
	2018	2019	2020	2021
Latin America and the Caribbean	**1.1**	**0.0**	**−8.1**	**3.6**
LAC excluding Venezuela	1.7	0.8	−7.8	3.8
South America	0.3	−0.2	−8.1	3.6
CAPDR	3.8	3.2	−5.9	3.6
Caribbean				
Tourism-dependent	2.0	0.5	−9.9	4.0
Commodity exporters	1.1	1.0	0.6	3.8
Memorandum items				
LA6	2.1	0.9	−7.6	3.6
Brazil	1.3	1.1	−5.8	2.8
Mexico	2.2	−0.3	−9.0	3.5

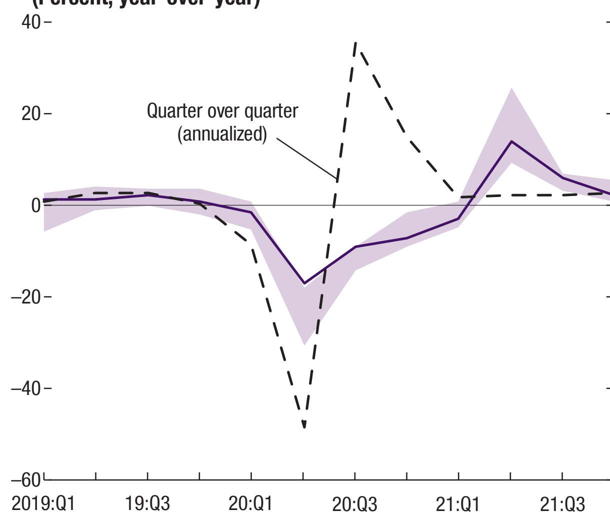
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Regional aggregates are purchasing-power-parity GDP-weighted averages. For country group composition, see page 35. CAPDR = Central America, Panama, and the Dominican Republic; LAC = Latin America and the Caribbean; LA6 = Latin America 6 (Brazil, Chile, Colombia, Mexico, Peru, Uruguay).

Regional Outlook: A Partial and Uneven Recovery

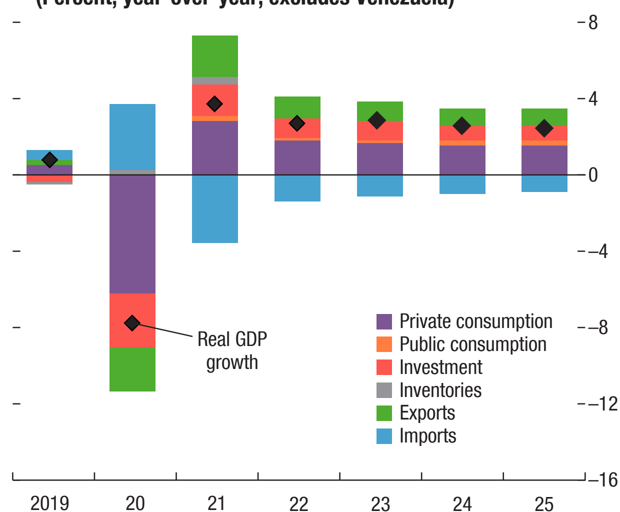
Real GDP is expected to contract sharply in 2020, followed by a partial recovery in 2021. Reflecting deep recessions across the region, growth in LAC is projected at –8.1 percent in 2020 and 3.6 percent in 2021 (Table 2). The strong recovery in remittances and exports, together with low oil prices, will contribute to a milder contraction in Central America, Panama, and the Dominican Republic, while tourism-dependent Caribbean countries will experience more severe recessions because of the sharp and long-lasting decline in tourism. After a steep and broad-based collapse

Figure 9. Real GDP Growth Projections

1. Real GDP Growth[1]
(Percent, year-over-year)



2. Contributions to Real GDP Growth[2]
(Percent, year-over-year; excludes Venezuela)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
[1]Includes Argentina, Brazil, Chile, Colombia, Mexico, and Peru.
[2]Purchasing-power-parity GDP-weighted average. Also excludes Aruba, Barbados, Dominica, Grenada, Guyana, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago because of data limitations. Inventories include statistical discrepancies.

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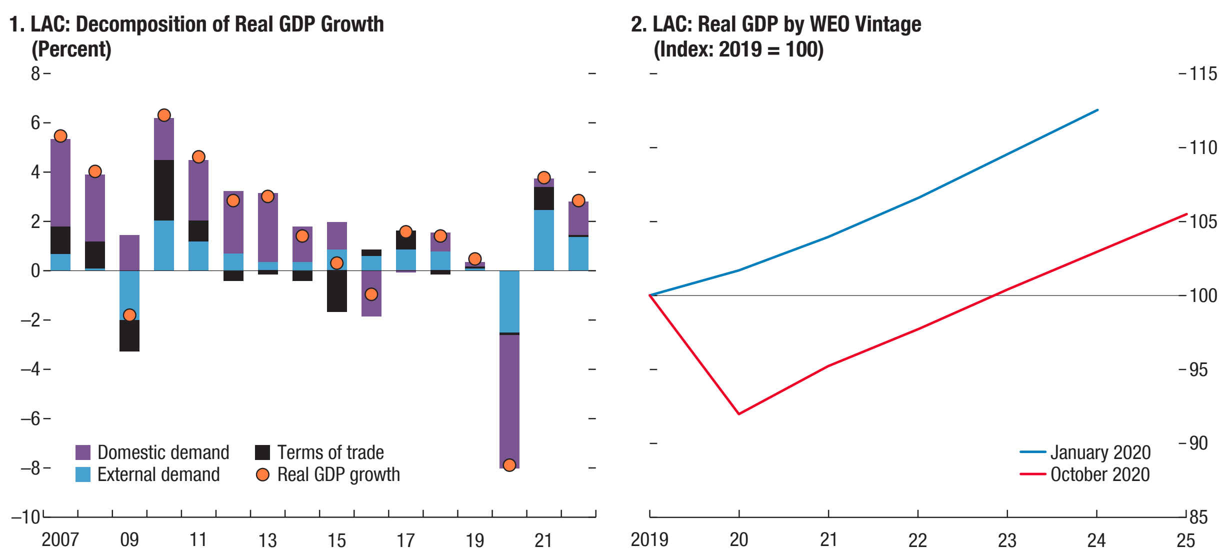
Figure 10. Drivers of Growth and GDP Losses



Sources: IMF, World Economic Outlook (WEO) database; and IMF staff calculations.
Note: LAC = Latin America and the Caribbean.

in activity in the second quarter, regional GDP is expected to rebound in the second half of 2020 and continue a gradual recovery (Figure 9, panel 1). Consumption, investment, and trade flows are also expected to fall in 2020 and partially recover in 2021 (Figure 9, panel 2). The 2020 growth projection is 1.3 percentage points higher than in the June 2020 *World Economic Outlook* (WEO) *Update*. Revisions to trading partners' growth and a better-than-expected second quarter outturn in Brazil improved the forecast. However, the baseline outlook is subject to an unusually high degree of uncertainty (October 2020 WEO).

LAC's short- and medium-term outlook will be shaped by factors affecting external and domestic demand and how the scars from the pandemic lower potential output. In contrast to the global financial crisis (when domestic factors buffered the negative impact of external factors, and a sharp rebound in the terms of trade boosted the recovery), domestic and external factors this time will move in tandem, and the terms of trade are expected to remain neutral through the recovery (Figure 10, panel 1).The medium-term outlook points to a protracted recovery, reflecting long-lasting economic costs, and most countries will not go back to pre-pandemic GDP levels until 2023 (Figure 10, panel 2).

Subdued External Conditions

The global economy is projected to experience a deep downturn in 2020 and a sluggish recovery afterward, dimming the outlook for LAC's exports. After falling to –4 percent in 2020, trading partner growth is expected to recover in 2021 (Figure 11, panel 1). The outlook is less promising for tourism—international travel restrictions and consumers' fear of health risks will continue to affect tourism until the pandemic is under control (October 2020 WEO). Oil prices are expected to remain subdued, while the prices of metals and, to a lesser extent, soybeans are projected to firm up over the medium term (Figure 11, panel 2). The impact of these factors on growth will vary within the region. In countries such as the Dominican Republic, El Salvador, Paraguay, and Uruguay, and in most of the Caribbean, a positive terms-of-trade shock will partly compensate for the large negative external demand shock. In Bolivia, Colombia, and Ecuador, a negative terms-of-trade shock will add a further drag to growth. Despite weak

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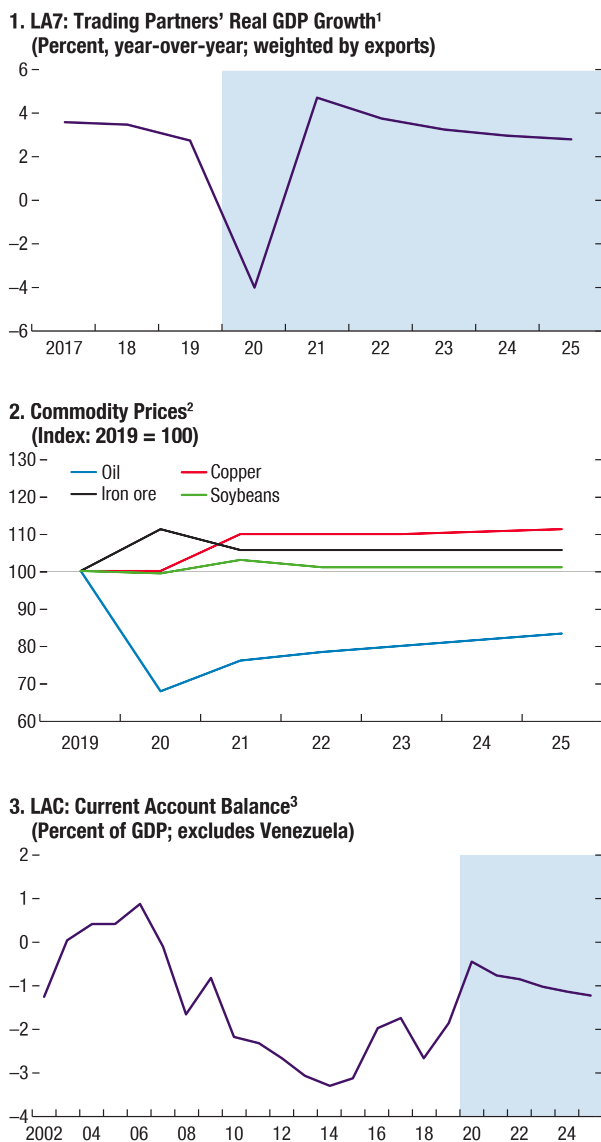
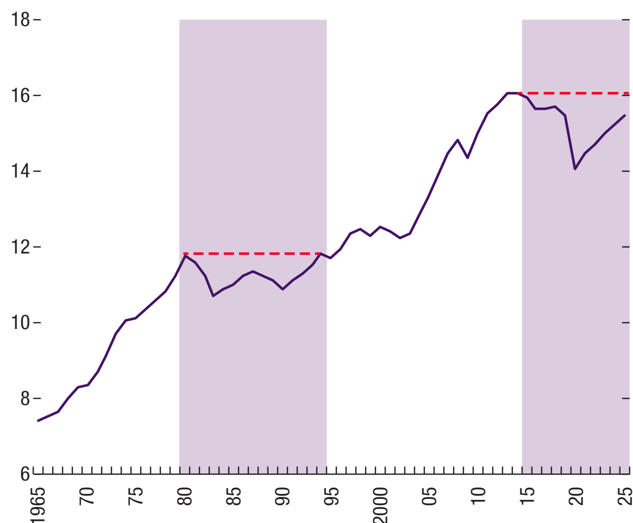
Figure 11. External Sector Developments



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: LAC = Latin America and the Caribbean; LA7 = Latin America 7 (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay).
[1]Based on data for non-LAC partner countries that together account for 100 percent of trade of reporting country.
[2]Values in US dollars.
[3]Current account balance is US dollar nominal GDP-weighted average.

export growth and low commodity prices, current account deficits are expected to remain contained (Figure 11, panel 3).

Figure 12. A Decade Lost? LAC Real GDP per Capita
(Thousands of PPP 2017 international dollars)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: LAC = Latin America and the Caribbean; PPP = purchasing power parity.

Weak Domestic Demand, Low Inflation, and Subdued Potential Growth

Near- and medium-term forces will keep domestic demand constrained. Fear of contagion is expected to weigh on consumption of contact-intensive goods and services until the virus is controlled. An erosion in income levels and precautionary saving that will persist even after the pandemic fades will likely accentuate this situation. In fact, LAC's real income per capita, is expected to remain below pre-COVID-19 levels until 2025 (Figure 12), which means that LAC faces the prospect of another lost decade, as in the 1980s.

Moreover, the COVID-19 shock is expected to have a large impact on jobs and erase some of the region's social progress made until 2015. In the second quarter of 2020 employment in LA5 countries fell by more than 30 million people, affecting especially workers with low educational attainment (Annex 2). Although many jobs will be recovered as activity resumes, current estimates point to lasting income losses, with poverty projected to increase significantly in 2020 (Table 3). The shock is also expected to exacerbate

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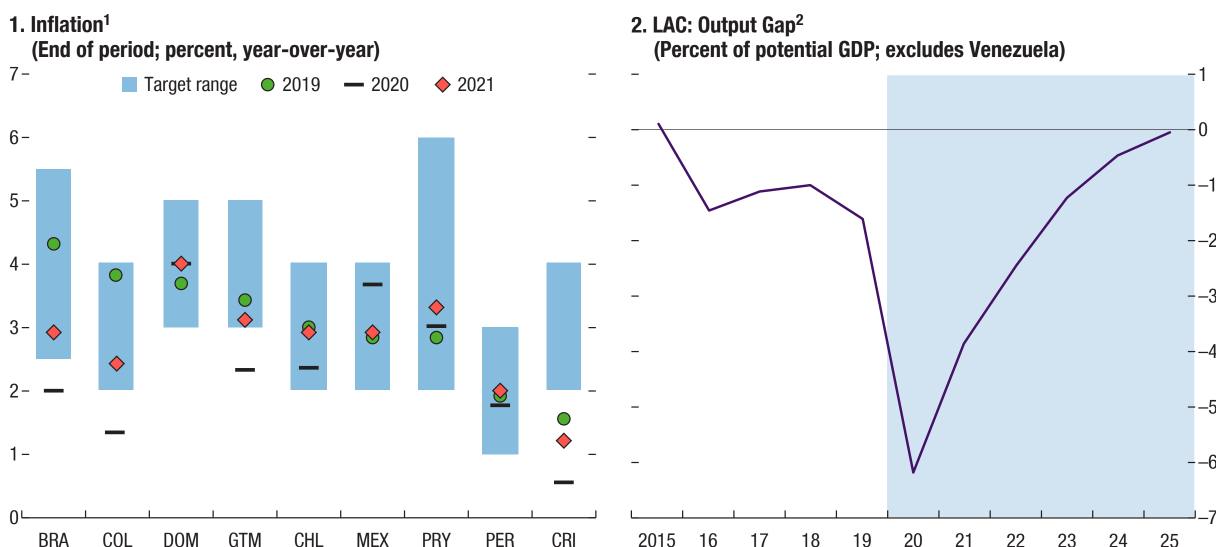
Table 3. Estimated Impact of COVID-19 on Poverty
(Millions)

Source	Change in Extreme Poverty Headcount (below US$1.90 per capita per day)	Change in Poverty Headcount (below US$5.50 per capita per day)								
			Argentina		Brazil		Colombia		Mexico	
	LAC	LAC	COVID-19	COVID-19 + Assistance	COVID-19	COVID-19 + Assistance	COVID-19	COVID-19 + Assistance	COVID-19	COVID-19 + Assistance
October 2020 *Fiscal Monitor*	14.7									
World Bank (June 2020)		18–35	1.48		6.86		2.66		9.21	
ECLAC (July 2020)		44								
Lustig and others (2020)			1.4–2.0	0.5–1.7	9.3–13.9	(0.4)–5.3	2.5–2.9	2.2–2.7	10.1–11.2	n.a.

Sources: ECLAC (2020); Lustig and others (2020); and World Bank (2020).
Note: Each estimate reflects different assumptions about baseline growth rates and the incidence of the crisis along the income distribution. Moreover, estimates are subject to a large degree of uncertainty, depending on pandemic developments, designated poverty thresholds, the growth outlook, and fiscal policy responses. World Bank LAC estimates are relative to the counterfactual poverty headcount without a pandemic. World Bank country-specific differences are relative to the 2019 poverty headcount. COVID-19 = coronavirus disease; LAC = Latin America and the Caribbean; n.a. = not available.

Figure 13. Inflation Forecasts



Sources: IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. LAC = Latin America and the Caribbean.
[1]Includes countries with an inflation-targeting framework.
[2]Purchasing-power-parity GDP-weighted average.

LAC's income inequality, which was among the highest in the world before the pandemic (ECLAC 2020). Emergency assistance programs are expected to mitigate the shock's social impact.

Amid economic slack, inflation is projected to decline and fall below its target range in many countries in 2020. This reflects the larger impact of deflationary forces associated with depressed activity and subdued commodity prices relative to the inflationary pressure of the supply shock and of currency depreciations (Figure 13, panel 1). Inflation is expected to rise gradually starting in 2021 but remain contained, amid persistently weak aggregate demand and negative output gaps (Figure 13, panel 2).

Fiscal measures are expected to provide short-term support to demand in 2020 (Figure 8, panel 4; Annex 3). However, under current plans, this

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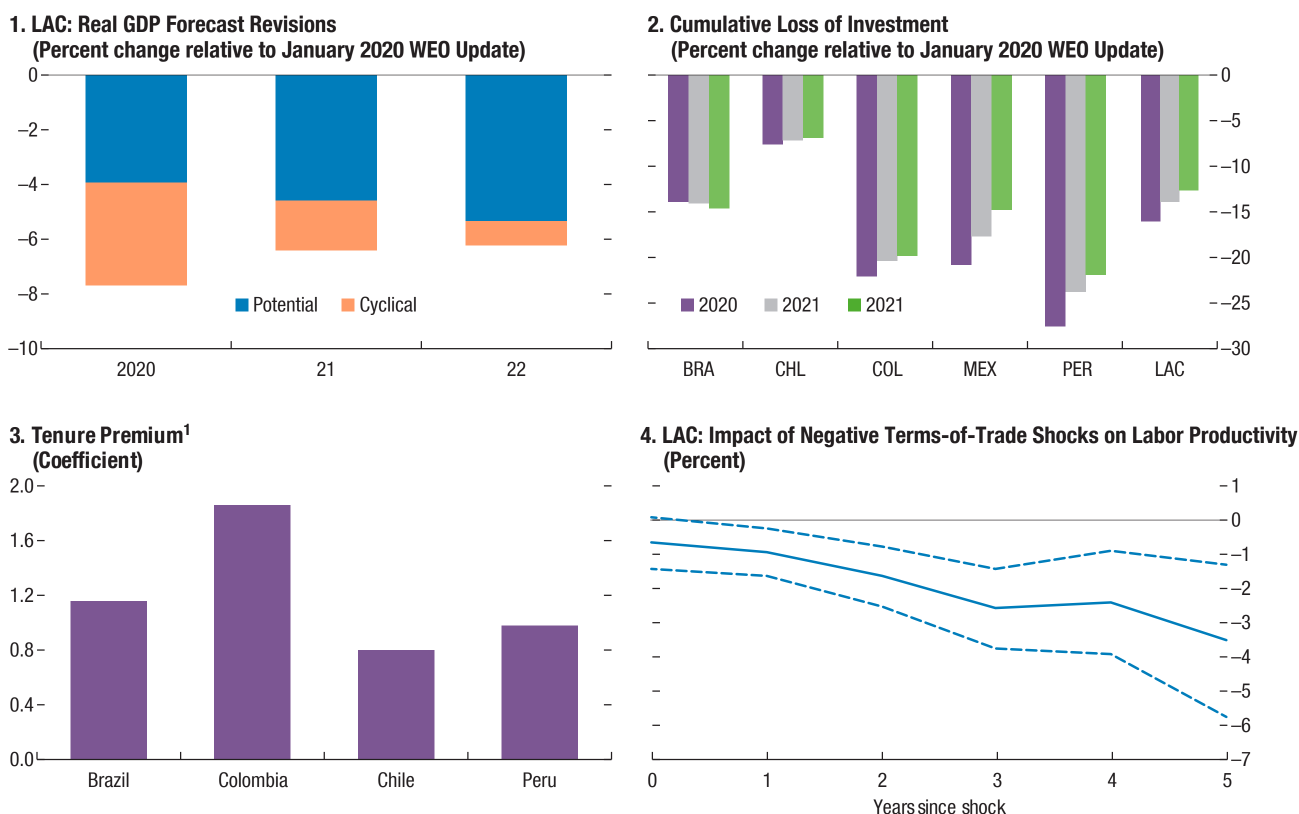
Figure 14. Scarring



Sources: IMF, World Economic Outlook (WEO) database; Inter-American Development Bank Harmonized Surveys database; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. LAC = Latin America and the Caribbean.
[1]Bars are the coefficients for log years of tenure from a Mincer regression of log hourly wages. Additional controls include education, gender, age, and sector fixed effects.

effect is expected to reverse in 2021 as support is unwound, with a negative impulse of about 3 percent of GDP. Moderate current account deficits and large fiscal deficits in 2020 and 2021 point to a strong crowding out of private domestic demand—in particular, investment will remain subdued as uncertainty about the pandemic's path persists.

The COVID-19 crisis is expected to leave lasting scars on potential GDP, especially in countries where policy support has been limited. Although the pandemic's impact on cyclical and potential output is quantitatively similar in 2020, the latter becomes more prominent as the recovery takes hold (Figure 14, panel 1). Several factors contribute to the long-lasting damage to potential GDP. The necessary support to the corporate sector, mostly to SMEs and some large firms in affected sectors, will exacerbate their high leverage and increase the prevalence of "zombie" firms (GFSR online annex). Bankruptcies, firm closures, and the postponement of business plans because of weak demand and uncertainty will keep investment depressed over the medium term (Figure 14, panel 2). The crisis will also lead to the destruction of organizational capital and relationship-specific capital between input suppliers and final goods producers, which is likely to amplify the effects of the crisis. Similarly, many workers with on-the-job experience—an attribute that adds to productivity and that firms value (Figure 14, panel 3)—are expected to be laid off, destroying firm-specific human capital. Past economic shocks in LAC have resulted in lasting adverse effects on productivity (Figure 14,

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panel 4; World Bank 2020), and the expected long episodes of unemployment and informality could lead to further skill losses, making the effects of the shock more acute (IMF 2020b).

Finally, total factor productivity is expected to suffer because some degree of misallocation is likely in a recovery that will be uneven across sectors and during which economies will be adapting and operating in ways compatible with social distancing (October 2020 WEO). An accelerated process of structural transformation is expected to arise because installed capital may need to be repurposed, and growing sectors will have to absorb displaced workers, which could result in high adjustment costs. The region's stringent labor market regulations and bankruptcy laws could also hamper this process (October 2019 *Regional Economic Outlook: Western Hemisphere*). Some of these factors will likely be mitigated in countries with strong economic support programs, especially those aimed at preserving formal employment and viable firms. By contrast, countries where support has been limited by fiscal space and lack of market access will likely suffer a larger impact on potential GDP. Still, too much preservation of existing jobs and firms through fiscal support to sectors that will remain depressed during the recovery might hinder the structural transformations that dynamic economies need, making the trade-offs of policy interventions very hard to assess (Blanchard, Philippon, and Pisani-Ferry 2020).

Risks to the Outlook

Risks to the outlook remain skewed to the downside. Uncertainty about the pandemic's evolution is a key source of risk. The gradual recovery of economic activity envisioned in the baseline scenario could be disrupted by new outbreaks that lead to a stiffening of containment measures or further depress demand for contact-intensive sectors. Also, intensification of the pandemic is likely to be associated with a tightening of financial conditions that would amplify the negative impact on activity in an *adverse scenario* (October 2020 WEO, Box 1.1). Improvements in treatment and early development of a vaccine could improve the outlook in a more *benign scenario*. Other external and domestic risks are discussed below.

External Risks

Lackluster global growth and a slowdown in global trade could weaken LAC's recovery. This risk could materialize if countries tighten their policy stance too quickly or turn toward protectionist policies (October 2020 WEO). An escalation of geopolitical tensions could also lower global growth and increase commodity price volatility. These factors may erode global risk appetite and reduce capital flows to the region.

Regional and Domestic Risks

A longer-lasting decline in activity could further tighten financial conditions and exacerbate debt and funding issues in the region's corporate and sovereign sectors. Vulnerabilities are rising in these sectors, and liquidity pressures may morph into insolvencies, especially if the recovery is delayed (October 2020 GFSR).

High sovereign debt levels could lead to a deterioration in sovereign credit ratings and reignite pressure in local bond markets. Large fiscal deficits and sharp contractions in GDP will lead to spikes in debt-to-GDP ratios (Figure 15, panel 1). Although debt is expected to stabilize in the baseline as growth resumes in 2021, concerns about fiscal sustainability among market participants could worsen in an adverse scenario, leading to rating downgrades and increases in funding costs. These could also dim interest by foreign participants, constraining governments' ability to meet financing needs. If that happens, domestic investors and banks would buy government bonds at the expense of corporate issuances. As shown in Figure 15, panel 2, debt service pressures are likely to be larger in domestic markets than in external markets in non-Caribbean countries.

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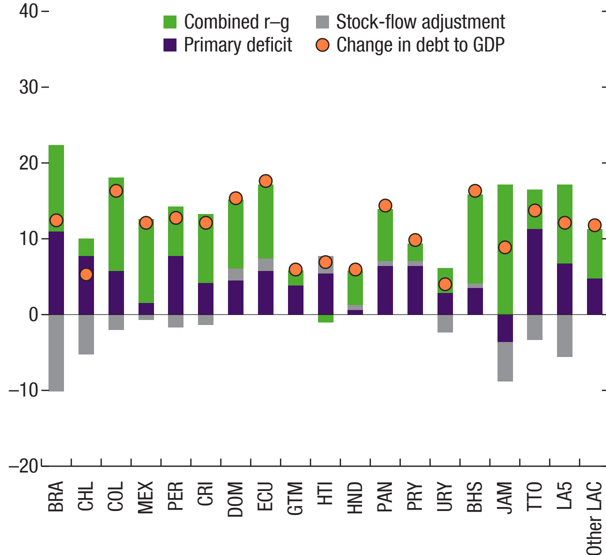
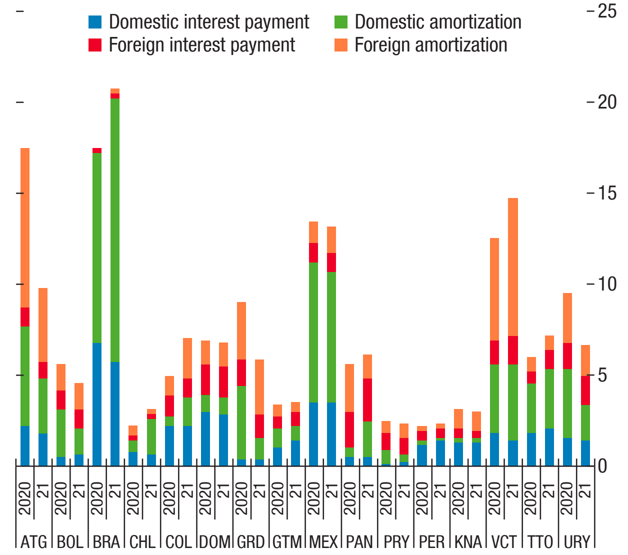
Figure 15. Debt Outlook

1. Drivers of Change in Public Debt, 2020[1]
(Percent of GDP)



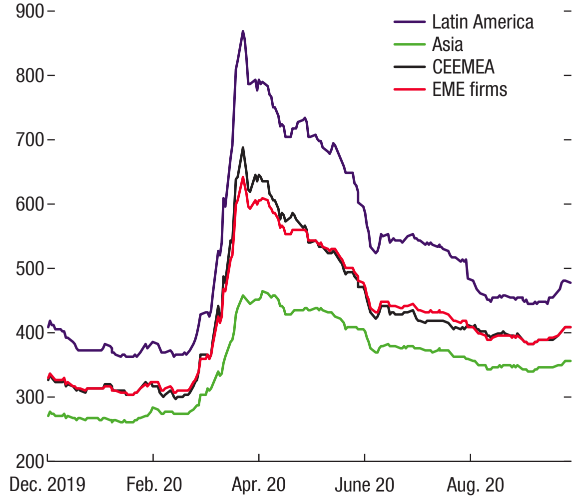
2. Public Debt Service
(Percent of GDP)



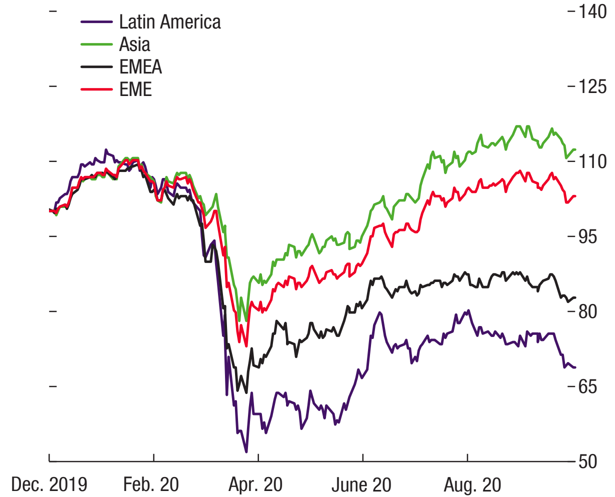
Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. LAC = Latin America and the Caribbean; LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).
[1]Real interest rate-growth (r–g) differential, adjusted for exchange rate changes. Stock-flow adjustments are a residual category that typically captures one-off factors. For example, in Brazil's case, they capture in part the use of cash reserves to reduce the need for new debt issuance. Aggregates are fiscal year US dollar nominal GDP-weighted averages. "Other LAC" comprises non-LA5 countries shown in the chart.

Figure 16. Financial and Corporate Developments

1. CEMBI Spreads in Emerging Market Economies
(Basis points)



2. MSCI Emerging Market Economies
(US dollars; index: December 2, 2019 = 100)



Sources: Bloomberg Finance L.P.; and IMF staff calculations.
Note: CEEMEA = Central and Eastern Europe, Middle East, and Africa; CEMBI = Corporate Emerging Markets Bond Index; EME = emerging market economies; EMEA = Europe, Middle East, and Africa; MSCI = Morgan Stanley Capital International.

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Corporate and financial stress is another source of risk in LAC. The COVID-19 shock negatively affected many large corporations in LAC more than those in other regions (Figure 16). However, SMEs are expected to feel the largest effect. In Brazil, firm surveys through August 2020 show that a higher fraction of small firms have reported declining sales than large firms. IMF (2020d) shows that nonfinancial corporate debt at risk has risen sharply in 2020 and could increase further in 2021 in an adverse scenario. On the financial side, LAC's banking sector entered the crisis in a strong position, limiting concerns about systemic risk. However, if downside risks to the outlook materialize, rising bankruptcies and nonperforming loans may create pockets of vulnerability that could lead to capital shortfalls in some banks.

A further deterioration in overall activity could lead to additional layoffs and permanent closures, especially among small and young firms (IMF 2020d). These factors, if not tackled properly, could deepen scarring and amplify existing inequities in the region further, raising the prospects of renewed bouts of social unrest.

Beyond pandemic-related risks, natural disasters and extreme weather events continue to be significant sources of risk in the region. These include hurricanes in the Caribbean and Central America and earthquakes in the countries located in the "ring of fire," where many earthquakes and volcanic eruptions occur

Regional Policy Focus

Policies will have to manage difficult trade-offs amid the health emergency, dire socioeconomic prospects, significant downside risks, and mounting fiscal imbalances. Containing the spread of the virus and addressing the health crisis remain the priorities. Short-term policies must remain focused on the recovery. The gradual reopening process could be facilitated by measures aimed at making workplace arrangements safer and improving access to digital technologies.

Fiscal support should be maintained in the short term to safeguard the incipient economic recovery (IMF 2020c). However, such support should be accompanied by explicit and clearly communicated commitments to consolidate and rebuild buffers over the medium term. In that context, fiscal rules will play an important role. Countries where fiscal rules were suspended due to the crisis should clearly communicate commitments to restore rules conditional on the state of the recovery. To provide credibility for medium-term plans and create fiscal space, countries could also consider passing legislation, such as preapproval of future tax reforms, to ensure that gradual adjustment occurs once the recovery is well underway.

In countries where activity is picking up and lockdowns are being loosened, emergency lifelines should be gradually unwound, avoiding sudden declines in income, especially among the vulnerable. Where fiscal space is available, governments could provide broad-based stimulus by, for example, enacting carefully designed temporary payroll tax cuts (covering existing employees and new hires) to incentivize firms to hire, and boosting public investment. Nonetheless, in countries with more limited fiscal space, as governments unwind emergency support, the priority would be to preserve measures with the largest social impact and increase the efficiency of spending, along with revenue mobilization.

Moreover, countries can foster market-based reallocations arising from the crisis by tackling existing burdensome regulations. Revisions to existing laws could provide further support to the recovery. For example, relaxing entry barriers (which favor incumbents at the expense of potential new firms) and labor market rigidities (which deter firms from hiring) could boost the recovery.

Monetary policy can help mitigate the impact of fiscal unwinding, both with traditional and unconventional instruments. Stable inflation expectations and persistent negative output gaps suggest that monetary policy in LAC should remain accommodative. Low policy

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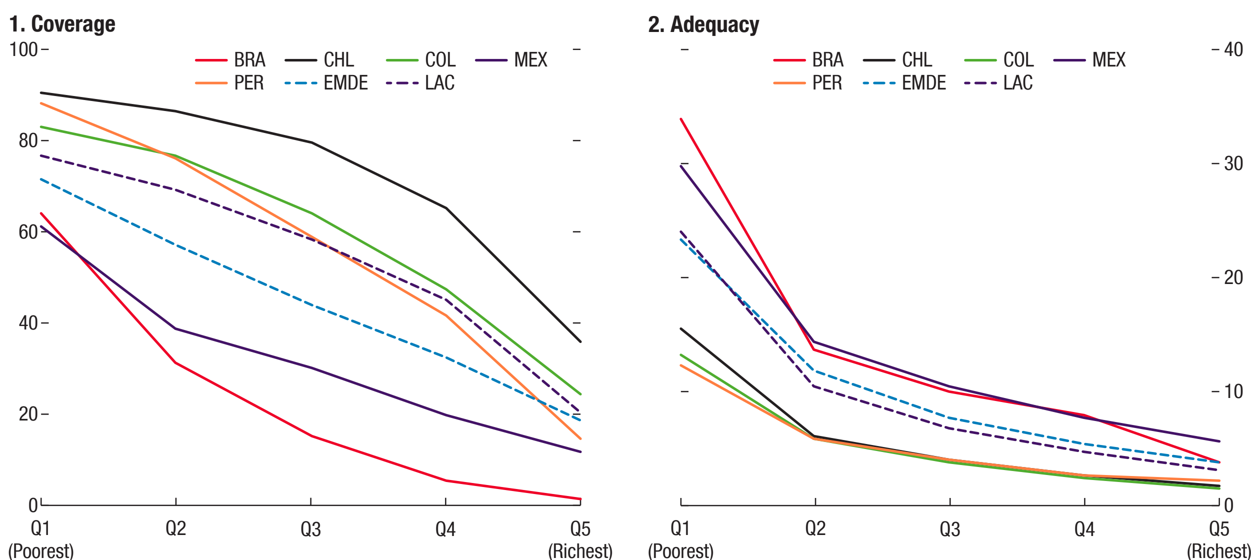
Figure 17. Social Safety Net Programs
(Percent)



Source: IMF staff calculations.
Note: Coverage measures the percentage of the quintile that receives a social safety net benefit. Adequacy of benefits measures the total transfer amount received by all beneficiaries in the quintile as a percentage of the pre-transfer total income and expenditure of beneficiaries (in that quintile). Calculations are based on pre-COVID-19 information. Years are as follows: BRA, CHL (2015); COL, MEX, PER (2014); EMDE, LAC (around 2015). Dashed lines for EMDE and LAC refer to the median. Data labels use International Organization for Standardization (ISO) country codes. COVID-19 = coronavirus disease; EMDE = emerging market and developing economies; LAC = Latin America and the Caribbean.

rates may need to be combined with bond and foreign exchange market interventions if financial conditions tighten. Asset purchase programs could help countries hitting the effective lower bound ease financial conditions by lowering term premiums and flattening the yield curve. However, they should be combined with a clear communication strategy to avoid undermining credibility and should not hamper the development of local capital markets and the growth of a stable and diversified local investor base. Moreover, asset purchase programs should be temporary and have clear exit strategies, should be designed in a way that focuses on high quality tradable assets, and should be consistent with central banks' objectives.

Policy priorities will change once pharmaceutical interventions or medical treatments (or both) are widely available, the pandemic is under control, and the recovery is well underway. Fiscal policy will then need to address legacy effects of the COVID-19 crisis and credibly rebuild space. This would require a further strengthening of medium-term anchors and fiscal structural reforms—with an eye toward enhancing automatic stabilizers, preserving public investment (while improving public investment management), tax progressivity, and fairness of the composition and quality of fiscal adjustments. For example, countries in the region have room to improve targeting of social safety nets by strengthening social registries, which could allow better identification of vulnerable households and could lead to savings without hurting vulnerable groups (Figure 17).

Financial regulation will need to address the legacy of the crisis. As activity recovers, banks need to rebuild capital buffers to ensure medium-term financial stability. Countries will need to tackle corporate debt overhang and distinguish between viable firms in the new domestic and global context and those that are not. For the former, debt restructuring may be critical to rebuild balance sheets. Standard restructuring

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solutions and incentives could help expedite this process. Out-of-court frameworks may be needed to deal with high case volume. For unviable firms, efficient and equitable bankruptcy frameworks that distribute losses among investors, creditors, owners, workers, and the government will be needed.

Increasing long-term growth and employment has become more pressing since the COVID-19 crisis. LAC entered the pandemic with clear gaps in infrastructure and productivity. Investments in green infrastructure and technologies could help close these gaps as part of a reprioritization of government expenditure (October 2020 WEO). However, these efforts should be complemented with a comprehensive structural reform agenda that tackles regulations in product and labor markets to facilitate cross-sectoral reallocation of resources from polluting sectors to green ones.

Policies that protect the income and employment of the vulnerable should accompany pro-growth structural reforms, especially at a time when inequality and poverty are expected to rise. Stronger safety nets, which focus on poverty alleviation and incentives for human capital improvements, should continue to play a buffering role. But countries now have an opportunity to embark on a broader strategy for addressing social objectives. A new generation of social safety nets and programs ensuring better access to basic utilities, education, health care, and formal markets could strengthen social cohesion and help prepare the region for ongoing changes in the global economy (such as automation and the use of artificial intelligence in productive processes). Addressing social objectives in this way could make LAC's social progress more resilient to economic shocks—including those associated with climate change (IMF 2020b, 2020c).

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Box 1. Sovereign Debt Restructuring in Argentina and Ecuador[1]

Argentina and Ecuador undertook successful debt restructurings in 2020, amid mounting debt sustainability concerns and financing pressures.

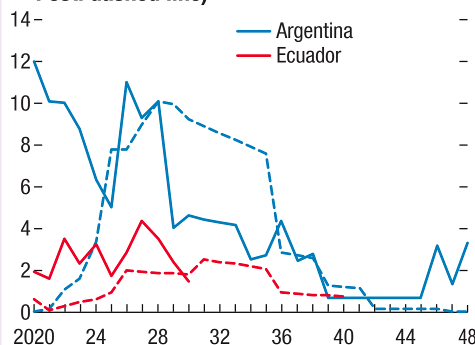
Argentina: After presenting debt restructuring offers in April and July, Argentina reached an agreement with its key external creditors in August. The complex restructuring of $65 billion in foreign-law bonds, which included 35 different bonds issued under two different indentures (with old and enhanced collective action clauses [CACs]) and in multiple currencies, was completed by September 4 with 99 percent creditor participation after CACs (94.6 percent tendered the exchange). In parallel, $15.2 billion of domestic law foreign exchange-denominated bonds were restructured by September 21, with 99.4 percent bondholder participation and under similar terms and conditions. The debt restructurings took place outside of an IMF-supported program.

Ecuador: Amid the COVID-19 crisis, Ecuador launched a market-friendly restructuring of its $17.4 billion international bonds, which was finalized on August 31 with 100 percent creditor participation facilitated by CACs (98 percent tendered the exchange). An IMF staff-level agreement on an IMF program—a precondition for the debt exchange—was reached on August 28.

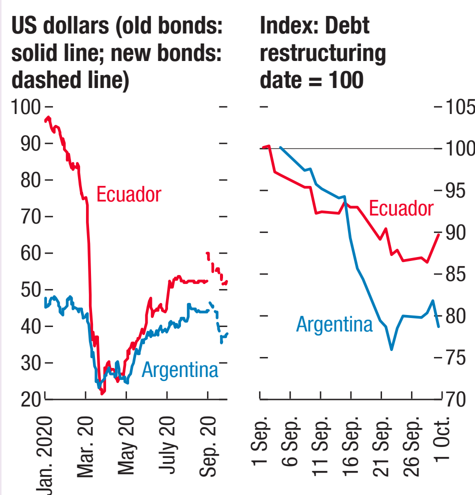
The debt deals feature: (1) a small nominal principal reduction of $1.6 billion in Argentina and $1.5 billion in Ecuador; (2) an increase in the weighted-average maturity from 7.9 years to 11 years in Argentina and from 6.1 years to 12.7 years in Ecuador; (3) a reduction in the weighted-average coupon rate from 6.5 to 3.2 percent in Argentina and from 9.2 to 5.3 percent in Ecuador; (4) a weighted-average grace period of 6.9 years in Argentina and 6 years in Ecuador; as well as (5) very low annual interest payments between 2021 and 2024, averaging 0.25 percent of GDP in Argentina and 0.35 percent of GDP in Ecuador; and (6) long-term past-due-interest bonds of $3.5 billion in Argentina and $1 billion with nominal haircut in Ecuador. Both restructurings include legal innovations aimed at encouraging bondholder participation, such as clauses to limit the possibility of voting abuses (IMF 2020e).

Box Figure 1.1. Debt Restructuring

1. Pre- and Post-Restructuring Debt Service (Billions of US dollars; Pre: solid line; Post: dashed line)



2. Bond Prices[1]



Sources: Bloomberg Finance L.P.; national authorities; and IMF staff calculations.
[1]Debt restructuring dates are as follows: Argentina (September 4, 2020) and Ecuador (September 1, 2020).

This box was prepared by Matteo Ghilardi and Michael Perks.
[1]The government of Argentina announced its intention to launch the debt restructuring process in December 2019 while the government of Ecuador did it in April 2020.

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Box 1 *(continued)*

The debt restructurings provide significant liquidity relief over the next decade ($33.3 billion to Argentina and $16.4 billion to Ecuador) and are expected to reduce public-debt-to-GDP ratios to 40 percent in Argentina and 45 percent in Ecuador. Bond prices recovered in the run-up to the restructuring but have declined since, reflecting, in part, domestic policy uncertainty.

Box Table 1.1. Selected Debt Restructuring Operations
(Billions of US dollars; unless indicated otherwise)

	Argentina	Ecuador
Public Debt (end-2019)[1]	206.5	55.7
Public Debt (end-2019; percent of GDP)[1]	56.2	51.8
Debt Subject to Restructuring	80.2	17.4
Foreign Law	65.0	17.4
Domestic Law[2]	15.2	. . .
Cash Flow Relief, 2020–30	33.3	16.4
Recovery Value (percent; 10 percent discount rate)	55.1	55.0
Restructured Bonds		
Rating[3]	CCC+	B−
Price[4]	45–52	49–74
Yields (weighted average)	11–12	9.6

Sources: National authorities; and IMF staff calculations.
[1]For Argentina, excludes debt held by other public sector entities.
[2]For Argentina, excludes US$3 billion in foreign currency debt converted to local currency.
[3]Standard & Poor's.
[4]Includes past-due interest (PDI) bonds. In the case of Ecuador, the amount of PDI is as of September 1 and is after the nominal haircut. For Argentina, PDI is as of September 4, 2020.

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