

## CENTRAL AMERICA AND MEXICO

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### Costa Rica

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The Costa Rican economy grew rapidly (7.5%) in 1999, thanks largely to the operations of a single large maquila firm that accounted for four percentage points of this growth. This duality of the economy was reflected in the unequal trends of the gross domestic product and gross national income, since the latter only grew by 2.1%, as a result of factor payments abroad. Tight monetary policy and weak domestic demand caused price increases, at 9%, to be less than those of the previous year. The smaller price rises and a larger supply of foreign currency allowed for a slower daily rate of devaluation, and the average exchange rate rose by 11%, as programmed.

The imbalance in the public finances remained one of the priority problems: the central government deficit expanded once more, as revenue growth slowed (16%) and expenditure accelerated (21%), causing the deficit in relation to the gross domestic product (GDP) to widen from 3.3% in 1998 to 3.9% in 1999. Although domestic debt has been replacing external borrowing since 1998, interest payments remain a heavy burden, absorbing more than 30% of total revenue.

The slowdown in demand basically affected taxes on consumption and income, with the former declining by 12%, and income tax revenue slowing from a growth rate of over 40% in 1998 to a rate of only 29%. Taxes in the customs category (including taxes on the sale and

consumption of imported goods) expanded by only 6%, compared to 27% in 1998; as these taxes account for 45% of total revenue, the impact on government income was considerable.

The growth in expenditure was the result of higher interest payments on the domestic debt (36%), whose repayment had had to be postponed to the current year as a result of the zero-coupon bond issues which had begun in June 1998, and higher wage and salary payments stemming from the creation of new posts in the areas of education and security. Up to 1997 the deficit had been covered exclusively with domestic borrowing, but this year 60% was covered with external resources.

## COSTARICA: MAIN ECONOMIC INDICATORS

	1997	1998	1999 <sup>a</sup>
	<i>Annual rate of variation</i>		
Gross domestic product	3.5	5.5	7.5
Consumer prices	11.2	12.4	9.4
Real wages	0.8	4.6	4.5
Money (M1)	43.2	12.3	21.4
Real effective exchange rate <sup>b</sup>	2.2	1.4	2.9
Terms of trade	6.0	3.2	1.1
	<i>Percentages</i>		
Urban unemployment rate	5.9	5.4	6.2
Fiscal balance/GDP	-3.9	-3.3	-3.9
Real deposit rate	-0.1	0.9	3.8
Real lending rate	8.2	9.6	14.1
	<i>Millions of dollars</i>		
Exports of goods and services	5 478	6 884	8 150
Imports of goods and services	5 690	7 047	7 540
Current account	-330	-495	-475
Capital and financial account	556	346	860
Overall balance	226	-149	385

Source: See the statistical appendix.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> A negative rate signifies an appreciation of the currency in real terms.

The tight monetary policy adopted in September 1998 was maintained during the first half of 1999. To absorb liquidity, open-market operations were intensified, and the gradual increase in the reserve requirement on new financial intermediaries and instruments was continued. Monetary policy was reviewed in mid-year, and although it was eased somewhat it remained restrictive. The upper limit for annual growth in credit for the private sector was raised from 26% to 30%, and open-market operations were carried out less frequently than in the first semester.

The money supply (M1) grew by 11.8% during the year, and local currency liquidity (M2) expanded by 12.8%, both percentages being below the growth rate of nominal GDP (18.3%). Foreign currency deposits, which had expanded by 41% in 1998, slowed to 17.1% in 1999; nonetheless, foreign currency liabilities still accounted for 40% of total liquidity.

Domestic credit grew by only 7.3% (compared with 39.8% in 1998), as a result of reduced net lending to the public sector and a slower growth of finance for private individuals. The net reserves expanded by 35% thanks to bond sales amounting to US\$ 300 million and slow import growth.

The exchange rate, which operates under a crawling-peg regime, rose by 11% from an average of 257.42 colones per dollar in 1998 to 285.91 in 1999. To bring it in line with the slow rate of price increases, the rate of devaluation was reduced from 12 to 10 centavos per day as from July.

External demand, with a growth rate of 6.7%, was the most buoyant component of the economy, while domestic demand shrank slightly. The small 3% increase in gross fixed investment, which was due to a rise in public investment, since private investment stagnated, was insufficient to make up for the 0.5% drop in consumption. On the supply side, the GDP expanded by 7.5%, while imports of goods and services shrank by 5%. Apart from the maquila sector, the rest of the economy grew at 4.3%, down from 5.5% in 1998. This was the result of the tight monetary policy and credit restrictions, especially in the first half of the year.

The growth rate of agriculture slowed owing to a decline in export production, especially of coffee and bananas, while output for the domestic market strengthened. The expansion of manufacturing industry gathered pace and exceeded the previous year's figure of 10.4% by 14 points. This result is due to manufacturing operations located in free zones, especially those of the Intel Corporation. "Componentes Intel de Costa Rica" is a big new assembly enterprise, 70% of whose production is computers and 30% microchips; its first plant came on stream in 1998, and was followed by a second in 1999. Growth in other industrial segments weakened, and those producing for the domestic market actually contracted. Construction expanded, however, thanks to demand from the public sector, since private-sector construction was inhibited by higher materials prices and a shortage of credit.

The slowdown in demand and the tight monetary policy helped to limit price rises to 9%, compared with 12% in 1998. Other factors in this result were higher fuel prices and a fall in the price of certain agricultural products. Private-sector wages rose by 6.5% in the first half of the year and by a further 4.6% in the second, resulting in an increase of 11.1% for the year in nominal terms (2% in real terms).

Exports of goods and services grew by 18% and imports by 7%, giving a trade surplus of US\$ 610 million. This highly satisfactory result was diluted by higher factor service payments which surged up from US\$ 445 million to nearly US\$ 1.2 billion, as profit and dividend remittances trebled. The current account deficit came to US\$ 475 million: 4% lower than in 1998.

The performance of the external sector was strongly influenced by the expansion of Intel, which accounted for nearly 30% of total exports of goods, a significant percentage of imports, and about 70% of the profits and dividends remitted abroad. The remainder of export activity (apart from the free zones) declined by nearly 20% because export values were lower for all products except a few of minor importance. Imports of goods grew by only 8%, due mainly to bigger external

purchases of intermediate goods, as consumer and capital goods imports both declined in the wake of sluggish domestic demand. Capital inflows from abroad increased significantly (63%) thanks to bond placements on the international market and direct investment. Public external indebtedness grew by 7% to US\$ 3.790 billion, equivalent to 33% of GDP, and the cost of servicing it rose slightly to the equivalent of 12.5% of export earnings.

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## El Salvador

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GDP growth in El Salvador slowed to 2.5% in 1999 from 3.2% the year before, as a result of tight monetary policies and the less buoyant performance of the external sector, construction and commerce. In general, however, the country continued to display significant macroeconomic stability, with very low inflation, a steady exchange rate and lower interest rates. The central government deficit rose slightly to 2.4% of GDP, and the balance-of-payments current account deficit widened.

The basic objectives of economic policy in 1999 were essentially the same as in 1998, with priority given to preserving macroeconomic stability, and particularly to maintaining low inflation and a steady exchange rate.

Fiscal policy continued to focus on broadening the tax base and reducing evasion. Between January and August the overall non-financial public sector deficit (including donations) grew by 3.3%, financed largely with external resources. Current and capital expenditure were generally below the budgeted levels, the lower capital expenditure being the result of a cutback of more than 18% in gross investment, due in turn to the five-month delay in approving the general budget. Up to October 1999, total tax revenue grew by 5.6%, with income-tax revenue increasing by 11.3% and but the income from the value added tax (VAT) slipping back by 0.4%. An increase in the fiscal deficit by four-tenths of a percentage point to 2.4% is projected for the end of 1999.

The central government deficit was financed with external resources, and a set of reforms to VAT and income-tax legislation were approved in mid-September to compensate for lower collection rates and increase tax revenue.

The monetary policy of the Central Reserve Bank was in line with the restrictive measures applied in recent years and continued to be aimed at controlling and absorbing excess money-market liquidity. Open-market operations were used as the main tool for short-term liquidity adjustment. An additional 3% reserve requirement had been introduced in 1998, but this was gradually phased out by the end of 1999, and open-market operations were increased to make up for this.

Nominal interest rates on loans averaged 15.5%, while deposit rates averaged 10% for local-currency operations. Following the pattern of the last two years, exchange-rate stability was maintained in 1999 through intervention by the Central Bank and the sterilization of excess dollars.

## EL SALVADOR: MAIN ECONOMIC INDICATORS

	1997	1998	1999 <sup>a</sup>
<i>Annual rate of variation</i>			
Gross domestic product	4.2	3.2	2.5
Consumer prices	1.9	4.2	-0.6
Money (M1)	-1.9	8.6	7.1
Real effective exchange rate <sup>b</sup>	-0.3	-0.3	0.6
Terms of trade	11.5	-0.9	-8.1
<i>Percentages</i>			
Urban unemployment rate	7.5	7.6	7.6
Fiscal balance/GDP	-1.7	-2.0	-2.4
Real deposit rate	6.9	7.6	10.3
Real lending rate	11.0	12.2	14.9
<i>Millions of dollars</i>			
Exports of goods and services	2 708	2 742	2 860
Imports of goods and services	3 888	4 268	4 515
Current account	97	-84	-290
Capital and financial account	266	387	390
Overall balance	363	303	100

**Source:** See the statistical appendix.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> A negative rate signifies an appreciation of the currency in real terms.

Trade policy pressed ahead with the tariff reduction programme to reach a floor of 5%, with a 10% ceiling for intermediate goods and 15% for final goods, in July 1999. Tariffs on raw materials and capital goods had been lowered to zero as from December 1996.

Significant progress has been made in the trade negotiations between the Northern Triangle (El Salvador, Guatemala and Honduras) and Mexico, but there are differences over certain safeguard clauses that still have to be overcome.

Lastly, in order to give a boost to the external sector an Investment Law was approved in October which seeks to increase the level of foreign investment in the country and establish an appropriate legal framework for its operation. An important element in the Law is the creation of a National Investment Office.

The structural reform process continued in 1999 with the adoption of financial supervision and oversight mechanisms such as the Banking Law, which provides for the creation of a Deposit Guarantee Institute. The privatization process concluded with the sale of the National Telecommunications

Administration (ANTEL), electric power distributors and thermal power generating plants.

Economic activity was affected by the sluggishness of the external sector, especially of traditional exports, slower growth of non-traditional exports, and a reduction in levels of public investment and in family remittances, which nevertheless continued to be substantial and in October amounted to US\$ 1,111 billion. The overall result for the year is that public investment is expected to decline by 3.6%, gross fixed investment to increase by 4.1%, and domestic demand to rise modestly by 1.8%.

The sectors registering the highest growth rates included manufacturing industry (4%), agriculture (3.7%), and electricity, gas and water (3.5%). The year's least dynamic sectors were construction (2.2%) and commerce (1.7%). Foreign direct investment has been one of the key factors in economic activity, especially the US\$ 250 million invested in the thermal power generating plants.

Inflation, as measured by the variation in the consumer price index (CPI), posted an average for the year close to 0%, with negative monthly rates being recorded between February and June and again in November (-0.6%).

Minimum wages were raised as from 30 September. A 6% rise was awarded to construction workers as from 21 July and an additional increase of 5.6% was scheduled for 21 December. Minimum wages in agriculture have not changed since April 1998, and those in industry, commerce and services have remained unchanged since May of that year. Unemployment nationally stood at 7.6%, similar to the average for the period 1996-1998.

The external sector turned in a less favourable performance than in 1998. The current account deficit is expected to end up at US\$ 290 million –significantly higher than the previous year– but the overall balance of payments is expected to show a surplus of US\$ 100 million by year's end thanks to net capital inflows. Against this background, the Central Reserve Bank has been able to accumulate over US\$ 1.9 billion in net international reserves, equivalent to more than five months' imports.

As a result of the foregoing, the trade deficit widened by 8% to US\$ 1.65 billion. The value of exports increased by 0.7%, thanks mainly to non-traditional products and the maquila sector, while imports are estimated to have risen by 4%, despite reduced purchases of agricultural raw materials. In trade with Central America, exports grew by half a percentage point and imports by just 0.3%.

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## Guatemala

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The gross domestic product grew by 3.5% during the year, which was less than in 1998. The slowdown was caused by a downturn in the external trade variables, weaker domestic demand, a more cautious credit policy, the aftermath of Hurricane Mitch, solvency problems affecting certain entities in the financial and brokerage sector, and the typical concerns of an election year. Inflation stayed low, held down by the falloff in consumption, restraints on price increases in a variety of articles due to competition, and lower prices among other items.

The fall in the nominal exchange-rate up to mid-August forced the authorities to tighten their monetary and fiscal policies. For this reason the last two months of the election campaign unfolded in a context of greater fiscal and monetary discipline aimed at restraining an increase in the fiscal deficit, checking the loss of reserves and halting the slide of the exchange rate in pursuit of more stable macroeconomic conditions.

The central government deficit reached 3.2% of GDP in 1999, with expenditure growing significantly, mainly because of the momentum of public-sector investment. Direct investment was up by 70% from its 1998 level, largely as a result of reconstruction work on basic infrastructure and the expansion of social projects. Tax revenue registered positive results thanks to the greater efficiency of the responsible authorities, and the tax burden rose from 9.5% to 10%. March saw the formal establishment of the preparatory commission for the Fiscal Pact— a commission designed to coordinate the efforts to reach social consensus on a long-term fiscal policy based on clear and stable rules.

Monetary policy was relatively expansionary until July 1999, and the bank reserve rate was lowered four times. Open market operations were effected from May onwards, however, and there was frequent participation in the money-market desks of the banking sector in order to absorb liquidity and ease pressures in the foreign-exchange market. This led to interest rate hikes in the short-term money market.

Lending to the private sector ended the year with a cumulative increase of 10%, but the volume of bad loans as a percentage of the total portfolio grew considerably. These circumstances forced the authorities to take measures such as granting emergency advances to underpin banks' financial positions and promote reforms to the banking laws aimed at strengthening the sector's institutional framework.

The nominal exchange went down by a total of 13.7% up to mid-August. Subsequently the Central Bank reduced its net sales of dollars and raised the rates on its open market operations, so that the global liquidity of the economy registered a downward trend, causing the exchange rate to stabilize.

As regards trade policy, early in 1999 Guatemala signed a partial-scope agreement with Cuba giving tariff preferences to 386 Guatemalan and 260 Cuban products; in August it signed an agreement with El Salvador for a customs union to come into effect in 2000, and in October, together with the other Central American countries, it signed a framework agreement on a free-trade treaty with Chile.

In order to protect small-scale producers, customs tariffs were raised on imports of several dairy products, while import duties on petroleum products were lifted in order to ease their selling prices.

In 1999 action was taken on certain complementary aspects of the privatization process which had ended in 1998, such as opening up the international telephone service to competition and the

**GUATEMALA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999 <sup>a</sup>
<i>Annual rate of variation</i>			
Gross domestic product	4.3	5.0	3.5
Consumer prices	7.1	7.5	5.2
Money (M1)	31.3	13.5	...
Real effective exchange rate <sup>b</sup>	-5.0	1.1	13.3
Terms of trade	8.2	-0.6	-6.1
<i>Percentages</i>			
Unemployment rate	5.0	5.9	...
Fiscal balance/GDP	-1.5	-2.4	-3.2
Real deposit rate	-3.5	-1.3	2.3
Real lending rate	8.7	9.1	13.5
<i>Millions of dollars</i>			
Exports of goods and services	3 180	3 466	3 395
Imports of goods and services	4 188	5 038	4 735
Current account	-634	-1 036	-870
Capital and financial account	863	1 272	740
Overall balance	229	236	-130

**Source:** See the statistical appendix.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> A negative rate signifies an appreciation of the currency in real terms.

of the shares of the electric power distribution companies that was still in government hands.

GDP growth for 1999 is estimated at a little over 3.5%, which is significantly below the previous year's 5%. Domestic demand slowed because of the lower growth of gross capital formation and consumption, both public and private, while international trade in goods and services also grew more slowly, especially on the import side. The only aggregate demand variable which grew more than in 1998 was gross fixed investment by the public sector.

Agricultural production suffered from decreases in important categories such as sugar and bananas. Manufacturing industry was also less buoyant, as domestic consumption retreated and exports to the Central American market grew more slowly. Mining activity expanded by only 1% because of the fall in oil

production. The construction sector, for its part, grew at half the rate recorded in the two previous years, because of the slower activity in private-sector construction, especially in housing projects.

Average inflation for the year is estimated to have fallen from 6.6% in 1998 to 5.5% in 1999 (5.2% up to November), helped by lower price rises in the foodstuffs and beverages sector (0.5%) and a cut in electricity charges. A new Family Income and Expenditure Survey was carried out between March 1998 and April 1999 and reported an open unemployment rate of 1.9%. Minimum wages in agricultural, commercial and industrial activities were raised by 10% as from February 1999.

The balance of payments registered a smaller deficit on the current account in 1999, but also a significantly reduced surplus on the financial account, so that the international monetary reserves decreased. External trade contracted in terms of both exports (-2.1%) and imports (-6.1%), and the trade deficit narrowed to US\$ 1.34 billion. Apart from oil exports, which were higher in value because of the rise in international prices, other exports (including sugar and bananas) fell significantly, while coffee managed to offset the fall in its average price with an increase in exportable output. Exports of non-traditional products declined, especially to the Central America market, and there was also a significant loss of buoyancy in the maquila sector. Imports of consumer goods, raw materials and capital goods all shrank because of weaker domestic demand and exchange-rate slippage.

Public external indebtedness increased, while the net inflow of capital declined. Disbursements of official capital practically trebled between 1995 and 1999, rising from US\$ 161 to US\$ 476 million, the latter being the highest level since 1991. On the other hand, the cost of servicing the public external debt has decreased and is now equivalent to only 6% of goods and services exports. The combination of larger disbursements and lower debt service has led to a sustained increase in the public external debt, which is estimated at US\$ 2,733 billion.

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## Honduras

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The devastation caused by Hurricane Mitch in October 1998 affected the overall performance of the Honduran economy in 1999. Economic activity declined by 2%, although the contraction was mainly concentrated in agriculture –especially banana production, which was the worst affected sector– while the other productive sectors suffered relatively less damage. The maquila sector kept up its momentum, and both mining and construction grew strongly. The public finances posted a large fiscal deficit as a result of increased expenditure on reconstruction programmes, and the current account balance also widened significantly. On the other hand, macroeconomic management restrained price rises, so inflation was slightly lower than in 1998. The supply of foreign exchange expanded thanks to an exceptional increase in family remittances, the inflow of funds for reconstruction and a reduction in debt payments negotiated in the framework of programmes to relieve the foreign debt burden.

Macroeconomic management was concentrated on containing the effects of the severe economic upheaval caused by Hurricane Mitch, but progress was also made in the privatization of State entities and the tariff reduction programme continued.

The fiscal deficit amounted to 5% of GDP and was covered basically with external financing. Taxation followed the course set by the reforms of June 1998, with the marginal rate of income tax dropping to 25%. Tax revenue amounted to 13 billion lempiras, and with the inclusion of non-tax revenues total fiscal income came to 14.3 billion lempiras (18.5% of GDP).

Central government outlays accounted for nearly 24% of GDP. Current expenditure was only slightly higher in real terms than in 1998, but capital expenditure grew significantly as a result of public investment to repair the damage caused by Hurricane Mitch.

There were upward pressures on the exchange rate, but these were counteracted through the foreign

exchange auction mechanism, and the lempira was devalued by 6% in nominal terms.

At the same time, the tariff reduction process continued. Trade negotiations with Chile were concluded at the Central American level and proceeded to the bilateral stage. Conclusion of an agreement with Mexico, however, remains pending.

The legal reserve requirement was unchanged during the year, and the supply of money balances grew by 10% up to the third quarter –less than the year before. Over the same period, domestic credit contracted in nominal terms to 6% below its December 1998 level, as a result of the restriction on the use of domestic resources to finance government spending. The aggregate behaviour of domestic credit was entirely due to reduced lending to the public sector (whose outstanding balance in the first half-year went down by 146%); credit to the private sector was unaffected by this and expanded by nearly 14% between January and September. There were no significant movements in

**HONDURAS: MAIN ECONOMIC INDICATORS**

	1997	1998	1999 <sup>a</sup>
<i>Annual rate of variation</i>			
Gross domestic product	5.0	3.9	-2.0
Consumer prices	12.7	15.6	10.6
Money (M1)	33.6	12.7	21.1
Real effective exchange rate <sup>b</sup>	-5.3	-8.4	-3.3
Terms of trade	24.3	2.3	-5.6
<i>Percentages</i>			
Urban unemployment rate	5.8	5.2	5.4
Fiscal balance/GDP	-2.8	-3.4	-5.0
Real deposit rate	0.9	4.5	6.4
Real lending rate	9.9	15.0	16.4
<i>Millions of dollars</i>			
Exports of goods and services	2 176	2 463	2 245
Imports of goods and services	2 453	2 796	3 155
Current account	-183	-66	-380
Capital and financial account	370	207	455
Overall balance	187	141	75

**Source:** See the statistical appendix.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> A negative rate signifies an appreciation of the currency in real terms.

domestic interest rates, which remained steady at their high end-1998 levels.

During the year, certain companies suspended loan repayments and one commercial bank was forced into liquidation. These events were precipitated by a weakening of payment capacity, but this had developed as a result of shortcomings in the supervision of non-bank financial intermediation. Swift intervention by the financial authorities managed to isolate the potentially disruptive effects of both episodes, but the need to speed up reorganization of the financial sector became clear.

The privatization of both HONDUTEL and airport services entered their final phase, and concessions should be awarded in March 2000. The task of reading electricity meters was also transferred to the private sector, while reform of the social security system remains pending.

Aggregate demand was influenced by the expansion of over 16% in public-sector investment and the slowdown in private investment spending. Consumption expenditure, however, followed a moderate course.

Agriculture suffered its most drastic fall in activity in recent years (9%), with the biggest losses concentrated in export crops, especially bananas, where production slumped by four-fifths. There were losses among livestock, and a significant proportion of shrimp larva production for export was also lost. There was also a decline in the electricity, gas and water and financial sectors. Other sectors registered a general slowdown, except for mining and construction, which grew strongly as a result of reconstruction work. Maquila activity also remained buoyant.

Inflation up to November amounted to 10.6%, which was less than in 1998. Inflationary pressures were kept under control thanks partly to food donations from abroad and the fact that fuel prices were unchanged until July. The minimum wage rose by 25%, while doctors' salaries increased by 30% and those of teachers by 20%. A programme was put into effect in the public sector to make wages in similar jobs more uniform.

March 1999 saw one of the sharpest falls in economic activity, and 26% of the economically active population suffered some degree of unemployment. The information available for the rest of 1999 suggests that the overall situation has not changed substantially.

The balance-of-payments current account deficit widened from US\$ 66 million in 1998 to US\$ 380 million in 1999, as merchandise exports shrank by 13% and imports grew by 14%. Exports to Central America increased by 5%, while imports rose by 8.5%. The overall trade deficit with the four Central American countries grew by 13%.

The external deficit was covered by an exceptional inflow of private transfers and a significant flow of funds from multilateral agencies and other sources of cooperation. International reserves grew to nearly US\$ 150 million (sufficient to cover five months' imports) rather than the US\$ 45 million anticipated in the monetary programme.

Total outstanding external indebtedness increased by 3%. Contributions amounting to US\$ 72 million were obtained from the Trust Fund for Central America to cover multilateral liabilities. The Paris Club condoned debt repayment obligations amounting to US\$ 225 million at current values and postponed liabilities of US\$ 439 million due in the period 1999-2002. The Highly Indebted Poor Countries (HIPC) initiative will provide a further US\$ 750 million in debt relief.



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## Mexico

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The growth of the Mexican economy slowed to around 3.5% in 1999, compared with 4.9% the previous year, so that the per capita product rose by 1.8%. This was better than anticipated at beginning of the year, thanks to a steady improvement in the external situation. Employment expanded and there was a slight recovery in real incomes, but domestic demand slackened. Inflation showed a downward trend (13.9%) and, following a few episodes of volatility early in the year, interest rates and the exchange rate both steadied and then displayed a downward trend. Budget cuts and higher oil revenues helped to achieve fiscal targets, and the external gap was smaller than in the previous year. Despite this overall situation, the local banking system remained in a weakened state.

Economic policy was aimed at bringing inflation down and accommodating economic growth to external constraints, using tight fiscal and monetary measures and keeping the existing exchange-rate regime in place. As an insurance against possible financial shocks, the authorities took out loans with international financial organizations (IMF, World Bank, IDB, and Eximbank of the United States) for a total of US\$ 16.9 billion and secured contingent funds from the North American Financial Agreement to a value of US\$ 6.8 billion.

The public-sector deficit came to 1.25% of GDP (in line with the target set at the beginning of the year) as fiscal and monetary policies pulled together in the pursuit of stabilization and growth. Budgetary outlays were cut back to keep financing needs in line with smaller oil revenues. Tax collection was strengthened, and revenues from taxation and public-sector enterprises and agencies grew, but other non-tax income showed a downward trend.

The effect of the recovery in oil prices only began to be felt in the second half of the year. Total public expenditure in the first nine months of the year grew by 5.2% as a result of the substantial increase in financial costs, though primary expenditure fell slightly. The

social development category absorbed 62% of total expenditure.

Public external indebtedness did not vary significantly in 1999, and as a proportion of GDP (19%) it was at its lowest level since 1993. The government bought back Brady bonds amounting to US\$ 1.035 billion from the market and issued US\$ 825 million of new debt in their place. In addition, the issue of government paper on international markets was resumed, and by late November total placements amounted to US\$ 7.455 billion.

In view of the volatile international financial situation, monetary policy was tightened early in the year. Quarterly limits were set on variations in the monetary base, and these were generally complied with apart from small deviations in the first part of the year, but as from the third quarter there was an expansion in the money supply in response to the stronger demand generated by the upturn in economic activity.

The key interest rate for deposits (the 28-day CETES rate) was still high in January (32%), but it went down during the year to reach 20% by April and 18% by October. The rigid monetary stance and the fragility of the banking system prevented further interest-rate

**MEXICO: MAIN ECONOMIC INDICATORS**

	1997	1998	1999 <sup>a</sup>
<i>Annual rate of variation</i>			
Gross domestic product	6.8	4.9	3.5
Consumer prices	15.7	18.6	13.9
Real wages	-1.2	2.8	0.5
Money (M1)	29.4	15.6	23.1
Real effective exchange rate <sup>b</sup>	-13.3	0.1	-7.3
Terms of trade	-0.8	-2.4	4.1
<i>Percentages</i>			
Urban unemployment rate	3.7	3.2	2.6
Fiscal balance/GDP	-0.6	-1.2	-1.3
Real deposit rate	-5.1	-0.8	10.6
<i>Millions of dollars</i>			
Exports of goods and services	121 831	129 387	148 300
Imports of goods and services	122 424	137 859	154 620
Current account	-7 454	-15 957	-13 750
Capital and financial account	21 452	19 167	13 310
Over all balance	13 997	3 210	-440

Source: See the statistical appendix.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> A negative rate signifies an appreciation of the currency in real terms.

cuts. The deposit rate gave yields of about 10% in real terms, and nominal lending rates remained high.

The financial authorities issued new rules on capitalization and loan-portfolio rating, as part of its programme to rehabilitate the commercial banking sector. The index of arrears (the ratio of overdue loans to the total loan portfolio) stood at 22.7% in September 1999 compared with 21.1% in December 1998, and this partly explains why financing decreased in real terms for the fifth year running.

Following the episodes of marked instability registered in the previous year, the foreign exchange market steadied in 1999, and the peso actually appreciated substantially (11% in real terms up to November). The total fiscal cost of the bank bailout and the support programme for borrowers is calculated at 21.7% of estimated GDP for 1999. The operation of the exchange rate flotation regime allowed the peso to adjust to sporadic market volatility. The inflow of resources from abroad -mainly from foreign direct investment, investments in the stock market and the placement of public and private debt abroad- acted to strengthen the local currency.

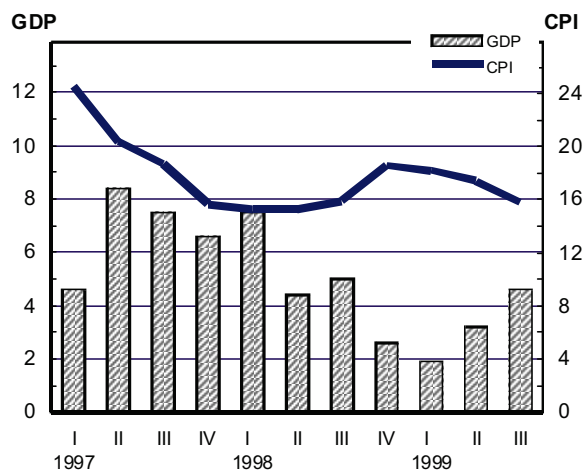
During the year, the index of share prices on the Mexican Stock Exchange rose strongly, albeit with some volatility, and by early December it was 60% above its end-1998 level, which represented a gain of nearly 70% in dollar terms.

In 1999, restrictions on foreign investment in the financial sector were lifted, and the Institute for the Protection of Bank Deposits (IPAB) was set up in place of FOBAPROA, to take over the liabilities generated by the bailout of the banking system and administer the corresponding assets. Congressional debate delayed privatization in the electric power sector, and approval for other important initiatives also remains pending.

The economic slowdown that began in the latter part of 1998 lasted until the first quarter of 1999, but as from the second quarter the economy began to regain momentum thanks to more buoyant external demand and a revival in domestic demand. Private capital formation recovered steadily during the year, and its growth for the year is estimated at 6.7%.

The agricultural GDP recovered from the virtual stagnation it had displayed in 1998. Manufacturing industry slowed, but areas of activity linked to exports (mainly metal products, machinery and equipment, and the maquila industry) turned in a better performance than in 1998. The automotive industry produced 1.25

**MEXICO: GROSS DOMESTIC PRODUCT AND INFLATION**  
(Percentage variation)



Source: ECLAC, on the basis of official figures.

million vehicles in January-October (4.2% more than in the same period in 1998); exports grew by 11% and domestic sales expanded by 2.8%. Construction grew satisfactorily despite the 5.7% drop in public-sector investment, but there was a downturn in mining, partly as a result of unfavorable prices on international markets. In the services sector, an upturn in domestic demand generated growth in commerce and the communications subsector remained extremely buoyant.

Inflation showed a firm downward trend in 1999 and came close to meeting the official target of 13% for the year. The strength of the peso was a factor in this trend, which was also influenced by moderate price hikes in products such as fruit and vegetables, though tortilla prices and telephone charges rose more substantially.

The purchasing power of wages recovered very slightly in 1999. Average real wages in manufacturing increased by 0.5% between January and September, and there was a similar rise in contract wages. On the other hand, the 14% nominal increase in the minimum wage was insufficient to compensate for inflation, and real incomes are still below their 1994 levels in all sectors.

In late October there were 12.1 million permanent workers registered in the Mexican Social Security Institute (6.7% more than in December 1998) and open unemployment stood at 2.6%: the lowest level in 14 years. The most dynamic sector for job creation continued to be the maquila industry, where employment grew by 15% to stand at 1.2 million in 1999. In contrast, however, high levels of underemployment and informality persisted.


The balance-of-payments current account deficit came to US\$ 13.75 billion, equivalent to nearly 2.9% of GDP (3.8% in 1998). This result was helped in particular by the recovery in oil exports (23.8% in January-October), although non-oil exports also grew considerably (9.8% in the same period). On the capital account, there were increases in equity investment (US\$ 3 billion up to the third quarter) and in securities issued abroad by the public and private sectors (US\$ 8.5 billion in the same period), while foreign direct investment continued to flow into the country at an undiminished rate (estimated at nearly US\$ 11 billion for the year as a whole).

The merchandise trade gap narrowed from US\$ 8 billion to less than US\$ 5 billion, while total trade in goods was estimated at US\$ 277 billion (49% corresponding to exports), equivalent to nearly 60% of GDP.

The slower pace of economic growth, the buoyancy of external demand and the recovery in oil prices were decisive in reducing the current account deficit. The value of oil exports rose by 24% in the first 10 months of the year, while foreign sales of non-oil products also grew (14.5%), with exports of manufactures accounting for 90% of the total. Of total merchandise exports, 46% came from the maquila industry.

Imports grew by nearly 12% during the first 10 months of the year, with a similar increase predicted for the year as a whole. Capital goods imports grew most strongly (17%), although intermediate goods still accounted for the major share (77%). Imports by the maquila industry rose by 18%.


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## Nicaragua

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The Nicaraguan economy recovered strongly in 1999, growing by 6%. In the face of slack external demand, growth was largely based on a substantial increase in investment, mainly relating to public expenditure on rehabilitation and reconstruction work to repair the damage caused by hurricane Mitch at the end of October 1998, and an expansion of social projects. This vigorous economic performance was only possible thanks to the increase in financial resources from abroad, which helped to maintain macroeconomic stability, provide financing for the reconstruction programme and meet external debt commitments. Inflation slowed to 8%, and the open unemployment rate dropped to 10.5%. With the basic aim of reducing inflation, the annual rate of nominal exchange-rate devaluation was cut from 12% to 6%. The wider trade gap caused the current account deficit to increase still further, but it was possible to finance nearly all of this thanks to increased donations and investment from abroad, and there was also a considerable improvement in the net international reserves.

Economic policy focused on implementing the emergency rehabilitation and reconstruction programme, supported by a supply of international financial aid amounting to US\$ 2.5 billion over the next four years. Economic policy outcomes are generally expected to fulfill the targets and performance criteria agreed with the International Monetary Fund (IMF) in the Enhanced Structural Adjustment Facility, which, in September 1999, made Nicaragua eligible to participate in the Highly Indebted Poor Countries (HIPC) debt reduction initiative of the IMF and the World Bank. The government must also fulfill a series of requirements, however.

Thanks to corrective measures adopted during the year and improved tax administration, the central government deficit is expected to grow to only 2.7% of GDP, despite the significant increase in expenditure on reconstruction work and higher social spending.

In order to keep the deficit down despite the decline in revenues resulting from the tariff reduction programme, the specific tax on cigarettes, carbonated

beverages and alcoholic drinks was increased, and the prices of petroleum products were freed. In addition, charges for basic services (especially electricity) were raised, and steps were taken to restrain the growth of expenditure by cutting back on unproductive outlays.

The main goals of monetary policy in 1999 were to reduce net domestic assets held by the Central Bank -consistent with the target of increasing the net international reserves- and to bring down inflation.

In March the Central Bank lowered the legal reserve rate, thereby providing additional financing during the initial stage of economic recovery, after which it adopted a neutral policy in open-market operations. Real demand for money expanded significantly, and the growth of deposits in the banking system gathered pace; bank lending to the private sector also increased rapidly.

With the basic aim of lowering inflation, the annual rate of nominal exchange-rate devaluation was cut from 12% to 9% in July, and then again to 6% in November.

**NICARAGUA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999 <sup>a</sup>
	<i>Annual rate of variation</i>		
Gross domestic product	5.5	4.2	6.0
Consumer prices	7.3	18.5	7.7
Real wages	-0.2	7.4	3.0
Money (M1)	30.7	17.1	7.4
Real effective exchange rate <sup>b</sup>	5.7	-0.4	-0.8
Terms of trade	5.4	4.8	-6.5
	<i>Percentages</i>		
Unemployment rate	14.3	13.2	10.5
Fiscal balance/GDP	-1.3	-1.7	-2.7
Real deposit rate	-1.3	-1.9	1.1
Real lending rate	9.7	7.7	12.2
	<i>Millions of dollars</i>		
Exports of goods and services	927	830	830
Imports of goods and services	1 608	1 656	1 930
Current account	-783	-812	-995
Capital and financial account	856	582	980
Overall balance	73	-230	-15

**Source:** See the statistical appendix.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> A negative rate signifies an appreciation of the currency in real terms.

The structural reform programme moved ahead in 1999, with 700 jobs being cut from the government payroll. Progress was also made in drafting and approving legislative bills relating to State procurement and hiring, the civil service, and administrative disputes. Proposals were also made to the National Assembly for reform of the Customs Law and the General Revenue Directorate.

Management of the petroleum products distribution company PETRONIC was handed over to an international concern, and the process of divestiture of the electric power company ENEL began; privatization of the State telephone company, ENITEL, however, suffered a fresh setback. Sale of the Banco Nicaragüense de Industria y Comercio (BANIC) was completed, while prudential standards and supervision arrangements for the banking system were strengthened, as was its legal framework. Tariff

reduction proceeded in accordance with the timetable established in 1997, so that there is now a ceiling of 10% (except for certain agricultural products), a floor of 0% and an average effective tariff of 7%.

GDP growth is estimated at about 6%. Weaker external demand was more than offset by the buoyancy of the domestic market (mainly gross fixed capital investment arising from higher public expenditure on reconstruction); employment and real wages were also higher. The overall growth figure was helped by the trend in construction, with its spillover effects on industry, commerce and transport, and the expansion of primary activities, due mainly to the recovery in agriculture.

Cumulative inflation for the year is estimated at 7.7%, taking into account the effects of higher charges for basic services, and price hikes in transport, petroleum products and building materials. A rise was approved in the minimum wage for the country's different productive sectors. The economic growth achieved has brought unemployment down to 10.5%.

The wider trade gap led to a larger current account deficit than in 1998, which will be financed by the expected substantial increase in foreign investment and donations from abroad. The net international reserves are also expected to expand considerably thanks to additional financing obtained under the programme agreed with the IMF and an increase in arrears on current payments.

The merchandise trade gap widened as exports declined by 7% and imports grew significantly (17%). The reduction in exports was mainly due to lower sales of coffee, sugar and bananas, as a result of the ravages of hurricane Mitch and lower international prices. On the other hand, non-traditional exports grew, while imports increased considerably, largely because of the reconstruction effort, though the value of consumer goods imports also continued to rise, largely due to explosive growth in durable goods imports, since purchases of non-durable consumer goods noticeably diminished.

Public external debt outstanding at the end of 1999 is estimated at US\$ 6,685.8 million. In covering its external financing requirements, government policy has concentrated on obtaining loans under highly concessional terms.

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## Panama

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Economic activity in Panama grew by 3% in 1999 – a slowdown from the 4.4% achieved in 1998, and less than the 3.5%-4.0% expected by the authorities when the year began. This result was influenced by the evolution of consumption and investment, but also by the fact that 1999 was an election year and a new administration took office four months from the year-end. Foreign trade in goods weakened, but other international services, such as the Panama Canal, the International Banking Center and trans-shipment operations, all posted good results. Inflation was very low, and the consolidated public-sector deficit moderated somewhat.

The objectives of economic policy continued to include adapting the economy to the definitive closure of military bases and the final handover of the Panama Canal assets. In the last four months of the year, tariffs were raised on certain agricultural products, within the limits established by the World Trade Organization (WTO).

Fiscal policy was marked by an increase in capital expenditure, mainly on infrastructure works, and by ongoing efforts to restructure the external debt. The central government deficit reached a high level for the second year in a row, although better results from public-sector enterprises enabled the consolidated public-sector deficit to be brought within the limits agreed with the International Monetary Fund (IMF). At the end of the first six months it stood at 0.9% of the gross domestic product (GDP).

Central government current income grew by 12.7% in the first nine months of the year. Direct tax revenues rose by 8.4% and non-tax income increased as a result of interest earned on the fund set up with privatization proceeds. Indirect tax revenues stalled as imports declined, with revenues from taxes on domestic sales increasing by 13.7% during the period. Public-sector outlays grew by 4.7% in the first half of the year, with capital expenditure up by 16%, and current expenditure rising by 3%.

In the first half of the year, the government placed Global Bonds to a value of US\$ 500 million on

international markets in an operation to buy back Brady Bonds (US\$ 200 million) and obtain budgetary financing. External debt service for the year as a whole amounted to US\$ 748 million: up by 55% from the 1998 figure as a result of increased payments of both interest and principal. Early in the year the sale of 50% of the electric power company assets was completed in an operation that produced a US\$ 603 million capital inflow deposited in the Development Trust Fund, which now stands at US\$ 1.3 billion. Privatization of the water and sewerage company, however, was delayed.

Three banking regulations were put into effect, relating to: (i) private economic groups; (ii) loans to related parties; and (iii) banking conglomerates. The process of reducing the number of banks continued. The activities of the national banking system continued to expand in 1999, with deposits growing by 4.3% and loans granted rising by 2.3%, according to the August figures. Lending to the domestic market increased by 16.4%, while external lending declined by 12.8%. External loan and deposit operations of the banking system contracted. Interest rates were substantially unchanged, and preferential rates on loans for middle- and low-income housing construction were maintained.

Apart from the Colón Free Zone, international services posted positive results in 1999. Revenues from Panama Canal operations grew by 4.3%, partly because

**PANAMA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999 <sup>a</sup>
<i>An nual rate of variation</i>			
Gross do mes tic product	4.7	4.4	3.0
Con sumer prices	-0.5	1.4	0.8
Terms of trade	8.5	0.0	1.0
<i>Percentages</i>			
Urban un employment rate	15.5	15.2	14.0
Fis cal balance/GDP	-0.2	-4.5	-4.0
<i>Mil lions of dollars</i>			
Ex ports of goods and services	8 316	8 023	6 750
Im ports of goods and services	8 650	8 869	7 320
Cur rent account	-593	-1 212	-1 095
Cap ital and fi nan cial account	934	749	895
Over all balance	341	-463	-200

**Source:** See the statistical appendix.

<sup>a</sup>Preliminary estimates.

of a larger number of vessels passing through and partly due to toll increases. The Canal pressed ahead with its modernization programme, investment for which will be completed in 2002. Port services grew strongly, as containerized cargo handling increased by 32% in the first six months.

Agricultural output rose by 3%, thanks to a recovery in banana production. Electric power generation grew by 8.7% in the first nine months of the year, but manufacturing industry stagnated (0.2%), while the construction industry expanded by 15% (compared to 6.7% the previous year), thanks to the greater buoyancy of private construction. Public-sector works in progress, such as the Southern Corridor, the Pan-American Highway and hospitals, were finished. The number of tourists decreased by 10.4% in the first nine months of the year, and their spending was down by 3.2%.

Inflation slowed late in the year (0.8%), but it registered a slight increase -estimated at 1.6%- for 1999 as a whole, as a result of higher international oil prices. Nevertheless, the country continues to have one of the lowest inflation rates in Latin America. There were increases in the prices of health care (6.2%), rent, fuel and electric power (4.2%), and recreational activities (3.3%), but food prices were unchanged and footwear and clothing rose by only 0.6%.

The minimum wage remained unchanged, although there was an increase in the first half of the year in the average wages in manufacturing and wholesale and retail trade. In August, employment was 4.9% higher than a year earlier, while unemployment fell from 15.2% to 14% in the same period.

Merchandise trade weakened considerably, while external services payments increased, giving a smaller current account deficit than in 1998. The financial account registered a significant inflow of capital, however, related particularly to the reinvestment of profits by foreign companies.

Up to September, total exports had fallen by 19.6% because of a drop in re-exports from the Colón Free Zone (-21.9%), while exports from the domestic economy practically stagnated (-0.2%). Sales from the Colón Free Zone were hit by lower demand from Ecuador, Colombia and Venezuela, while exports from the domestic economy were affected by a fall in the sale of marine products, though other categories turned in good export results, including petroleum products (56%), bananas (40%) and meat (39%)

Total imports shrank by 19%, as a result of a 32.5% reduction in those of the Colón Free Zone; purchases by the domestic economy grew by just 1%. There were substantial increases in imports of crude oil (89.9%) and foodstuffs (5%), while purchases of capital goods for agriculture and industry were also higher.

Financial inflows are estimated at US\$ 880 million, with a significant increase in foreign direct investment. For its part, total outstanding external indebtedness rose by 4.5% from the 1998 figure, to reach US\$ 5.59 billion.