CENTRAL AMERICA AND MEXICO

Costa Rica

The Costa Rican economy grew by only 0.3% in 2001, owing to a strong contraction of external demand, to which was added, after the events of 11 September, the reduction in tourist income. Fixed investment declined in view of the unfavourable prospects, despite the lower international interest rates and the greater flow of foreign direct investment. Despite the lower net factor payments abroad, national income fell by 1%, as a result of deterioration in the terms of trade. There was also an increase in open unemployment (6.1%), especially for women and in rural areas, and inflation rose to 11%.

The high-technology electronic industry suffered a marked setback, equivalent to 1.7% of aggregate GDP, as external demand contracted and production at one plant was halted owing to a restructuring phase. Meanwhile, the rest of productive activities grew by only 2%.

The authorities managed to adjust the economy to the new conditions. Measures were adopted to contain government expenditure and increase tax collection, but the central government deficit expanded. Public debt continued to grow and the interest payments amounted to 25% of total expenditure. During the second half of the year the exchange devaluation rate accelerated and interest rates rose.

Fiscal policy was restricted by high debt servicing payments and by expenditure for specific purposes. The central government deficit was 3.2% of GDP, while the non-financial public sector increased its surplus.

Despite the slowdown in economic activity, the income of the central government grew by more than 5% in real terms thanks to the payment of tax arrears, the elimination of Tax Credit Certificates, the application of the Tax Rules and Procedures Code and the approval of the Law on Tax Simplification and Efficiency.

Expenditure rose by 5.7% owing to increases in salaries and transfers for real investment in the National Road Council. In view of the large servicing payments for public debt, an effort was made to reduce interest payments by exchanging internal debt for external debt; the government placed US$ 250 million in bonds on the international markets at a fixed rate of 9% for a 10-year period. The size of the total public debt reached 57% of GDP in September, while internal debt was 37%.

The goal of monetary policy was to maintain inflation within a range of 10%. In the first few months an effort was made to expand credit without creating

COSTA RICA: MAIN ECONOMIC INDICATORS

	1999	2000	2001[a]
	Annual growth rate		
Gross domestic product	8.1	1.7	0.3
Consumer prices	10.1	10.2	11.0
Real wages	4.7	0.8	...
Money (M1)	9.7	5.4	-4.8
Real effective exchange rate[b]	4.4	0.1	-2.8
Terms of trade	-1.1	-6.9	-1.1
	Percentages		
Urban unemployment	6.2	5.3	5.8
Fiscal balance/GDP	-2.3	-3.0	-3.2
Real deposit rate	3.9	2.2	0.5
Real lending rate	14.3	12.6	11.4
	Millions of dollars		
Exports of goods and services	8 205	7 699	6 997
Imports of goods and services	7 183	7 289	7 243
Current account	-697	-751	-943
Capital and financial account	1 177	597	868
Overall balance	480	-154	-75

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] A negative rate indicates an appreciation of the currency in real terms.

inflationary pressures. Very few monetary stabilization bonds were issued, whereas the required reserve was reduced by two percentage points in May and reached 7% in September. This, together with the lowering of international interest rates, lead to some reduction in domestic lending rates, especially for housing and construction. Credit for consumption and construction continued to increase and total private credit had expanded by 20% as of October. Credit in dollars expanded rapidly, as interest rates were lower than rates for colones. Deposit rates in colones were reduced on average to 15% and lending rates were at 27%.

Total liquidity was reduced (growing nominally by 11%) and fixed-term deposits declined. Public cash holdings increased by 10% owing to the lower production growth rate and the availability of more profitable options in government securities. There was a boom in dollar deposits (22%) given the lower premium for investing in the national currency.

Exchange-rate policy aimed to maintain export competitiveness by means of a crawling peg regime. During the first half of the year the exchange rate devalued by 8 centésimos per day; as of July the devaluation rate increased to 12. The annual accumulated nominal devaluation rate was 7%, which in real terms was a slight appreciation.

In the area of commercial policy, the free trade agreements with the Dominican Republic and Canada were ratified. Implementation of the Agreement on Subsidies and Countervailing Measures of the World Trade Organization was postponed for five years; thus, the companies operating in export processing zones would continue to enjoy the benefits offered by this regime.

The gross domestic product stagnated in the face of the contraction in manufacturing and agriculture. The latter was adversely affected by the low prices for coffee, bananas and other agricultural goods. Internal demand remained almost stagnant, which reflects the poor performance of public investment and private consumption, as well as the lower level of equipment purchases. Meanwhile, construction, especially housing, was encouraged by the reductions in interest rates and in prices of inputs, which also stimulated mining activities. The adverse international economic situation affected in particular external demand in the high-technology electronic industry and textile manufacturing. In the case of agricultural goods, there was a negative impact on producer prices, despite the increase in the volume of external sales.

Inflation was at 11%, similar to the level in the previous year. During the first six months, the increase in electricity and water tariffs, together with the rise in transport, caused an increase in the consumer price index. During the second half of the year prices for fuel derivatives and electricity tariffs diminished, but the higher exchange-rate devaluation rate had the opposite effect.

In order to avoid a deterioration in real salaries, at the beginning of January minimum salaries were readjusted by 5.1% and in June another increase of 7.7% was agreed. Workers in the public sector received an increase of 6.6% (4% in July and the rest in October). Unemployment increased in manufacturing and in agricultural export activity; in the last quarter, it also increased in tourism. A reform to the Labour Code was approved, prohibiting discrimination by gender, age, ethnicity or religion.

The trade gap increased considerably; the current account deficit rose to 5% of GDP. Exports of goods contracted generally (-13%); in contrast, tourist services increased by 7.5% until August, but fell in the last quarter. Sales of software, medical and surgical services also increased. Exports to Central America grew by 6.4% and represented 11% of the total.

Imports of goods contracted, mainly those of capital goods, which declined by 11%. The deficit in goods almost quadrupled. The lower profits of companies in the export processing zones meant that external payments in this connection were 35% less than in the previous year.

Capital flows, much higher than those in 2000, were insufficient to cover the current account deficit, so that the reserves of the issuing bank fell by US$ 75 million. Foreign direct investment increased and there was a new bond issue by the central government, which thus obtained a level of resources which was higher than the payments for amortizing public debt and the purchase of foreign bonds by private investors.

El Salvador

GDP growth in El Salvador slowed to barely 1.5%, owing to the economic recession in the United States and the drought-induced contraction in export volumes. The earthquakes in January and February, which killed almost 1,200 people and caused material damage estimated at US$ 1.6 billion (approximately 12% of GDP), gave rise to an increase in public spending, which pushed the central government deficit up to almost 4% of GDP. The fall in merchandise exports and the expansion in imports led to a sharp increase in the external deficit. With the entry into force of the Monetary Integration Act in January, a fixed exchange rate was set and the dollar was established as a unit of account of the Salvadoran economy; in this context, annualized inflation declined to 3%.

Economic activity continued at a sluggish pace. The weakness of domestic demand and the virtually flat performance of exports following the recession in the United States economy eroded overall demand. Moreover, the after-effects of the two earthquakes, the record low in the price of coffee, and the drought that crippled the production of staple grains had an adverse effect on supply.

The economy started to pick up in April after the devastating earthquakes with the strongest impetus coming from tradables, associated with non-traditional exports, and from export processing. The highest-growth sectors were mining (12%), construction (9%), transport, storage and telecommunications (almost 7%), power, water and gas, and manufacturing (both over 4%). The effects of the drought were felt in agriculture, which experienced a 2% decline. Financial services showed a similar contraction. In other sectors, including business, growth was flat. In this context, the unemployment rate remained at about 6%.

Despite the lower supply of agricultural products, food prices trended downwards; the same was true of house rentals. The weight of these two major items of household expenditure in general price levels brought annualized inflation down to 3%, one percentage point below the level recorded in the previous year. Minimum wages did not vary. Construction wages were raised by 5%, as from 21 July.

The natural disasters referred to above seriously affected fiscal management. Even though current expenditure declined, public spending had to be increased substantially in the aftermath of the earthquakes (12% in real terms) in order to cover reconstruction work (indeed, one quarter of public investment was allocated for this purpose). Current revenues showed no improvement in real terms, at a time when weak domestic demand compounded the familiar problems of tax avoidance and evasion. The fall in income-tax receipts during the year was offset by higher proceeds from value added tax and the tax on imports.

EL SALVADOR: MAIN ECONOMIC
INDICATORS

	1999	2000	2001[a]
	Annual growth rates		
Gross domestic product	3.4	1.9	1.5
Consumer prices	-1.0	4.3	3.0
Money (M1)	14.6	-5.2	8.2
Real effective exchange rate[b]	0.9	0.6	-0.9
Terms of trade	-5.2	-4.8	-2.0
	Percentages		
Urban unemployment rate	6.9	6.5	6.1
Fiscal balance/GDP	-2.1	-2.3	-3.9
Real deposit rate	10.2	6.8	1.7
Real lending rate	14.9	11.3	5.6
	Millions of dollars		
Exports of goods and services	3 175	3 637	3 854
Imports of goods and services	4 714	5 657	6 054
Current account	-239	-473	-500
Capital and financial account	447	353	420
Overall balance	208	-120	-80

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] A negative rate indicates an appreciation of the currency in real terms.

The significant growth in expenditure widened the fiscal deficit to 3.9% of GDP (2.3% in 2000). The fiscal deficit was financed to the extent of over 80% with external funds from the issue of treasury notes (LETES). Fiscal management in the coming years should take into account above all the expenditures associated with the new pension system, which will exceed the US$ 1 billion mark in the next five-year period. During the year, privatization of State-owned companies, especially the telecommunications and electricity corporations, was completed and the operation of the five pension fund administrators was consolidated.

Dollarization of the economy was initiated in the early part of the year and has recently been approved by the Supreme Court, which dismissed various claims of unconstitutionality. The United States dollar was thus adopted as legal tender and the rate of exchange of the colón has been set at 8.75 colones to the dollar, following a fixed exchange-rate system that had been in force since 1993. This measure has been implemented in the context of the high volume of trade between El Salvador and the United States, the market for two thirds of Salvadoran merchandise exports and the country of origin of the substantial family remittances received in El Salvador, which account for 14% of GDP. In October, 46% of money in circulation and of deposits had been converted into dollars.

The slow economic activity has had the effect of stabilizing the demand for credit and lowering lending and deposit rates. Now that the exchange risk has been eliminated, it is much easier for industrial, electricity, transport and business firms to secure foreign loans directly.

The performance of the external sector was less favourable than in 2000. The trade deficit grew to the equivalent of 16% of GDP, as a result of the contraction in exports and the expansion (7%) in imports. Exports to Central America expanded by 3%, but sales to the rest of the world stopped expanding. Plummeting coffee prices on the international market caused a sharp contraction in coffee sales (-62%) and consequently a slump in traditional exports as a whole (-44%), while non-traditional exports expanded by almost 7%, with *maquila* exports performing well (15%). The increase in imports is attributable to higher purchases of intermediate goods (15%) and consumer goods (8%), since purchases of capital goods remained stable.

The large trade deficit declined substantially at the current account level, thanks to the increasing inflows of remittances from nationals abroad, which have already exceeded the US$ 2 billion mark, or the equivalent of 90% of the trade deficit. The balance-of-payments current-account deficit stood at US$ 500 million and was financed through foreign direct investment, which bordered on US$ 200 million, and new loans. In August, the country's external debt represented approximately 25% of GDP.

The trade policy was focused on international trade negotiations and further advances were made with the free trade agreements being forged with Panama and Canada. The entry into force of the free trade agreement between Mexico and the Central American Northern Triangle (El Salvador, Guatemala and Honduras) enabled El Salvador to expand its trade. Negotiations with the Andean Group are at a standstill, while El Salvador is continuing to participate in the rounds relating to the Free Trade Area of the Americas. It should be noted that the extension of the free zone regime to 2010 is an extremely important decision for the country's *maquila* sector.

Guatemala

The external crisis, coupled with persistent extra-economic problems on the home front, caused a slowdown in the Guatemalan economy in 2001 for the third consecutive year; growth is expected to be 2%, while inflation is estimated to be of the order of 10%, almost double the rate recorded in 2000. Nevertheless, thanks to renewed efforts to bring fiscal policy in line with monetary policy, the exchange-rate remained stable, a significant deterioration in the budget was avoided and fiscal reform –a milestone in the country's recent economic history– was achieved. Further measures were taken with a view to the adoption of legislation for improving financial supervision and strengthening the central bank's autonomy. Progress was also made in the negotiation of an agreement with the IMF on special drawing rights, which would provide access to funds for modernizing the financial system and implementing a strategy for poverty reduction. The entry into force of the Free Trade Agreement with Mexico, Honduras and El Salvador was another major advance.

Notwithstanding the fiscal reform, the government deficit increased to 2.5% of GDP in 2001 (compared with 1.9% in the previous year), owing, mainly, to the transfer of obligations postponed from 2000, to emergency support for the coffee industry and to the low level of tax revenues. These were disappointing compared with the expected outcome of efforts to control tax evasion and the yield anticipated from increases (from 10% to 12%) in the rate of value added tax and the taxes on corporate assets, fuel oil, transport, the import of vehicles and other goods (cigarettes and liquor).

Financing for the budget was based on external funding. For purposes of public debt restructuring, a US$ 325 million sovereign bond issue was launched in November. The central bank used open-market operations, lowered the nominal rediscount rate to 6.1% per year and successfully reduced the rate of expansion of money and quasi-money, although the latter remained in double digits. The real lending rate fell by five percentage points to average approximately 11% per year, but loans to the private sector declined in real terms.

For the first time in years, banking authorities intervened in banking and financial institutions. The Free Negotiation of Currencies Act was implemented and attracted higher inflows of funds into offshore banking services. Pressures on the rate of exchange between 12 September and the end of November, resulted in a nominal depreciation of the quetzal of 2%.

GDP growth slackened to 2% in 2001, the third year of steady slowdown; this is attributable to the worsening terms of trade and shrinking external demand. In addition, the extended conflict between certain corporate groups and the government eroded the business climate and was reflected in a fall of close to 4 percentage points in private investment. The only strong components of demand were public investment and public consumption. For the first time in the decade, export earnings contracted in real terms (-1%).

Merchandise production expanded by a mere 1.4% during the year. Agriculture showed modest growth (1%) and manufacturing weakened for the fourth consecutive year. Interrupting the sharp contraction in 1999, the rally in public investment and in some loans to the private

GUATEMALA: MAIN ECONOMIC INDICATORS

	1999	2000	2001[a]
	Annual growth rate		
Gross domestic product	3.9	3.1	2.0
Consumer prices	4.9	5.1	9.8
Money (M1)	8.9	14.5	1.1
Real effective exchange rate[b]	14.3	2.6	-3.0
Terms of trade	-7.5	-2.9	-3.5
	Percentages		
Fiscal balance/GDP	-2.8	-1.9	-2.5
Real deposit rate	2.6	4.0	1.6
Real lending rate	13.6	14.1	11.1
	Millions of dollars		
Exports of goods and services	3 435	3 783	3 701
Imports of goods and services	4 984	5 323	5 342
Current account	-1 015	-884	-959
Capital and financial account	890	1 538	1 359
Overall balance	-125	654	400

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] A negative rate indicates and appreciation of the currency in real terms.

sector contributed to a 1% expansion in construction in real terms. Only those services branches with a significant share of public expenditure, electricity, water, transport and community services grew by more than 4%.

The slowdown is estimated to have caused a number of job losses in the formal sector and to have made the job market even more precarious. The situation was especially difficult in areas affected by the fall in the coffee operations, where job losses, combined with the effects of the drought, prompted applications for assistance from the World Food Programme and the Inter-American Agency for Cooperation and Development, since some 500,000 full- or part-time workers depend on this activity.

The annualized variation in the consumer price index was almost 10% in December, almost double the rate observed in 2000 and double the target set in the government programme. This resurgence in inflation may be attributed to the effect of the nominal exchange-rate depreciation, the rise in the price of some foods due to the drought and the one-off increase in general price levels associated with the increase in various taxes (in particular, value added tax). The persistent and sharp expansion in monetary liquidity, which outstripped the supply of goods and services, may also have had an impact.

External capital flows swelled international reserves, offsetting a current-account deficit equivalent to 4.8% of GDP (compared with 4.6% in the previous year). Foreign direct investment, representing the final payment for privatization of the telephone company, and the US$ 325 million sovereign debt issue on the eurobond market were major components of these flows. The current-account deficit increased slightly reflecting a modest expansion in merchandise imports at a time when exports were down. The slump in international prices for coffee to a record low, combined with lower sales volumes, led to a sharp contraction in export earnings from this product (-33%); thus, notwithstanding the rise in exports of sugar (24%), banana (5.5%) and cardamom (4.3%) sales of traditional exports were down by13%. As a whole, non-traditional exports were flat (1%). Expansion in in-bond processing was down, at only 8% (compared with 21% in the preceding year). Exports to Central America increased by 4.5%, marking an improvement compared with the previous year's performance.

Honduras

The Honduran economy recorded modest growth in 2001 (2.5%), owing largely to negative spillover from abroad. The slump in coffee prices was compounded by the effects of the recession in the United States. The main impetus for growth came from the buoyancy of domestic consumption in a context of relative stability with respect to the economic and financial aggregates and an intensive campaign culminating in the general elections in November. Inflation remained within the same range as in 2000; the real rate of exchange showed a slight appreciation, notwithstanding an acceleration in the nominal slide and public finances reflected a deficit similar to that of the previous year's. Towards the middle of the year, the country suffered a drought and later the onslaught of Hurricane Michelle, confirming its high vulnerability to natural disasters.

The central government fiscal deficit rose to 5.5% of GDP, in keeping with the objective of boosting public investment in infrastructure reconstruction and poverty alleviation. However, the outlays under these headings were lower than projected as the transparency requirements laid down by international cooperation sources and the State Procurement Act resulted in delays in the use of resources. The central government deficit was financed wholly from foreign funding, as has been the case since 1998.

Direct tax revenue expanded by 8% and its main component, income tax, by almost 12%. Indirect taxes grew by slightly more than the rate of inflation. Central government revenue, including non-tax items, was almost equivalent to 18% of GDP (approximately one percentage point lower than in 2000).

Total public expenditure was equivalent to 23% of GDP (24% in 2000). Current outlays accounted for almost two thirds of the total, investment for 28% and debt payments for 7%. Honduras benefited under the Highly Indebted Poor Countries Debt Initiative from external debt relief amounting to US$ 100 million (or 40% of the interest paid out in 2000). The total external debt balance stood at US$ 4.6 billion at the end of the year, similar to the previous year's level.

The money supply showed a year-on-year increase of close to 1%, much lower than in 2000, and the annual growth rate for foreign currency deposits was almost three times that of local currency deposits. This is attributable to the uncertainty typical of an election year and to expectations of a devaluation which were rife up to September. Bank loans to the private sector, mainly for real estate purchases and consumption, rallied slightly (1.5% in real terms). Bank finance charges remained high, with a spread of 12%. Further progress was made in banking supervision and capitalization ratios improved throughout the system.

The foreign-exchange policy became one of the major issues of debate. For the fourth consecutive year, the lempira appreciated, this time by 2%. To avert political pressures in favour of a sudden devaluation, the Central Bank decided in September to speed up the crawling peg devaluation; thus, by November the monthly average rose to double the rate recorded between January and August.

Further preparations were made for the implementation of a Customs Union in Central America and the trade agreement signed with Mexico a year earlier entered into force. The privatization of Hondutel remained pending, but the Insurance and Reinsurance

HONDURAS: MAIN ECONOMIC INDICATORS

	1999	2000	2001[a]
	Annual growth rates		
Gross domestic product	-1.5	5.0	2.5
Consumer prices	10.9	10.1	9.0
Money (M1)	9.9	-4.9	-6.2
Real effective exchange rate [b]	-3.2	-3.3	-2.4
Terms of trade	-6.6	-5.8	-3.7
	Percentages		
Urban unemployment rate	5.3	...	6.3
Fiscal balance/GDP	-4.0	-5.9	-5.5
Real deposit rate	6.9	4.5	4.4
Real lending rate	16.6	14.3	13.0
	Millions of dollars		
Exports of goods and services	2 281	2 507	2 515
Imports of goods and services	3 053	3 319	3 539
Current account	-200	-204	-359
Capital and financial account	415	197	263
Overall balance	216	-7	-96

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] A negative rate indicates an appreciation of the currency in real terms.

Institutions Act and the Deposit Insurance Act for Financial Institutions were adopted. The Social Insurance Reform Act was challenged by private business and the Supreme Court of Justice is expected to make a pronouncement on this action.

GDP growth (2.5%) was lower than expected (4.5%) and was buoyed up by domestic consumer spending, since gross fixed capital formation contracted for the second consecutive year. The agricultural sector experienced a sudden slowdown (growing by 1%, compared with 9.8% in 2000), falling below the levels recorded before Hurricane Mitch, which devastated the country in 1998. A drought mid-year slashed staple grain production, while the fall in international coffee prices meant a sharp decline in income for producers.

The manufacturing sector experienced a cooling off (with growth down to 4%), although crucial activities (cement, sheets and plates, and textiles) maintained their level of activity. Some in-bond industries shut down their operations and sought locations that would enable them to reduce costs, but the sector as a whole expanded. Services also enjoyed higher than average growth.

At the close of the year, inflation stood at 9% (lower than in 2000), owing to the exchange-rate appreciation and the fall in fuel prices on international markets. The minimum wage increased by an average of almost 16% in nominal terms (6% in real terms). Statutory public-sector wages rose by 19.5% (9.7% in real terms). The loss of momentum in the production sector caused a sharp increase in unemployment. The resumption of the national survey on the labour market revealed an open unemployment rate of 4.2% (compared with 3.3% in 1999) and visible and invisible underemployment of 3.3% and 35.9%, respectively (2.3% and 23.7% two years earlier).

The current account deficit increased by just over US$ 100 million, to stand at US$ 359 million. This was largely due to the continuing decline in international coffee prices, reflected in a loss of income of US$ 160 million (45% of the current account balance). This deficit was financed through family remittances, other transfers and foreign investments.

Merchandise exports were flat. Banana sales soared (41%); shrimp sales also expanded (8.8%) as did melons (6.4%). Value added from the export-processing zones increased (13.1%). Conversely, export figures were lower for coffee (-47%), wood (-3.6%), zinc (-11.8%) and tobacco (-6.4%). Imports rose by 6.6%, with agricultural products significantly higher (31.6%), food products (16.5%) paper and paper products (34.4%) and electrical machinery (12.3%). On the other hand, fuel imports declined (-5.6%) together with transport equipment (-2.5%).

Direct foreign investment flows (US$ 186 million) diminished. Notwithstanding the increase in financial flows, the overall balance was negative for the second year in a row. The Central Bank's gross international reserves were of the order of US$ 1.05 billion, or the equivalent of four months' imports of goods and services.

Mexico

In 2001 the Mexican economy stagnated, which was in sharp contrast to the targeted growth rate of 4.5% and well below the previous year's rate of 7%. The economic slowdown in the United States caused a considerable downturn in output in the second semester, although the rest of the country's macroeconomic targets were met. The public-sector deficit was 0.7% of GDP and the balance-of-payments current-account deficit was 3.1%. Voluminous flows of foreign direct investment contributed to a real appreciation of the peso, which in turn helped to reduce inflation (5.4%).

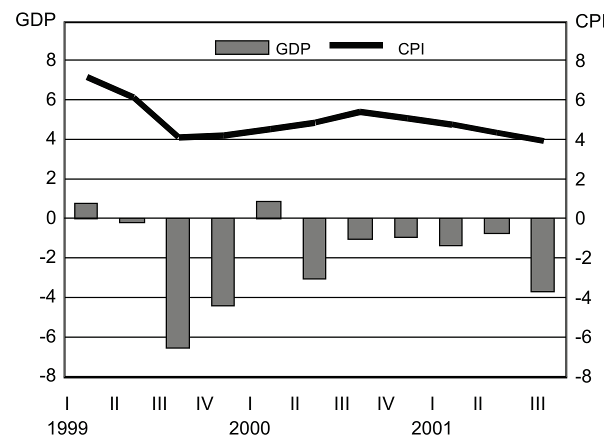
The sluggishness of the economy hurt employment and the overall performance of the production sectors. From the first half of the year export activities and investment suffered the effects of slackening external demand. An upturn in real wages boosted consumption, but in the following months domestic demand trended downwards as the wage bill contracted and uncertainty mounted with regard to the timing of an economic recovery in the United States, especially in the wake of the attacks of 11 September.

Economic policy continued along the same lines as previous years. Priority was afforded to reducing inflation and to maintaining the fiscal accounts in balance in the framework of a floating exchange rate.

Monetary and fiscal stances were adjusted as the international situation grew bleaker, and in response to the economic downshift in the United States. Early in the year, monetary policy remained tight in order to keep inflation on target, but later eased as trends and expectations with respect to inflation became increasingly favourable. This led the authorities to lower the nominal interest rate, which was also a reflection of the interest cuts in the United States, and the average prime rate on deposits recorded a single-digit figure for the first time since 1994, though lending rates continued to be high.

Public spending cuts (equivalent to 1.3% of approved programmable spending) were made to offset the drop in income that was anticipated in view of the downshift in production activity, the appreciation of the peso and the downturn in the price of petroleum (which generates over 30% of public income). The government kept the public-sector deficit on target in GDP terms by means of budget adjustments, mainly to investment. Public-sector borrowing requirements, which include a number of items in addition to the traditional definition of public deficit, are estimated at 3% of GDP at the end of 2001. The Bank Savings Protection Institute (IPAB) and privately co-financed public investment projects absorbed most of the resources (0.87% and 0.69%, respectively).

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



Source: ECLAC, on the basis of official figures.

In April the Executive submitted to Congress a financial and fiscal reform proposal that generated some controversy. Reforms to financial affairs were approved; and alternative fiscal reform proposals made by the country's three main political parties were discussed, but in early December no agreement had been reached. The government's proposal seeks to expand the country's small tax burden (11% of GDP) by setting a standard rate of 15% for value-added tax (VAT) on basic consumption sectors that are exempt or have zero rates, mainly food and medicines. It also proposes a lower rate of income tax for individuals and firms.

The peso remained stable, mainly due to foreign direct investment flows and to public and private international debt issues, which benefited from the low international interest rates and the investment grade rating obtained by Mexico in 2000. In real terms, the currency appreciated by 5% against the dollar, which was a continuation of the trend recorded since 1998. International reserves stood at over US$ 40 billion, posting a gain of US$ 6.5 billion on the year's end figure of 2000. External investment in the money market decreased considerably to account for less than 2% of the total, while the stock market displayed a slight fall.

In the first half of 2001 the effects of the economic slowdown in the United States were felt severely in Mexico. As a result, output declined gradually and in mid-2001 the economy slipped into recession. After growing by 1% in the first semester, in the third quarter of 2001 GDP thus began to slip (-1.6%) for the first time since 1995, which resulted in a slight contraction for the year overall.

External sales were the first sector to suffer the effects of the downswing. By contrast, private consumption expanded in the first semester, chiefly thanks to an increase in real wages (owing to lower-than-expected inflation), which offset the effects of a decrease in employment. In the second half of the year, however, the decline in output became widespread. Investment decreased (down by 5% in January-August) and continued to slide gradually as the year went on.

In the first nine months of the year, services expanded by 1.7% and the agricultural sector by 1.3%, while industry slipped back by 3.2%. In the third quarter the output of the manufacturing, construction and mining sectors clearly showed the effects of the downturn with declines of 5.5%, 4.1% and 1.1%, respectively.

The output of the automobile sector decreased by 3.5% in the period from January to October –with production for the local market down by 2.3% and for the export sector by 3.8%– although domestic sales grew by 9% in the same period, due mainly to financing programmes offered by automobile distributors. Similar schemes were operated for purchases of other durable goods and sustained the growth of private consumption, although this indicator trended downwards in the second half of the year. By contrast, commercial bank credit to the private sector shrank in real terms for the seventh year running (-7.5% to October). The real appreciation of the exchange rate helped to being the rate of inflation down to 5.4%, which was the lowest figure recorded since 1972.

The number of urban workers registered with the Mexican Social Security Institute (IMSS) decreased by 2.9% between October 2000 and October 2001, which represented a loss of almost 323,000 jobs. For the first time in 15 years, employment declined in the *maquila* export industry, with a drop of 14% between September 2000 and September 2001, which brought the number of jobs in the sector to 1.149 million, while the man hours worked decreased by 18%. Employment in manufacturing was down by 3.7% in the period January-September. In the first 10 months, the average rate of open unemployment was 2.5%, which was slightly higher than the figure for the same period of 2000, partly due to the absorption of workers by the informal sector.

MEXICO: MAIN ECONOMIC INDICATORS

	1999	2000	2001[a]
	Annual growth rates		
Gross domestic product	3.7	7.0	-0.1
Consumer prices	12.3	9.0	5.4
Real wages	0.9	6.1	5.5
Money (M1)	13.3	6.0	7.1
Real effective exchange rate[b]	-8.2	-7.6	-5.2
Terms of trade	1.9	5.0	-2.0
	Percentages		
Urban unemployment rate	2.5	2.2	2.5
Fiscal balance/GDP	-1.2	-1.1	-0.7
Real deposit rate	2.6	3.8	4.2
Real lending rate	7.9	8.0	7.6
	Millions of dollars		
Exports of goods and services	148 083	180 136	171 268
Imports of goods and services	155 465	190 509	184 566
Current account	-14 325	-17 690	-17 198
Capital and financial account	18 602	24 800	23 398
Overall balance	4 277	7 110	6 200

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] A negative rate indicates an appreciation of the currency in real terms.

The increase in real wages, in combination with economic stagnation and a decline in labour productivity, considerably increased the unit costs of labour, especially in manufacturing.

External trade decreased essentially because of the recession in the United States, which accounts for 90% of Mexico's exports and supplies over 80% of its imports. Together, the downturn in exports (-3.1% to October) and in imports (-1.9%) made for a deficit of close to US$ 9 billion, which was larger than the deficit posted in 2000. To October, imports of intermediate goods decreased by 4.4%, and of capital goods by 4.6%, while purchases of consumer goods increased by 23%. The decline in exports was also partly attributable to a sharp reduction in petroleum exports, which plunged by 19% to October, and to a backslide of 1.1% in manufacturing sales abroad (down by 1.7% in *maquila* and by 4.3% in non-*maquila* exports).

Interest payments on external debt are estimated at US$ 12 billion. Transfers –mainly remittances by Mexicans abroad, which are equivalent to 70% of petroleum exports– posted a significant increase. This pared the current-account deficit down to US$ 19 billion, or 3.1% of GDP, which was similar to the 2000 figure.

Foreign direct investment (FDI) also contributed to financing the current-account deficit. Not including income from the sale of Banamex to Citigroup (US$ 12.447 billion), in the first three quarters FDI was almost US$ 10 billion and it is estimated that total flows for the year overall have reached US$ 12 to 13 billion, which is much the same as the sum recorded in 2000.

In the third quarter net public external debt was just over US$ 77 billion and represented 24.7% of GDP, or 1.3 percentage points more than the previous year. Private external debt stood at around US$ 55 billion mid-year, which was similar to the figure recorded at the end of 2000.

Nicaragua

In 2001 the Nicaraguan economy slowed down, as the country's external and financial vulnerability became more acute, as well as the global degree of underemployment of the work force. Despite the fact that the internal and external imbalances were higher than expected, inflation was less than 6%. The gross domestic product (GDP) grew by 2%, which represents a slowdown of more than two percentage points compared to the previous year. The lower increase is associated with the unfavourable external environment, the high fiscal deficit and the continuing difficulties in the banking sector. It was also due to the natural uncertainties of an election year, which caused a decline in private investment and in international financial cooperation flows.

The adverse economic environment affected the fiscal results, so that in the first nine months of the year the total income of the central government grew in nominal terms by only 1.2%. The government was obliged to limit expenditure, choosing mainly to cut capital outflows (-21%), which eroded the effectiveness of public spending as a catalyst for the economy. On the other hand, current disbursements grew by a nominal 12%, so that total expenditure increased slightly by 3.4%, stretching the deficit to more than 8% of GDP.

In view of the failure to achieve the goals agreed with the International Monetary Fund in the second year of the Poverty Reduction and Growth Facility, the government managed to agree on only one interim programme for the second half of 2001. If the reduction in public expenditure stipulated in the programme is achieved, the global deficit in the non-financial public sector will fall to 7.8% of GDP (8.3% in 2000).

Owing to the high fiscal deficit and the costs associated with the banking crisis which erupted in the previous year, monetary policy remained tight. The central bank provided a full guarantee for the deposits and liquidity support for those banks where intervention had been necessary, while it sterilized a substantial portion of the liquidity through the placement of indexed debt securities. Also, in July it provided for a gradual increase of three percentage points in the legal reserve requirement rate, which reached 19.25% in September. In this context, the net credit of the central bank to the non-financial public sector expanded considerably, while international reserves were substantially decreased.

After the high levels recorded during the reconstruction programme carried out after the passing of Hurricane Mitch in 1998, public investment declined, as well as private investment in the residential sector. Both factors resulted in a major downturn in construction, one of the main causes of the loss of growth in the economy as a whole. The growth in trade, transport and governmental services was also eroded. In contrast, the industrial, energy and financial sectors stimulated economic activity. The mediocre performance of agriculture was due to a drought that caused substantial crop losses in different parts of the country.

The unfavourable external environment was characterized by an additional deterioration in the terms of trade and a significant slowdown in the global economy and trade, which resulted in a loss of sales for Nicaragua's main export products, particularly coffee. The worsening of the United States economy was felt in exports of manufactures situated in the export-processing zones and the tourist industry, and this will probably also affect the level of family remittances. Also, the cost of exports rose, owing to the additional security measures adopted.

As the accumulated inflation over the first eleven months was 4.5%, a figure of less than 6% is estimated for the year as a whole (9.9% in the previous year). This drop is mainly due to the slowdown in the economy, the lower prices for petroleum products and the greater stability of tariffs for basic services.

The increase of 12% in minimum salaries, which had not changed since 1999, the salary adjustments in the public sector and the increase in remuneration in certain sectors meant that real average remuneration showed a substantial improvement. The loss of growth in the economy resulted in a rise in unemployment to 10.7% (9.8% in the previous year) and underemployment to 12.4%.

NICARAGUA: MAIN ECONOMIC INDICATORS

	1999	2000	2001[a]
	Annual growth rates		
Gross domestic product	7.4	4.7	2.0
Consumer prices	7.2	9.9	5.8
Real wages	4.4	1.6	2.9
Money (M1)	16.5	-3.2	-0.3
Real effective exchange rate [b]	1.4	-1.3	-1.7
Terms of trade	-7.2	-4.6	-4.1
	Percentages		
Unemployment rate	10.7	9.8	10.7
Fiscal balance/GDP	-4.9	-7.8	-8.5
Real deposit rate	-0.9	-1.9	0.9
Real lending rate	9.8	8.8	13.2
	Millions of dollars		
Exports of goods and services	838	942	898
Imports of goods and services	2 034	1 981	1 950
Current account	-1 092	-919	-976
Capital and financial account	1 001	724	697
Overall balance	-90	-194	-280

Source: Statistical Appendix.
[a] Preliminary estimates.
[b] A negative rate indicates an appreciation of the currency in real terms.

The excess of expenditure over production was again financed by external savings. It is estimated that the current account deficit will increase slightly to reach US$ 980 million (39% of GDP). This is attributable to the increase in the trade deficit and the larger payments for interest, profits and dividends. Current transfers, however, especially family remittances, remained at the high level of the previous few years.

The deficit in the trade in goods (37% of GDP) remained very high, especially taking into account the context of lower growth of the economy. Exports, including those from companies operating in the export-processing zones, declined more than imports (-4.7% and -1.6%, respectively). The drop in exports was principally due to the reduction in traditional product sales (-18.5%) caused mainly by the collapse of coffee exports (-40.3%) that was in turn a consequence of the fall in international prices. The value of imports was undermined by the lower levels of external purchases of intermediary goods and capital, a phenomenon which could be attributed in turn to the slowdown in economic activity. In contrast, the imports of consumer goods rose significantly (9%).

The capital and financial account showed less income in the first nine months of the year, owing to the reduction in official transfers and loans. This could not be offset by the relief of external debt in the framework of the HIPC initiative, although the amount allocated for this purpose in 2001 was higher than in the preceding year.

Panama

The Panamanian economy, which had been losing momentum in recent years, experienced a sharper slowdown in 2001. GDP growth was down to 0.5%, signifying a per capita decline in output for the first time in over a decade. This was due to both domestic and external factors. External demand weakened considerably, putting a damper on economic activity, although with a downward adjustment in imports, it was possible to reduce the current-account deficit.

Capital formation contracted sharply for the second consecutive year, partly as a result of a weakening in foreign investment flows. Consumer spending also grew more slowly, despite a continuing expansion in personal credit. Open unemployment rose but inflation continued to be very low.

In the early part of the year, the Government adopted counter-cyclical measures as part of a revitalization plan to counter this slackening of business activity; however, the sharper slowdown and the decline in public revenues defeated the incipient public investment programme. Discussion of the fiscal reform proposed by the executive authorities was therefore postponed.

Under the IMF standby agreement, the primary objective of which was to balance the government budget, economic policy sought first and foremost to adopt a moderate countercyclical approach through concerted action with the private sector for government expenditure on labour-intensive activities. However, with the economy weakening, revenue falling and fiscal reform becoming increasingly difficult, the authorities decided to cut back on budgetary expenditures in an attempt to rein in the deficit.

The public-sector deficit rose to 2% of GDP, as a result of the reduction in revenue and the decline in contributions from State-owned corporations. In the first nine months of the year, current revenue declined by 1% owing to the 10% fall in tax receipts and the lower direct and indirect tax collections. Production, sales and excise taxes fell (-2.8%) as, indeed, did imports (-16.5%), which continued to decline in the last quarter, owing in part to a reduction in tariffs. Non-tax revenues, which had been very high in preceding years, contracted sharply (-14.1%). These results were partly offset by advance interest payments from the Development Trust Fund, which had been credited with US$ 1,213,000 from privatizations. In addition, 750 million United States dollars' worth of global bonds were issued on the international market in the first half-year to support the budget and finance loan repayments.

Under central government expenditure, staff remuneration increased, owing to an expansion in employment in the education and health sectors. Total interest payments on public debt also increased, accounting for more than one quarter of current expenditure. These increases were partly counterbalanced by a reduction in investments.

Loan operations within the domestic banking system increased in the period January-September both on the domestic market (6.3%) and abroad (3.8%), mainly as a result of loans to the business sector, the mortgage sector and for consumer spending. Interest rates on deposits and on loans did not vary significantly.

The performance of the different sectors was uneven. Merchandise production as a whole fell back considerably, while services expanded, albeit only moderately. Banking services and transport, storage and communications showed increases. Telecommunications

PANAMA: MAIN ECONOMIC INDICATORS

	1999	2000	2001[a]
	Annual growth rates		
Gross domestic product	3.5	2.6	0.5
Consumer prices	1.5	0.7	0.7
Terms of trade	2.5	-5.8	0.5
	Percentages		
Urban unemployment rate	14.0	15.2	16.9
Fiscal balance/GDP	-0.7	-1.3	-2.0
	Millions of dollars		
Exports of goods and services	7 096	7 666	7 710
Imports of goods and services	7 832	8 164	7 843
Current account	-1 320	-933	-404
Capital and financial account	1 172	605	-881
Overall balance	-148	-328	-1 284

Source: Statistical Appendix.
[a] Preliminary estimates.

and port services continued to expand, especially the handling of container cargo, with operations from the Caribbean countries being more firmly established in Panama. Although the transit of vessels through the Panama Canal diminished (-2.7%), toll receipts were higher. The number of tourists increased by 3.7% until September and tourist spending was up 6.3%. Electricity generation expanded by 4.2%, with a sharp increase in production from thermal power stations, which compensated for the reduction in hydroelectricity generation due to the drought.

Agricultural production expanded by scarcely 0.6% (1.6% in the previous year) owing to the persistent decline in banana production (-20%), attributable to adverse conditions on the international market and labour problems. Fish ¾especially shrimp¾ catches expanded (16%) but were insufficient to compensate for the setback in livestock production. Manufacturing also contracted (-5%) while the sector sought to adjust to the new conditions imposed by trade liberalization.

Following the completion of sundry road projects, hotels and commercial centres, the construction industry suffered a slump (-15%), which also dragged down ore, concrete and cement production. As a result, the unemployment rate rose to 13.7% in August (compared with 13.3% in the same month of the previous year). There was no nominal increase in the minimum wage.

The low level of inflation (0.6%) reflects the fall in food and beverage prices and in transport and communications rates. Other headings, however, showed increases: clothing and footwear (4.3%), furniture and accessories (2.6%) and medical and health care (2.6%). Wholesale prices declined (-1.1%) owing to the decline in the cost of imports and industrial goods.

The current-account deficit narrowed to US$ 400 million compared with US$ 933 million in the preceding year, equivalent to 4% and 9% respectively. The merchandise trade balance (-US$ 825 million) was partly offset by the surplus on the services balance. However, as the capital account was also in deficit, authorities resorted to bond issues on the international market, which boosted international reserves to over US$ 1 billion.

Merchandise exports grew by just 1.4%, in contrast with 10% in the previous year. Reexports from the Colón Free Zone (over 80% of total) were flat owing to weak demand from the Latin American countries. For their part, national exports increased by 10% between January and September, thanks to larger catches of shrimp (23.8%), shrimp larvae (4.4%) and fish meal and oil (67.9%). Production figures were also stronger for melons (178%), watermelons (130%) and petroleum products (85%). Conversely, banana exports were down (-17%), as were those of coffee (-12.1%) and clothing (-26.4%).

A 4% contraction in imports reflects zero growth in imports into the Colón Free Zone and the fall in national purchases (-10%). With the exception of crude oil, all import categories showed a dramatic decrease: capital goods (-27.7%), food products (-6.1% and intermediate goods (-9.3%). Lastly, foreign investment flows amounted to US$ 250 million , in contrast with the figure of over US$ 600 million in 1999 and 2000, respectively.