Mexico and Central America

Costa Rica

1. General trends

Following an exceptional upswing of 6.5% in 2004, the Costa Rican economy expanded at a more moderate pace that was close to the trend growth rate.

Real gross domestic product (GDP) rose by 4.2% (4.4% excluding the high-technology sector), on the strength of the expansion of exports (6.8%) and higher revenues from the tourist industry. Per capita GDP rose by 2.3%, whereas national disposable income grew by only 0.7%, owing to worsening terms of trade.

Although the economy grew by an average rate of over 5% in the last two years, employment increased by only 2.1% in 2004, while the open unemployment rate dipped slightly, from 6.7% to 6.5%. In addition, average income decreased by 6% in real terms, and minimum wages declined again (-1.6%).

In terms of public accounts, the deficit of the overall narrowly defined public sector shrank from 4.5% of GDP to 3.6%, despite delays in the adoption of the Fiscal Covenant and Structural Fiscal Reform Act.

Although monetary policy was tight, especially in the second half of the year, inflation came in at a high 13.1%, the colón appreciated in real terms and the trade deficit widened, mostly as a result of sharply rising international prices for petroleum and certain industrial commodities.

Total liquidity in the banking system (which includes M1 plus commercial banks' quasi-monetary liabilities in local and foreign currency) expanded considerably (34.1%) as a result of the crisis in investment and pension funds in April and May. This prompted a shift in the composition of financial savings, with funds previously invested in public debt instruments being transferred to the banking system. Private sector demand for credit cooled, however, reflecting sluggish growth in sectors producing to meet domestic demand and the poor expectations of economic agents regarding future interest rates. In these circumstances, the banks (especially State institutions) lowered their lending rates, in an effort to boost demand for credit in local currency. Given the level of liquidity, borrowing rates remained relatively stable throughout the year.

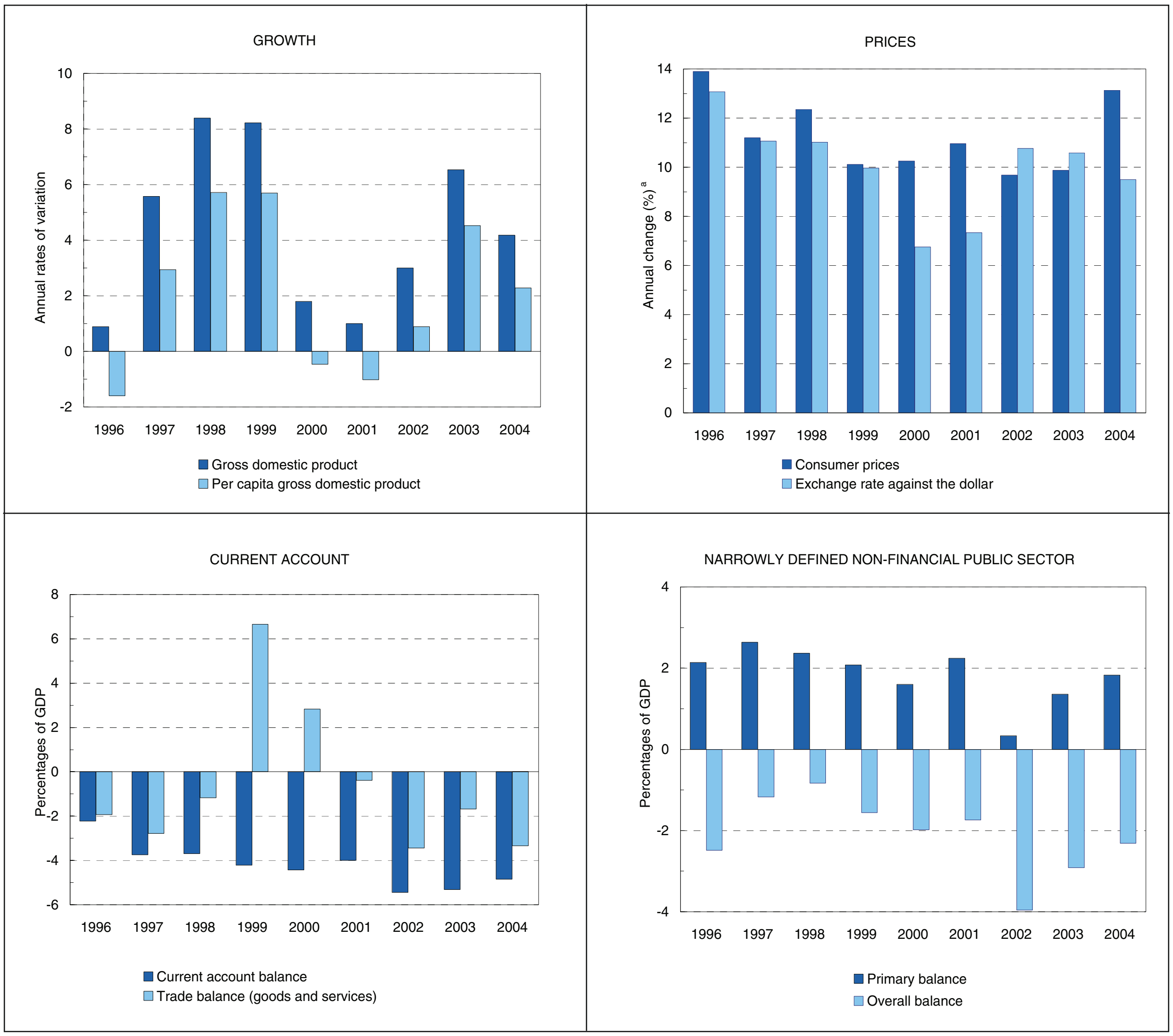
In the external sector, the balance-of-payments current-account deficit (4.8% of GDP) narrowed slightly, which, combined with inflows of external financial resources, helped to swell international reserves.

The monetary programme for 2005-2006 shows projected GDP growth of 3.2% and inflation at 10% for 2005. The consolidated public-sector deficit is expected to be similar to the level recorded in 2004 and the current-account deficit should drop to 4.2% of GDP.

2. Economic policy

For 2005, the principal aim of the central bank's monetary policy is to reduce inflation. To this end, it has been using open market operations as the main instrument of monetary control, since the legal reserve requirement remained at 12% up to June. In keeping with monetary policy, the authorities have sought to maintain a neutral stance on exchange-rate policy, in order to avoid real depreciation or appreciation of the colón in relation to

Figure 1
COSTA RICA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

the level recorded at the end of 2004. This is in addition to a tight fiscal policy, with domestic spending controls expected to bring down inflation. In the first five months of 2005, however, the liquidity in the financial system expanded by 4%, owing to a limited increase in credit (2.5%) combined with a rise in savings (6%). At the same time, the monetary base expanded, reflecting considerable inflows of foreign capital attracted by high rates of interest and the stability conferred on the foreign exchange market by the policy of mini-devaluations. In May cumulative inflation stood at 6.37%, which was a larger increase than in the year-earlier period (5.14%). Year-on-year inflation rose from 11.45% to 14.46%. In those circumstances, the central bank decided to raise the legal reserve requirement from 12% to 15% in June 2005.

In 2004, various external and domestic factors encumbered the management of economic policy. Given the limited manoeuvring room available for fiscal policy, much of the adjustment burden fell to monetary policy. The economy did absorb most of the destabilizing effect of adverse variations in those factors. High international prices for the main imported raw materials and problems in the supply of certain agricultural goods contributed to a terms-of-trade downturn, an increase in domestic prices, a real appreciation of the colón and a widening of the trade gap. Mounting expectations of a rise in United States interest rates brought down the prices of Costa Rica's sovereign debt on the international market, leading, in turn, to large adjustments in the local financial market. With returns on investment and pension funds thus reduced, investors began to transfer some of their resources to short-term fixed-rate banking instruments. This sharply reduced the stock of assets held in those funds, sent the prices of the respective securities plummeting and pushed up interest rates. In May 2004, the central bank was therefore forced to buy back bonds from its own issues, in order to inject liquidity into the financial market and thus contain withdrawals from investment funds and stabilize interest rates.

(a) Fiscal policy

In 2004, the deficit of the overall narrowly-defined public sector shrank from 4.5% to 3.6% of GDP. This performance was thanks to all the components of that sector: central government, the rest of the non-financial public sector (NFPS) and the central bank.

Higher income and the curbing of expenditure narrowed the central government's financial imbalance, from 2.9% of GDP to 2.7%. About a third of the difference was covered with external resources from the most recent issue of eurobonds (US$ 250 million) authorized as part of the financing programme approved in 1999.

Current income remained constant at 13.7% of GDP. The strongest income categories corresponded to general tax on domestic sales, customs duties and income tax. Total expenditure dipped from 16.8% of GDP to 16.4%, as growth in current expenditure slowed owing to wage and salary adjustments and lower interest payments on the public debt.

The net result of the rest of the non-financial public sector also posted an improvement on the previous year. The surplus (0.4% of GDP) reflected a larger positive balance registered by the Costa Rican Social Security Fund (thanks to stricter monitoring of spending) and a reduction in the Costa Rican Electricity Institute's deficit (attributable to higher income from sales of electricity and mobile telephone services).

The central bank reduced its losses from 1.6% to 1.3% of GDP, thanks to the combined effect of various factors: partial capitalization conducted by the government; a higher legal reserve requirement, an active public-debt management policy and a decrease in the average cost of monetary management. At the beginning of 2004, resources from the 2003 domestic issue of fixed-term, dollar-denominated deposit certificates were used to make prepayments on all the country's series B Brady bonds. This operation resulted in better financial conditions for Costa Rica's foreign-currency-denominated debt.

In 2004, total public debt expanded by 14%, which was lower than the 17.6% rise recorded the previous year. Contributing factors included a reduction in the debt of the central bank and a smaller increase in the debt of the rest of the NFPS, given that growth in central government debt was higher than in 2003. The ratio of total public debt to GDP held steady at around 60%, however.

(b) Monetary policy

Several supply shocks affected the Costa Rican economy in 2004, prompting the central bank to review its policy and take remedial measures to ease inflationary pressures and avoid sharpening the external imbalance. In July 2004, the central bank raised the legal reserve requirement from 10% to 12%, increased the short-term interest rate and the daily devaluation rate, and stepped up open market operations.

Despite these measures, liquidity rose sharply, reflecting an expansion in quasi-money, since narrow money expanded at a lower rate than in the past two years. The behaviour of monetary aggregates was affected by the crisis in investment and pension funds, whose administrators were forced to sell part of their security holdings to commercial banks in order to deal with liquidity problems brought on by mass withdrawals.

Private-sector credit climbed by 17.6%, which was below the 19.9% recorded in 2003. This was mainly due to negative expectations about future interest rates on the part of economic agents. The housing sector has become consolidated as the largest recipient of credit to the private sector, while consumer credit grew at a similar rate to the previous year's figure.

(c) Exchange-rate policy

In 2004 the authorities continued to implement the policy of daily mini-devaluations based on the expected difference between domestic inflation and inflation in Costa Rica's main trading partners. Slackening of the colón's nominal year-on-year depreciation against the dollar, rising domestic prices and a widening trade gap prompted the central bank to raise the rate of its daily nominal currency devaluations from 15 to 17 cents in July. Nevertheless, although the nominal rate of devaluation of the colón stood at 9.6% at the end of the year, the inflation differential translated into a 1.9% real appreciation against the dollar.

Table 1

COSTA RICA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	0.9	5.6	8.4	8.2	1.8	1.0	3.0	6.5	4.2
Per capita gross domestic product	-1.6	2.9	5.7	5.7	-0.5	-1.0	0.9	4.5	2.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.8	1.5	8.2	4.5	0.7	1.4	-3.3	7.5	0.8
Mining	-4.7	13.0	9.2	-6.1	6.3	6.4	-3.1	3.8	7.7
Manufacturing	0.5	7.7	11.4	24.7	-2.9	-9.1	3.4	8.7	2.2
Electricity, gas and water	2.6	5.6	8.7	6.2	6.4	4.1	5.3	5.8	4.6
Construction	-17.9	6.1	17.4	-1.6	4.4	14.4	-1.5	4.8	6.6
Wholesale and retail commerce, restaurants and hotels	-0.6	6.1	8.5	2.4	1.5	1.9	1.6	2.9	5.1
Transport, storage and communications	4.8	9.9	8.1	6.9	10.2	9.3	12.2	13.7	11.3
Financial institutions, insurance, real estate and business services	2.1	4.8	4.7	7.6	8.1	6.8	4.6	7.0	6.2
Community, social and personal services	1.4	2.6	4.6	3.0	2.6	2.0	3.0	3.1	2.0
Gross domestic product, by type of expenditure									
Consumption	2.0	5.1	5.0	2.1	1.1	1.4	3.0	2.9	3.0
General government	-0.6	4.6	2.2	1.8	1.4	3.6	2.2	0.2	2.4
Private	2.4	5.1	5.4	2.2	1.0	1.1	3.2	3.3	3.1
Gross domestic investment	-10.4	24.9	25.4	-15.7	-1.5	31.4	9.3	-4.1	9.4
Exports (goods and services)	6.2	8.6	27.1	21.3	-0.3	-9.6	3.8	12.3	7.1
Imports (goods and services)	2.7	14.7	25.2	0.4	-2.6	1.1	6.9	1.3	7.8
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	16.0	18.1	20.5	17.1	16.9	20.3	22.5	20.5	22.1
National saving	13.7	14.3	16.8	12.9	12.5	16.3	17.1	15.2	17.3
External saving	2.2	3.7	3.7	4.2	4.4	4.0	5.4	5.3	4.8
	Millions of dollars								
Balance of payments									
Current account balance	-264	-481	-521	-666	-707	-655	-916	-929	-892
Merchandise trade balance	-249	-498	-399	580	-210	-820	-1 267	-1 131	-1 522
Exports, f.o.b.	3 774	4 221	5 538	6 576	5 813	4 923	5 270	6 163	6 311
Imports, f.o.b.	4 023	4 718	5 937	5 996	6 024	5 743	6 537	7 294	7 832
Services trade balance	20	140	234	471	663	757	688	839	907
Income balance	-184	-249	-469	-1 822	-1 252	-748	-517	-849	-517
Net current transfers	149	126	113	104	93	155	181	213	239
Capital and financial balance [d]	194	288	16	896	365	669	1 079	1 268	973
Net foreign direct investment	421	404	608	614	404	447	624	547	535
Financial capital [e]	-227	-116	-592	282	-38	221	455	720	438
Overall balance	-69	-193	-504	230	-341	13	163	339	82
Variation in reserve assets [f]	77	-216	150	-481	153	-13	-163	-339	-82
Other financing [g]	-8	409	355	251	188	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	100.9	100.9	114.0	101.7	100.0	97.1	97.6	103.6	106.5
Terms of trade for goods (index: 2000=100)	102.1	125.9	117.5	106.9	100.0	98.4	96.9	95.5	91.9
Net resource transfer (percentage of GDP)	0.0	3.5	-0.7	-4.3	-4.4	-0.5	3.3	2.4	2.5
Gross external public debt (millions of dollars)	2 859	2 640	2 872	3 057	3 151	3 243	3 338	3 753	3 884
Gross external public debt (percentage of GDP)	24.1	20.6	20.4	19.4	19.8	19.8	19.8	21.5	21.1
Net profits and interest (percentage of exports) [i]	1.8	3.4	5.6	20.9	14.7	8.2	4.9	7.8	4.0
	Average annual rates								
Employment									
Labour force participation rate [j]	52.2	53.8	55.3	54.8	53.6	55.8	55.4	55.5	54.4
Open unemployment rate [k]	6.2	5.7	5.6	6.0	5.2	6.1	6.4	6.7	6.5
Visible underemployment rate [k]	12.0	11.0	11.7	12.0	9.7	9.5	11.2	13.2	12.5
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	13.9	11.2	12.4	10.1	10.2	11.0	9.7	9.9	13.1
Variation in industrial producer prices (December-December)	13.3	10.1	8.8	11.3	10.2	8.6	8.4	11.0	17.7
Variation in nominal exchange rate (December-December)	13.1	11.1	11.0	10.0	6.8	7.3	10.8	10.6	9.5
Variation in average real wage	-2.1	0.8	5.6	4.7	0.8	1.0	4.1	0.4	-2.6
Nominal deposit rate [l]	...	12.7	13.3	14.6	12.9	11.3	11.6	10.9	10.0
Nominal lending rate [m]	...	22.7	23.0	26.0	24.0	22.2	24.2	23.4	21.2

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Percentages of GDP								
Non-financial public sector, narrowly defined									
Current income	22.2	22.5	22.3	19.7	21.5	22.9	22.7	22.6	22.7
Current expenditure	20.8	19.5	19.0	17.5	19.5	20.9	22.1	21.4	21.2
Current balance	1.4	3.1	3.3	2.2	2.0	2.0	0.6	1.2	1.5
Net capital expenditure	3.9	4.2	4.2	3.7	3.9	3.7	4.5	4.0	3.8
Primary balance	2.1	2.6	2.4	2.1	1.6	2.2	0.3	1.4	1.8
Overall balance	-2.5	-1.2	-0.8	-1.6	-2.0	-1.7	-4.0	-2.9	-2.3
Central government public debt	33.2	30.0	39.5	35.2	36.6	38.6	40.8	40.0	41.4
Domestic	24.0	22.2	31.4	26.6	26.4	27.7	28.6	26.9	27.8
External	9.2	7.8	8.1	8.6	10.1	10.9	12.2	13.1	13.7
Interest payments (percentage of current income)	20.9	16.9	14.3	18.5	16.6	17.3	18.9	18.9	18.2
Money and credit [n]									
Domestic credit [o]	14.9	15.5	18.1	19.0	24.3	28.0	32.0	34.2	37.4
To the public sector	3.1	3.1	3.1	2.4	3.4	4.3	5.0	6.0	8.5
To the private sector	11.8	12.4	15.0	16.6	20.9	23.7	27.0	28.2	29.0
Liquidity (M3)	28.4	28.1	28.4	28.4	30.8	32.0	33.3	34.1	38.3
Currency in circulation and local-currency deposits (M2)	18.9	18.2	17.1	16.5	18.0	17.9	17.9	18.7	19.5
Foreign-currency deposits	9.4	10.0	11.3	11.9	12.8	14.1	15.4	15.5	18.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1991 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment and underemployment rates as percentages of the economically active population; nationwide total. [l] 90-day deposits at State-owned banks. [m] Rate on loans to industry from State-owned banks. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

(d) Trade policy

The main trade policy advances in 2004 consisted of the conclusion of free trade negotiations with the United States and the signing of a free trade agreement with the countries of the Caribbean Community (CARICOM). Activities were also stepped up in the framework of the Central American economic integration process, with a view to establishing a customs union, and initial steps were taken towards negotiating a trade agreement with the European Union.

In the first half of 2005 the adoption of the fiscal reform was delayed, which had negative repercussions for the ratification process of the free trade agreement with the United States and the Dominican Republic. This occurred in a context dominated by the political tensions of a pre-election year and lack of parliamentary support for the initiatives of the executive branch.

3. The main variables

(a) Economic activity

In 2004, output growth slowed from 6.5% to 4.2%. For the second year in a row, economic expansion was driven by buoyant exports (6.8%) and tourism. Domestic demand also picked up (3.9%). If restocking is not included, however, the rise in domestic demand is much smaller (1.5%), owing to the decline of gross fixed capital formation (3.6%) and stalled growth in consumption (2.9%). The main factor in the investment decrease was lower public investment in machinery and equipment and in construction, while private consumption reflected a downturn in disposable national income, as well as employment and wage trends.

On the supply side, imports expanded, especially purchases of raw materials and intermediate goods. In sectoral terms, as in the past five years, economic growth reflected expansion across the full range of service activities (6.1%), which generated 58.4% of GDP. The most buoyant sectors were transport, telecommunications

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	7.1	5.7	6.9	6.4	3.5	4.8	4.4	3.9	1.9	...
Merchandise exports, f.o.b. (millions of dollars)	1 530	1 648	1 500	1 425	1 571	1 112	1 523	1 568	1 594	...
Merchandise imports, c.i.f. (millions of dollars)	1 939	1 887	1 908	1 908	2 015	1 420	2 080	2 094	2 140	...
International reserves (millions of dollars)	1 790	1 688	1 596	1 836	1 746	1 634	1 656	1 918	2 101	2 191
Real effective exchange rate (index: 2000=100) [c]	101.0	103.3	104.5	105.7	105.7	105.9	106.1	108.3	108.1	107.9 [d]
Consumer prices (12-month percentage variation)	9.4	10.2	8.4	9.9	11.3	11.9	13.8	13.1	13.6	13.8
Average nominal exchange rate (colones per dollar)	384	394	404	414	423	433	443	453	464	473
Average real wage (variation from same quarter of preceding year)	...	...	...	...	0.1	-3.1	-4.0	-3.5	-1.1	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	11.5	11.1	10.6	10.2	10.1	10.0	10.0	10.0	10.1	10.5
Lending rate [f]	24.0	25.7	22.7	21.4	21.0	20.9	21.3	21.4	21.5	22.2
Interbank interest rate [g]	17.3	16.4	15.1	13.9	13.6	13.5	13.9	14.3	14.8	15.5
Domestic credit (variation from same quarter of preceding year) [h]	21.9	23.7	20.0	20.5	19.9	29.0	31.8	29.5	26.5	22.1 [i]
Non-performing loans as a percentage of total credit [j]	2.2	2.0	2.0	1.7	1.6	1.7	2.0	1.9	1.7	1.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1991 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] 90-day deposits at state-owned banks. [f] Rate on loans to industry from State-owned banks. [g] Average reference rate, calculated by the Central Bank of Costa Rica. [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Data for April. [j] Refers to total credit extended by the financial system.

(especially mobile telephones and Internet services), financial services and commerce.

Merchandise production edged up by only 2.1% and agricultural activity slackened considerably. Growth in agricultural value added dropped from 7.5% to 1.6% as a result of lower coffee, maize, bean and milk production, combined with only a slight increase in banana production. In contrast, production of pineapple, flowers and foliage, root crops, tubers and fresh fruit continued to climb strongly. The reduction in coffee production was attributable to early ripening of the 2003-2004 harvest and late maturation in the 2004-2005 season. Banana production was affected by weather conditions. The low prices fetched by basic grains were a disincentive to production. In the milk industry, however, the downturn in production was due to the fact that a number of dairy farms switched to growing pineapple, vegetables and cassava, which yield better returns. Growth in manufacturing value added (1.5%) was seven percentage points down on the previous year. This sharp decline was due mainly to fewer exports of microprocessors manufactured by the Intel plant and lower sales by a number of industrial enterprises producing for the domestic market. Construction, on the other hand, grew rapidly (6.6%) on the strength of private investment in projects to build housing, shopping centres and business premises.

(b) Prices, wages and employment

The rate of inflation, measured by the consumer price index (CPI), stood at 13.1%. This figure far exceeded the target of 11% established in the revised monetary programme and represented an eight-year high. Tight monetary policy and fiscal measures to contain public spending eased pressure on domestic demand. In this context, inflation was attributable mainly to rising international petroleum prices, higher utility rates (electricity and water) and supply problems that pushed up the prices of certain agricultural goods for domestic consumption. This was combined with the higher rate applied to nominal daily currency devaluation and the depreciation of the United States dollar against the euro and the yen, which resulted in higher prices for some imports.

Although the economy continued to grow, problems in the labour market worsened. The small increase in employment brought the nationwide open unemployment rate down only slightly, from 6.7% to 6.5%. Real average income retreated by 6%, reflecting shrinking income in public and private sectors alike. Despite adjustments made in the course of the year, real minimum wages slipped for the third consecutive year (-1.6%), raising the proportion of poor households from 18.5% to 21.7%.

(c) The external sector

Slackening growth in economic activity was accompanied by a slight decrease in the external imbalance. The balance-of-payments current-account deficit narrowed from 5.3% of GDP to 4.8%. In such a small and open economy, however, the current-account deficit remains a source of vulnerability to any harmful external developments such as a terms-of-trade downturn or a rise in interest rates.

The wider trade deficit was offset by a lower net outflow of investment income (reflecting, in turn, a decrease in repatriation of profits and dividends from foreign direct investment) and by larger surpluses on the services and transfers accounts. This increase in the trade deficit was the result of a rise in imports (7.4%), while exports grew by only 2.4%. Inflows of external financial resources, including foreign direct investment, covered the current-account deficit and helped to swell international monetary reserves, which rose by US$ 81.8 billion. Income from FDI amounted to US$ 596.8 million, which was slightly more than in 2003. FDI amounted to 3.3% of GDP and 67% of the current-account deficit. Most FDI corresponded to reinvestment by foreign firms already established in the country's free zones (especially in the electronics industry).

Despite a decline of 34.5% in external sales of microprocessors manufactured by the Intel plant, merchandise exports expanded, thanks mainly to non-traditional products, which represented 87% of total exports, with medical equipment and pharmaceutical product prominent in this category. Maquila exports also picked up. Industrial exports to other Central American countries performed particularly well, as did agricultural exports such as coffee, pineapple, melon, plants, flowers and foliage. In addition, revenues from the tourist industry, computer programming, call centres and business centres offset a sizeable chunk of the merchandise trade imbalance. In 2004, the number of tourist arrivals was up 16% on the previous year (with the highest growth rate in 15 years).

Raw materials and intermediate goods accounted for much of the rise in exports. This was a reflection of the imports of free zone enterprises; inventory stockpiling in the high-technology electronics industry; higher international prices for petroleum and a number of industrial commodities; and the depreciation of the United States dollar in relation to the euro and the yen (which pushed up the prices of some imports). At the same time, imports of capital goods declined due to a drop in purchases for the health, electricity and telecommunications sectors.

El Salvador

1. General trends

The Salvadoran economy grew by 1.5% in 2004, while per capita GDP fell for the fifth consecutive year. Rising inflows of foreign exchange in the form of family remittances (which amounted to 16.1% of GDP) and increased non-maquila exports were not enough to make up for the decline in maquila output and the sharp drop in public investment (40.4%) caused, in large part, by the delay in getting the national budget through Congress. With such a steep contraction of public investment and waning private investment in the construction sector, gross fixed capital formation was down by 3.8%.

The annual inflation rate was 5.3%. This was well above the 2003 figure of 2.5%, mostly because of rising fuel prices. The deficit of the non-financial public sector (NFPS), including pensions, fell to 2.4% of GDP from the previous year's figure of 3.7%. The stability of the main financial indicators was in large measure attributable to the still low level of international interest rates. Foreign direct investment (FDI) rose sharply to 2.9% of GDP. The current account deficit stood at 3.9% of GDP.

GDP is expected to grow by about 2.5% in 2005, with its expansion being buttressed by the higher public investment associated with a projected fiscal deficit of 2.7% of GDP. Lower inflation (3%) is anticipated, and aggregate demand should be boosted by stronger external demand for agricultural products, rising inflows of remittances and increased job creation. In the first few months of 2005, however, there was as yet no clear sign of a sustained economic recovery. On the domestic front, investment remained stagnant while, at the international level, high oil prices had a negative impact on supply conditions.

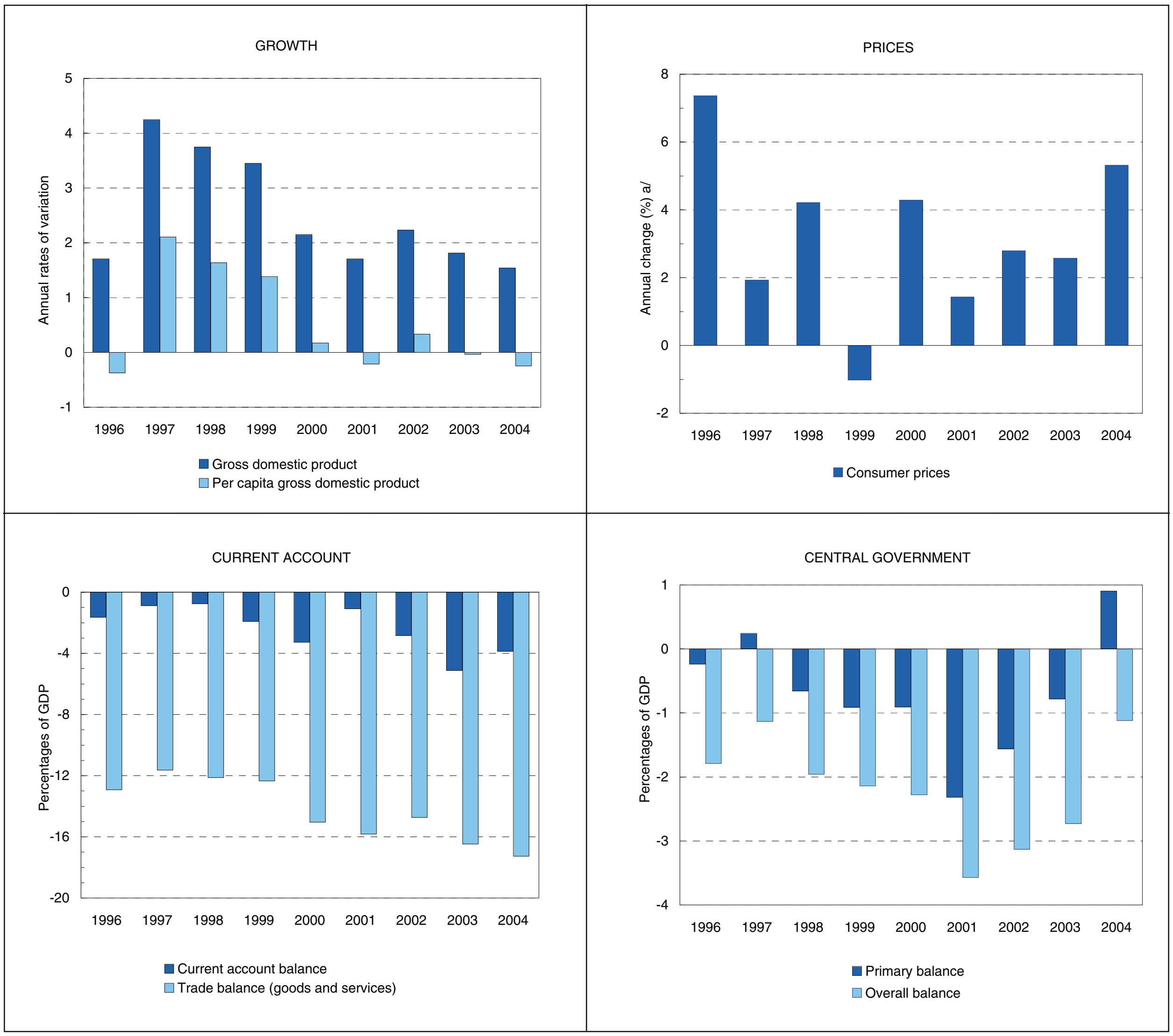
2. Economic policy

In 2004, the main economic policy challenges faced by El Salvador were to consolidate a stable tax base and finance more investment in order to spur growth, meet urgent social needs and curb the rapid increase in public debt seen in recent years.

(a) Fiscal policy

Because the budget took so long to win approval, the fiscal balance improved. The NFPS deficit, not counting pensions, decreased from 2.1% of GDP in 2003 to 0.6% in

Figure 1
EL SALVADOR: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2004. This was mainly due to the fact that, in real terms, current revenue rose by 2% while total expenditure fell by 6.8%.

The central government's deficit amounted to 1.1% of GDP, as against 2.7% in 2003. This outcome reflected a 1.1% rise in total revenue in real terms, together with a steep decrease in capital expenditure, particularly real investment (-50.5%).

The very slight (0.3%) upturn in tax revenues was the net effect of a decline in VAT receipts and a 1.6% rise in income tax collections. This brought the tax ratio in El Salvador to 12.3% of GDP, which is still quite low, in view of the need to fund social programmes in the country. Non-tax revenue was up by 22.2% in real terms, mainly thanks to the rise in receipts from property income and the sale of goods and services by public agencies.

As of May 2005, public accounts showed a cumulative fiscal surplus of US$ 102 million thanks to the 14.8% increase in tax revenues and the delayed execution of public investments.

In early 2005, the Government of El Salvador earmarked a specific portion of its tax revenues to start up the Health Solidarity Fund (FOSALUD) and the Solidarity Network programme. These schemes are designed to assist people living in extreme poverty and to promote economic and productive development on a comprehensive basis. The initiative involves a large-scale mobilization of resources and a further intensification of what have, thus far, been evaluated as effective efforts to work towards the Millennium Development Goals. The country has also launched a programme known as the National Education Plan for 2021, whose goal is to achieve universal primary-education coverage and to upgrade preschool and secondary education.

The NFPS debt was held to 38.3% of GDP in 2004. The total public debt (which includes the non-financial public sector, the financial public sector and the central bank), however, came to US$ 7,282,600,000, or 46% of GDP. This result is 1.5 percentage points down on the preceding year, but the situation nonetheless warrants greater attention, particularly in relation to the pension system. Reducing the cost of the pension system to below 1.7% of GDP and cutting the public sector's overall liabilities represent a major challenge for the current Administration.

A total of US$ 286.4 million in Eurobonds was issued in 2004 (17.8% less than in 2003) on relatively favourable terms. The plan for 2005 is to issue US$ 400 million of the US$ 542 million that has been approved by Congress. Meanwhile, El Salvador has obtained a US$ 40 million loan from the Inter-American Development Bank (IDB) and a US$ 485 million loan from the World Bank, to be disbursed between 2005 and 2008, with US$ 100 million of this sum to be received during the first year. This loan is part of the World Bank's new Country Assistance Strategy (CAS), which is aimed at supporting the Government of El Salvador's efforts to speed up the pace of an equitable and sustainable form of economic growth that will promote social cohesion while helping to reduce poverty.

(b) Monetary policy

Domestic interest rates continued their downward trend. In real terms, the average annual rate for 180-day deposits was negative (-1.1%), and the interest rate on loans with terms of up to one year was 1.8%. Net domestic credit to the public sector rose in real terms by 6.2%, but credit to the private sector edged up by a mere 0.1%. M3 was down by 1.7% in real terms.

Nominal interest rates have gradually begun to climb in 2005. In real terms, the average annual rate for 180-day deposits has held steady as of June, while lending rates for terms of up to one year stand at 2.7%. Liquidity has declined by 1% in real terms since December 2004.

The central bank's net international reserves amounted to US$ 1,888,300,000 in 2004, which represented a 0.9% decrease from their 2003 level. This was equivalent to 3.8 months' worth of merchandise imports, or 117.6% of the liquidity reserves that the central bank requires commercial banks to hold in order to ensure the stability of the financial system. In June 2005, international reserves rose slightly, while the liquidity reserve stood at US$ 1,552,500,000.

(c) Trade policy

The United States-Central American Free Trade Agreement (CAFTA) has continued to be the pivotal component of the country's trade policy. In late 2004, the Salvadoran Congress ratified the agreement and, in May 2005, the Presidents of the five Central American countries met with President George W. Bush to press for its ratification by the United States Congress. The agreement, which is broader in scope than the unilateral preferences granted under the Caribbean Basin Initiative, is expected to boost exports and investment in the long term, particularly in the case of non-traditional items, ethnic products and agro-industrial production.

3. The main variables

(a) Economic activity

Factors holding back production activity in 2004 included the downturn in maquila exports caused by competition from Asian countries in the textiles sector, the uncertainty associated with the elections, declining public investment and rising international oil prices. Private investment climbed by only 3.4%.

In the first five months of 2005, economic activity remained as weak as it had been in late 2004. As of May, the economic activity index had fallen by 1.1% as a result of a 21.3% slump in the construction sector and a 3.0%

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	1.7	4.2	3.7	3.4	2.2	1.7	2.2	1.8	1.5
Per capita gross domestic product	-0.4	2.1	1.6	1.4	0.2	-0.2	0.3	0.0	-0.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.3	0.4	-0.7	7.7	-3.1	-2.6	0.1	0.1	3.2
Mining	1.0	6.5	5.3	0.4	-4.7	11.7	5.5	4.0	1.9
Manufacturing	1.7	8.0	6.6	3.7	4.1	4.0	2.9	2.3	0.7
Electricity, gas and water	17.1	4.2	6.1	2.7	-2.3	4.6	7.3	3.1	2.9
Construction	2.7	6.2	8.5	-1.8	-3.4	9.6	6.7	4.2	-13.6
Wholesale and retail commerce, restaurants and hotels	0.4	2.9	4.0	2.0	3.6	1.9	1.5	1.2	1.4
Transport, storage and communications	1.9	7.7	4.2	9.5	6.1	4.3	5.0	2.5	2.5
Financial institutions, insurance, real estate and business services	2.2	4.4	3.8	3.0	3.0	-0.8	2.8	2.4	5.0
Community, social and personal services	2.4	3.4	1.2	1.0	1.1	-0.3	-1.0	0.7	1.1
Gross domestic product, by type of expenditure									
Consumption	1.6	3.0	2.4	3.4	3.7	3.2	1.8	1.9	1.8
General government	2.8	2.8	2.5	0.4	0.9	4.6	1.5	4.1	-2.7
Private	1.5	3.0	2.4	3.7	3.9	3.1	1.8	1.7	2.2
Gross domestic investment	-22.1	6.5	22.8	-4.0	2.7	5.1	-7.0	10.3	-3.8
Exports (goods and services)	8.7	30.2	6.2	7.1	16.8	-0.2	5.9	3.8	6.6
Imports (goods and services)	-6.1	16.8	9.2	2.7	14.5	4.2	1.7	4.8	3.4
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	15.2	15.1	17.6	16.4	16.9	16.7	16.7	16.9	15.8
National saving	13.5	14.2	16.8	14.5	13.6	15.6	13.9	11.8	11.9
External saving	1.6	0.9	0.8	1.9	3.3	1.1	2.8	5.1	3.9
	Millions of dollars								
Balance of payments									
Current account balance	-169	-98	-91	-239	-431	-150	-405	-764	-612
Merchandise trade balance	-1 242	-1 143	-1 306	-1 356	-1 740	-1 933	-1 865	-2 276	-2 619
Exports, f.o.b.	1 787	2 437	2 460	2 534	2 963	2 892	3 020	3 153	3 330
Imports, f.o.b.	3 030	3 580	3 765	3 890	4 703	4 824	4 885	5 428	5 949
Services trade balance	-90	-152	-149	-183	-235	-250	-240	-180	-109
Income balance	-90	-163	-163	-282	-253	-266	-323	-422	-460
Net current transfers	1 254	1 361	1 527	1 582	1 797	2 298	2 023	2 114	2 576
Capital and financial balance [d]	334	460	394	447	385	-27	282	1 080	572
Net foreign direct investment	-7	59	1 103	162	178	289	496	154	459
Financial capital [e]	341	401	-709	285	207	-316	-214	926	113
Overall balance	165	363	303	208	-46	-178	-124	316	-40
Variation in reserve assets [f]	-165	-363	-303	-208	46	178	124	-316	40
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [g]	106.5	104.0	101.9	100.4	100.0	99.6	99.6	101.1	101.0
Terms of trade for goods (index: 2000=100)	97.1	95.0	95.8	99.6	100.0	102.5	101.6	97.7	96.8
Net resource transfer (percentage of GDP)	2.4	2.7	1.9	1.3	1.0	-2.1	-0.3	4.4	0.7
Gross external public debt (millions of dollars)	2 517	2 689	2 646	2 789	2 831	3 148	3 987	4 717	4 778
Gross external public debt (percentage of GDP)	24.4	24.2	22.0	22.4	21.6	22.8	27.9	31.6	30.3
Net profits and interest (percentage of exports) [h]	0.0	0.0	1.0	3.5	1.6	2.0	2.3	2.1	1.9
	Average annual rates								
Employment									
Labour force participation rate [i]	51.3	50.9	53.5	52.6	52.2	53.3	51.2	53.4	51.7
Open unemployment rate [j]	7.7	8.0	7.5	7.0	6.7	7.0	6.2	6.9	6.8
Visible underemployment rate [k]	...	...	3.2	3.5	3.4	3.4	4.1	4.5	4.5

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual averages					
Prices									
Variation in consumer prices (December-December)	7.4	1.9	4.2	-1.0	4.3	1.4	2.8	2.6	5.3
Variation in real minimum wage	-3.6	-4.3	3.3	2.4	-2.2	-3.6	-1.8	2.1	-1.4
Nominal deposit rate [l]	...	...	...	...	6.5	5.5	3.4	3.4	3.3
Nominal lending rate [m]	...	...	...	...	10.7	9.6	7.1	6.6	6.3
				Percentages of GDP					
Central government									
Current income	12.8	11.5	11.5	11.2	11.3	11.6	12.2	12.9	13.0
Current expenditure	11.7	10.5	10.8	11.1	11.8	11.5	11.4	12.2	12.2
Current balance	1.0	1.0	0.8	0.1	-0.4	0.1	0.9	0.7	0.8
Net capital expenditure	3.2	2.6	2.9	2.4	2.7	4.1	4.3	3.9	2.3
Primary balance	-0.2	0.2	-0.7	-0.9	-0.9	-2.3	-1.6	-0.8	0.9
Overall balance	-1.8	-1.1	-2.0	-2.1	-2.3	-3.6	-3.1	-2.7	-1.1
Public debt	37.8	36.2	33.3	26.0	27.4	31.2	36.1	38.0	38.3
Domestic	13.4	12.0	11.2	7.9	9.6	11.9	11.6	11.4	11.9
External	24.4	24.2	22.0	18.1	17.8	19.4	24.5	26.6	26.4
Interest payments (percentage of current income)	12.1	11.9	11.3	11.0	12.1	10.8	12.8	15.1	15.6
Money and credit [n]									
Domestic credit [o]	33.7	36.0	37.9	39.7	40.4	42.6	38.5	38.2	39.7
To the public sector	-0.5	-0.9	-1.6	-1.7	-1.2	0.2	0.4	-0.8	0.2
To the private sector	34.3	36.9	39.5	41.4	41.7	42.4	38.1	39.0	39.5
Liquidity (M3)	41.0	42.0	44.3	44.7	45.1	43.9	41.9	40.1	38.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Annual average, weighted by the value of merchandise exports and imports. [h] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [i] Economically active population as a percentage of the working-age population; nationwide total. [j] Unemployment rate as a percentage of the economically active population; nationwide total. [k] Underemployment rate as a percentage of the economically active population; urban total. [l] Reference rate for deposits of up to 180 days in the financial system. [m] Reference rate for 1-year loans in the financial system. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

slowdown in manufacturing. The 12-month moving average of the IVOPI industrial output index was also down, by 0.8%.

With declines in gross domestic investment and public consumption, the main economic stimulus in 2004 came from the 2.2% rise in private consumption. Consumption in this sector was spurred by the upswing in transfers from abroad, most of which came in the form of remittances from emigrants. Total supply was bolstered by a 3.4% increase in imports of goods and services.

The agricultural sector achieved a growth rate of over 3% after having turned in a very sluggish performance during the preceding four years. The crop-farming subsector exhibited a 2.4% increase in activity following a 2.5% slump in 2003, and the livestock subsector grew by 4.5%.

Manufacturing output made little progress (0.7%), largely because of shrinking demand in the United States for maquila products, which made up over 50% of the country's merchandise exports. Production fared better in non-maquila industries. Food output (28.1% of total manufacturing production) increased by 4.1%, while production of machinery and metal products rose by 2%, thanks to the momentum provided by the output of machinery and of transport and other equipment as well as, to a lesser extent, metal products. The biggest drop (-11.8%) was in the output of petroleum products and was associated both with sluggish economic activity and with the high cost of inputs.

A 13.6% downswing in the construction sector followed three years of steady growth as the country worked to rebuild in the aftermath of the 2001 earthquakes. The 9% drop in cement production —the sharpest decrease in 20 years— was reflected in a 17.7% reduction in apparent consumption. Net electric power generation showed only a slight increase over the previous year, thus attesting to the economy's weak performance in 2004.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	1.1	1.9	2.2	2.5	1.8	1.5	1.4	1.5	1.6	...
Merchandise exports, f.o.b. (millions of dollars)	801	762	801	764	815	518	819	894	821	...
Merchandise imports, c.i. f. (millions of dollars)	1 412	1 417	1 474	1 452	1 462	1 061	1 534	1 739	1 542	...
International reserves (millions of dollars)	1 800	1 687	1 814	1 943	1 937	1 837	1 919	1 927	1 739	...
Real effective exchange rate (index: 2000=100) [c]	100.2	101.2	101.4	101.5	101.4	100.4	100.4	101.7	101.7	102.0 [d]
Consumer prices (12-month percentage variation)	2.4	1.5	2.2	2.6	3.9	4.6	5.3	5.3	4.7	4.3
Average nominal exchange rate (colones per dollar)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Nominal interest rates (annualized percentages)										
Deposit rate [e]	3.3	3.4	3.4	3.4	3.4	3.4	3.3	3.3	3.2	3.4
Lending rate [f]	6.6	6.5	6.6	6.6	6.6	6.2	6.3	6.1	6.9	6.8
Domestic credit (variation from same quarter of preceding year) [g]	0.9	5.8	7.7	8.9	8.5	12.7	10.8	6.3	7.7	...
Non-performing loans as a percentage of total credit [h]	3.5	3.3	3.2	2.8	2.7	2.6	2.7	2.4	2.5	2.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Reference rate for deposits of up to 180 days in the financial system. [f] Reference rate for 1-year loans in the financial system. [g] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [h] Refers to total credit extended by the banking system.

In January 2005 the government launched a project to construct the “dry canal” road links that are to connect Puerto Cortés, on the Honduran Atlantic coast, to the Pacific coast of El Salvador. This project is expected to serve as a catalyst for economic growth. With an investment of about US$ 170 million, the project will also include the construction of the Port of Cutuco, modernization of the Port of Acajutla, construction of a high-speed four-lane highway, and development of basic and hotel infrastructure. The project is slated to come fully on stream within three and a half years.

(b) Prices, wages and employment

Mostly because of rising international oil prices, which underlie about 70% of the inflation rate, the December-to-December consumer price index yielded a rate of 5.4%. This was much higher than any other rate registered since 1997, but was still one of the lowest figures in Central America. The sectors showing the largest increases were transport, furniture and household goods. Although in June 2005 the annual inflation rate began to decline (4.3%), the reduction has been so gradual that the official target of 3% may be hard to achieve. Rising fuel prices continue to exert upward pressure on production costs and consumer spending.

Despite the growing numbers of employed people paying into the social security system in 2004, the national unemployment rate fell by just 0.1 of a percentage point to 6.8%. This was chiefly due to the loss of some 8,000 jobs in the maquila sector. Underemployment, meanwhile, has been on the rise and now affects 34.6% of the working population.

With no increase in nominal minimum wages, agricultural workers’ purchasing power declined by 4.3%. In industry, the real minimum wage was down by 1.4%, and in commerce and services it was 0.5% lower. Nonetheless, the nationwide household poverty rate fell from 36.1% in 2003 to 34.6% in 2004, while the national extreme poverty rate was reduced from 14.4% to 12.6%. In both cases, the biggest decreases were seen in rural areas and were partly attributable to increased family remittances.

(c) The external sector

In 2004, El Salvador was faced with climbing international oil prices and growing competition from Asia on world markets. Its exports of goods rallied by 5.6%, however, thanks to rising external sales of non-traditional products. Increased inflows of remittances remained a key factor in buoying private consumption and contributed to the decrease of over one percentage point in the current account deficit.

In fact, family remittances were up by 21% over the previous year, amounting to US$ 2,547,600,000 and covering 93.4% of the aggregate trade deficit. One factor contributing to the strong performance of remittances was the decline in unemployment among Hispanic workers in the United States seen in the last few months of 2004. The United States extended the Temporary Protected Status (TPS) designation granted to nationals of El Salvador who entered the United States illegally before the 2001 earthquakes, thereby making the Salvadoran economy less vulnerable to a potential contraction in remittances. During the first half of 2005, remittances totalled US$ 1.379 billion, for a year-on-year increase of 14.3%.

The country's export activities were clearly not trouble-free in 2004. Its terms of trade deteriorated, and stronger competition from Asia triggered a 2.8% drop in maquila exports. Thus, for the first time ever, the maquila sector was clearly out of step with economic growth in the United States. On the other hand, non-traditional exports were up 19.9%, mainly thanks to higher exports of outerwear, plastic products, cotton yarns and fruit juices. The small increase in traditional exports (1.8%) was attributable to increased coffee exports. Exports of goods to other Central American countries were up by 10.2%, and merchandise exports to the rest of the world rose by 3.9%.

Between January and June 2005, exports totalled US$ 1.74 billion (10% more than in the first half of 2004); exports of coffee and non-traditional products were higher, while maquila exports edged up by a mere 0.6%.

The expansion of merchandise imports (9.6%) was mainly due to higher unit values rather than to an increase in the volume of shipments. Purchases of intermediate goods rose by 14.3%, those of consumer goods by 12.4%, and those of capital goods by 5.7%. The result was a US$ 2,619,200,000 deficit on the merchandise trade account, which was 15.1% more than in 2003. This 9.6% year-on-year increase in imports for the first half of 2005 caused the trade deficit to widen by 9.2% relative to its level in the comparable period of 2004.

Inbound tourism increased by 14% in 2004, and the country's foreign-exchange revenues from this source were 13% higher than they had been in 2003. The financial account showed a positive balance of US$ 426.5 million, or just one third of the 2003 level. This result was made possible by the fact that the decline in assets and liabilities under "other investment" was outweighed by FDI, which amounted to 2.9% of GDP thanks to the sale of State-owned shares in the telecommunications company and increased foreign investment in the banking sector and construction.

Lastly, in 2004 and early 2005, the main rating agencies maintained their risk ratings for the country's long-term foreign-currency debt. Moody's Investors Service continued to assign the country an investment-grade rating, while Fitch Ratings and Standard & Poor's left their ratings just under that scale. This has put the country in a more favourable position for obtaining international loans.

Guatemala

1. General trends

In 2004, a more buoyant Guatemalan economy posted growth of 2.7%, after expanding by around 2% in the previous three years. For the first time since 2001, per capita GDP increased slightly. GDP growth was driven by external demand (6.6%), although the terms of trade worsened because of higher prices for petroleum and other raw materials. There was a fresh rise in family remittances, which accounted for a record 9.5% of GDP, while tourism revenues also climbed. As a result of this and of short-term capital inflows, the quetzal appreciated considerably from April 2004 onwards.

The new government authorities had to take on the 2003 fiscal deficit, as well as the consequences of the Constitutional Court's decision to suspend both the tax on commercial and farming enterprises (IEMA) and the fuel distribution tax. The government therefore drastically cut public spending, since the changes to the tax regime presented to Congress were only partially approved and did not generate as much income as projected. The government deficit narrowed from 2.3% of GDP to 1.0% of GDP, with significant cuts in current expenditure (especially capital expenditure).

High prices for petroleum and other raw materials pushed up the variation in consumer prices from 5.9% to 9.2% between December 2003 and December 2004. Modest growth meant there were no significant changes in employment. Average real wages and salaries fell by 2.4% during what was the fourth consecutive year of virtual stagnation.

The balance-of-payments current account deficit was quite hefty at 4.4% of GDP, and the country's chronic trade deficit for goods and services was very high. Although the external public debt was 10.9% higher than in 2003, debt burden indicators remained moderate.

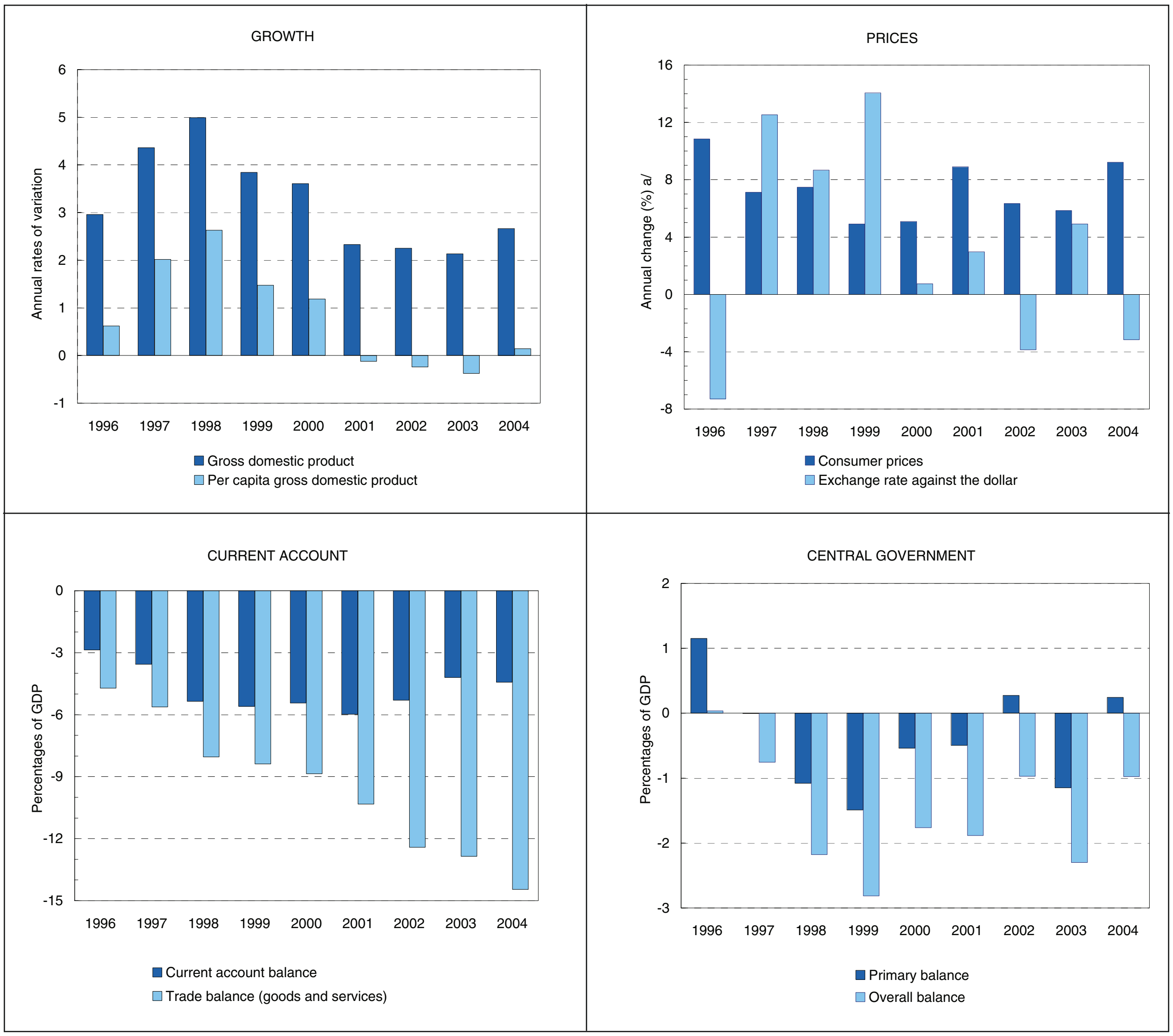
In the latter months of 2004 the government launched an economic and social recovery programme known as "*Vamos Guatemala*", which comprises a set of specific and measurable projects aimed at generating a propitious climate for production investment and creating tangible benefits for Guatemalan households.

In 2005, GDP is expected to rise by 3.2%. This should be facilitated by the consolidation of the new government and the *Vamos Guatemala* programme. The driving force behind growth is predicted to be construction (following the sharp decline in 2004) and increased buoyancy in the manufacturing industry. In contrast, growth is expected to falter in agriculture and commercial activities.

The authorities have expressed an intention to gradually introduce a system of explicit targets, as part of convergence towards a single benchmark interest rate for short-term monetary stabilization operations. Projections point to inflation of between 4% and 6% for 2005, although this target is likely to be overreached as it was in 2004. The fiscal deficit is expected to stand at 1.8% of GDP, which suggests both a looser stance on public spending and a slightly wider current account deficit than in 2004 (4.3% of GDP).

At the beginning of 2005, the government held negotiations for a new special drawing rights agreement with the International Monetary Fund (IMF), but did not ultimately formalize the accord, partly due to the positive performance of international reserves and smooth access to external financing. IMF will continue to monitor the economic targets set by the authorities and provide technical cooperation for the banking and tax systems, monetary policy and economic statistics.

Figure 1
GUATEMALA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2. Economic policy

The central bank sought to tackle the rise in international petroleum prices and the resulting impact on inflation and exchange rate appreciation, all without marring the recovery of economic activity. Fiscal policy was the instrument of choice for achieving these objectives. Although the real appreciation of the quetzal had not been halted by the end of the year, the authorities did manage to avoid sudden exchange-rate adjustments. Inflation remained in single-digit figures despite high prices for petroleum and other raw materials almost all year long.

(a) Fiscal policy

The government authorities had to grapple with the deterioration in the fiscal accounts seen in 2003 and the Constitutional Court's decision to overturn two taxes: first, the tax on commercial and farming enterprises (IEMA), which was partially suspended in a ruling of 3 February 2004, then the tax on fuel distribution, which was suspended on 16 December 2004.

Public spending was therefore slashed at the beginning of 2004. Congress was then presented with six tax reform proposals aimed at raising the tax burden to 12%. Four of the proposals were adopted mid-year, including a temporary tax to support the peace agreements (IETAP) and changes to income tax. At the end of the year, the Council of Ministers for Economic Integration (COMIECO) temporarily established a renewable three-month extraordinary tariff on fuel to offset the suspension of the fuel distribution tax.

The temporary tax to support the peace agreements (IETAP) and the income tax reforms failed to offset the fall in income following the suspension of IEMA. Total tax revenue remained constant thanks almost exclusively to higher VAT revenues as a result of the gradual economic recovery during the year and the measures adopted by the tax authorities to reduce evasion, although the income tax take still needs to be improved.

In 2004, the tax burden remained at the same level as in 2003 (10.3%), although lower than the 10.6% recorded in 2002. Indirect taxes grew by 0.2 percentage points, thereby compensating a similar fall in direct taxation. The narrowing of the deficit from 2.3% of GDP in 2003 to 1.0% in 2004 was entirely attributable to cuts in expenditure.

Indeed, total government expenditure dropped from 13.4% of GDP in 2003 to 12.0% in 2004, with a 0.7 percentage point decline in both current and capital expenditure. All headings of current expenditure were lower than in 2003, except interest on the external debt in the wake of international interest rake hikes and higher public debt.

Real current income declined by 1.5%, with a 7.3% fall in non-tax revenues (including transfers). The best performance among tax revenues was turned in by VAT (3.3%). Current expenditure dropped by 8.9% in real terms, owing mainly to smaller outlays on goods and services and a decline in current transfers. Capital expenditure was also down in real terms, by 15.6%, given the late adoption of the public investment programme. The government still faces the challenge of increasing tax revenues to meet its commitments under the peace agreements and to pay for overdue social investments.[1]

(b) Monetary policy

Among the factors that contributed to the economy's increased monetization were the central bank's purchases of foreign exchange on the market, in an attempt to slow the mounting appreciation of the quetzal during 2004 and up to April 2005.

In order to ease the expansion of the money supply, the central bank engaged actively in open-market operations, which in 2004 represented 1.4 billion quetzals more than the previous year. This was strongly offset by an increase in the government's deposits in the central bank, which stood at 8.385 billion quetzals at the end of 2004 (2.164 billion quetzals more than in 2003).

The monetary authority also raised interest rates on 28-day certificates of deposit in March, April and June, which produced a cumulative increase of 112.5 basis points. In October, the authorities responded to continued inflationary pressure by raising the interest rate on 91-day instruments by 25 basis points. This pushed up the average weighted interest rate on the total stock of open-market operations from 5.7% at the beginning of the year to 6.1% at the year's end. The result was that monetary aggregates showed little real variation, with M1 contracting by 2.0% and M2 by 1.1%. Domestic credit to the private sector went up by 6.7%, while domestic credit to the public sector dropped by 53%.

(c) Exchange-rate policy

The central bank has pursued a flexible exchange-rate policy based on occasional interventions in the foreign-exchange market to reduce volatility and purchase foreign exchange needed by the bank and the government. Unlike in 2003, when the quetzal depreciated by 3% in real terms, a real appreciation was observed in 2004 from April onwards.

Other determining factors included a large inflow of financial resources into the economy —mainly in the form of family remittances, short-term capital and other, unrecorded inflows— and Guatemala's wider interest-rate

---

[1] See the message sent by Secretary-General of the United Nations, Kofi Annan, on the occasion of the ceremony marking the closure of the United Nations Mission for the Verification of Human Rights and of Compliance with the Commitments of the Comprehensive Agreement on Human Rights in Guatemala (MINUGUA), Press Release SG/SM/9595/CA/27, 16 November 2004.

Table 1

GUATEMALA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	3.0	4.4	5.0	3.8	3.6	2.3	2.3	2.1	2.7
Per capita gross domestic product	0.6	2.0	2.6	1.5	1.2	-0.1	-0.2	-0.4	0.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.6	2.9	3.7	2.1	2.6	1.2	1.8	3.1	3.7
Mining	23.4	24.6	21.0	-1.9	-8.5	0.8	9.8	4.1	-8.2
Manufacturing	1.9	2.7	3.6	2.5	1.9	1.1	0.8	1.0	2.3
Electricity, gas and water	6.0	14.7	5.8	11.0	17.4	-3.0	9.1	4.4	6.0
Construction	3.1	10.0	9.3	7.8	-18.3	12.2	-15.3	-3.3	-19.6
Wholesale and retail commerce, restaurants and hotels	2.7	3.7	5.3	3.2	4.1	2.7	2.8	1.9	3.2
Transport, storage and communications	3.6	5.9	7.5	6.8	7.6	6.8	5.7	4.8	9.2
Financial institutions, insurance, real estate and business services	4.4	4.7	5.9	4.6	3.1	0.3	2.2	2.2	2.5
Community, social and personal services	2.4	4.7	4.1	4.7	4.6	3.5	1.2	-0.2	-2.8
Gross domestic product, by type of expenditure									
Consumption	2.5	4.2	5.1	3.7	4.2	4.0	3.0	2.9	2.3
General government	0.0	6.2	9.7	5.2	10.4	5.4	-2.1	-0.6	-10.1
Private	2.8	4.0	4.6	3.6	3.5	3.8	3.7	3.3	3.7
Gross domestic investment	-15.0	20.1	36.3	-0.4	2.5	6.4	14.3	4.0	7.0
Exports (goods and services)	8.7	8.1	2.4	4.6	3.8	-4.0	-6.7	-0.2	6.6
Imports (goods and services)	-6.9	19.5	24.5	0.7	6.0	6.9	6.6	5.3	7.3
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	12.7	13.7	17.4	17.4	17.8	17.8	19.1	18.0	17.5
National saving	9.8	10.1	12.0	11.8	12.4	11.8	13.8	13.8	13.1
External saving	2.9	3.6	5.4	5.6	5.4	6.0	5.3	4.2	4.4
				Millions of dollars					
Balance of payments									
Current account balance	-452	-634	-1 039	-1 026	-1 049	-1 253	-1 235	-1 039	-1 188
Merchandise trade balance	-643	-940	-1 409	-1 445	-1 660	-2 282	-2 972	-3 116	-3 760
Exports, f.o.b.	2 237	2 603	2 847	2 781	3 082	2 860	2 819	3 060	3 430
Imports, f.o.b.	2 880	3 543	4 256	4 226	4 742	5 142	5 791	6 176	7 189
Services trade balance	-101	-62	-152	-91	-48	117	79	-68	-115
Income balance	-230	-239	-184	-205	-209	-84	-318	-318	-319
Net current transfers	523	607	705	715	868	997	1 976	2 462	3 006
Capital and financial balance [d]	666	863	1 275	901	1 703	1 727	1 257	1 589	1 797
Net foreign direct investment	77	84	673	155	230	456	111	131	155
Financial capital [e]	589	779	602	746	1 474	1 271	1 146	1 458	1 642
Overall balance	214	230	235	-125	654	474	22	550	609
Variation in reserve assets [f]	-199	-258	-263	125	-654	-474	-22	-550	-609
Other financing [g]	-15	28	28	0	0	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	94.8	88.3	88.1	98.7	100.0	95.7	88.5	88.2	85.6
Terms of trade for goods (index: 2000=100)	92.7	97.9	115.3	101.9	100.0	96.7	95.8	93.0	92.1
Net resource transfer (percentage of GDP)	2.7	3.7	5.8	3.8	7.7	7.8	4.0	5.1	5.5
Gross external public debt (millions of dollars)	2 075	2 135	2 368	2 631	2 644	2 925	3 119	3 467	3 844
Gross external public debt (percentage of GDP)	13.1	12.0	12.2	14.4	13.7	13.9	13.4	14.0	14.3
Net profits and interest (percentage of exports) [i]	4.6	5.1	3.7	4.3	5.8	4.4	5.7	6.6	5.2
				Average annual rates					
Employment									
Labour force participation rate [j]	...	...	...	...	...	...	60.8	...	...
Open unemployment rate [k]	5.2	5.1	3.8	...	...	...	3.1	3.4	3.1

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	10.9	7.1	7.5	4.9	5.1	8.9	6.3	5.9	9.2
Variation in nominal exchange rate (December-December)	-7.3	12.5	8.7	14.1	0.7	3.0	-3.9	4.9	-3.2
Variation in average real wage	9.7	2.8	3.6	5.8	3.8	0.5	-0.9	0.5	-2.4
Nominal deposit rate [l]	...	5.8	5.4	7.9	10.2	8.8	7.1	5.2	4.5
Nominal lending rate [m]	...	18.7	16.5	19.4	20.9	19.0	16.9	15.0	13.8
				Percentages of GDP					
Central government									
Current income	9.4	9.9	10.3	11.0	11.0	11.0	11.4	11.1	11.0
Current expenditure	6.7	6.7	7.9	8.6	9.1	9.2	8.6	8.9	8.2
Current balance	2.7	3.2	2.3	2.4	1.9	1.8	2.8	2.1	2.8
Net capital expenditure	2.7	3.9	4.5	5.2	3.7	3.7	3.8	4.5	3.8
Primary balance	1.2	0.0	-1.1	-1.5	-0.5	-0.5	0.3	-1.1	0.2
Overall balance	0.0	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0	-2.3	-1.0
Public debt	13.5	14.0	14.6	17.5	16.9	18.0	16.4	18.5	19.1
Domestic	5.3	5.4	5.0	5.8	5.8	5.6	4.5	5.6	6.0
External	8.2	8.5	9.6	11.8	11.2	12.4	11.9	12.9	13.1
Interest payments (percentage of current income)	11.8	7.6	10.7	12.0	11.1	12.6	10.9	10.4	11.1
Money and credit [n]									
Domestic credit [o]	19.2	20.1	20.0	20.5	19.8	19.6	18.7	18.5	19.2
To the public sector	1.4	2.4	2.3	1.0	0.8	1.1	0.4	0.3	0.7
To the private sector	17.8	17.7	17.7	19.6	19.0	18.5	18.3	18.2	18.6
Liquidity (M3)	...	...	...	...	...	...	26.6	27.5	28.2
Currency in circulation and local-currency deposits (M2)	21.0	22.4	23.0	23.1	23.8	25.1	25.1	25.4	25.3
Foreign-currency deposits	...	...	...	...	...	...	1.5	2.1	2.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1958 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment rate as a percentage of the economically active population; nationwide total. [l] Average rate for deposits in the banking system. [m] Average rate for loans in the banking system. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

spread with respect to its main trading partners. In order to avoid a sudden adjustment in the exchange rate, in 2004 the central bank bought US$ 449 million in foreign exchange on the market, authorized the issuance of dollar-denominated certificates of deposit and coordinated bond issues with the Ministry of Public Finance.

The government helped to contain the money supply by increasing its deposits in the central bank. Even so, official figures from the end of 2004 show that the quetzal appreciated by 7.5% over the value recorded at the end of 2003.

(d) Other policies

The Free Trade Agreement between Central America and the United States (CAFTA) was approved by the Guatemalan Congress in March 2005 and subsequently enacted by the government.[2] There has been some controversy over the likely impact of the Agreement once it comes fully into effect. Trade liberalization is not a recent phenomenon in Guatemala, as Central America has been making progress on integration instruments for over forty years.[3] In 2000 Guatemala concluded free trade agreements with Mexico

---

2 See Economic Commission for Latin America and the Caribbean (ECLAC), *El tratado de libre comercio, Centroamérica-Estados Unidos* (LC/MEX/R.854), Subregional Headquarters in Mexico, Mexico City, March, 2004.

3 Secretariat for Central American Economic Integration (SIECA) [on line] <http://www.sieca.org.gt/SIECA.htm>.

Table 2
GUATEMALA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	1 078	1 151	1 172	1 059	1 174	867	1 344	1 262	1 293	...
Merchandise imports, c.i. f. (millions of dollars)	1 978	1 991	2 016	2 141	2 194	1 584	2 358	2 549	2 344	...
International reserves (millions of dollars)	2 361	2 483	2 897	2 833	2 862	2 872	2 896	3 426	3 563	...
Real effective exchange rate (index: 2000=100) [b]	87.0	88.2	88.2	89.3	88.6	85.9	84.6	83.3	81.3	79.9 [c]
Consumer prices (12-month percentage variation)	5.8	5.2	5.7	5.9	6.1	7.4	8.0	9.2	9.5	8.8
Average nominal exchange rate (quetzals per dollar)	7.84	7.91	7.94	8.07	8.10	7.99	7.90	7.79	7.71	7.61
Nominal interest rates (annualized percentages)										
Deposit rate [d]	6.1	5.4	4.9	4.6	4.4	4.4	4.5	4.5	4.6	13.1 [c]
Lending rate [e]	15.8	15.2	14.6	14.2	13.9	13.9	13.8	13.6	13.5	4.6 [c]
Domestic credit (variation from same quarter of preceding year) [f]	2.8	4.0	9.6	11.8	15.4	11.1	9.3	14.4	14.1	18.1 [g]
Non-performing loans as a percentage of total credit [h]	10.4	9.6	7.8	7.5	7.0	7.0	7.5	5.9	6.9	6.5 [c]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Data to May. [d] Average rate for deposits in the banking system. [e] Average rate for loans by the banking system. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Data for April. [h] Refers to total credit extended by the banking system.

and then the Dominican Republic, and has concluded partial scope agreements with the Bolivarian Republic of Venezuela, Colombia, Cuba and Panama. Negotiations are currently under way for a free trade agreement with Taiwan Province of China and a partial scope agreement with Belize.

In recent years, significant progress has been made towards improving regulation and supervision of the financial system with the implementation of the risk-based capital adequacy standards established in the Basle Accord. At the end of 2004, the banking system's portfolio of loans that were non-performing or in arrears (not including the portfolios of banks in which the authorities have intervened) showed a slight improvement, representing 6.8% of total loans. In November 2004, dead assets represented 8.2% of total assets in the banking system. Of these, 40% corresponded to non-performing or arrears portfolios, mainly in two banks, whereas 19 other institutions reduced their non-performing portfolio to some extent.

3. The main variables

(a) Economic activity[4]

GDP grew by 2.7% on the strength of external demand (6.6%), since domestic demand expanded by only 3.0%. The sharp declines in public consumption and public investment (down by an average of 13.5%) were offset by the improved performance of private consumption and investment (averaging 4.6%). In the last four years, the economy has been driven by private consumption —which in turn is buoyed by considerable income from family remittances.

4 Estimates for the System of National Accounts (SNA) are currently being reviewed. The current version - SNA2 (constant 1958 quetzals) will be replaced by SNA4 (constant 2001 quetzals). Among other things, the methodological changes will affect the calculation of GDP levels.

Export performance was affected by the appreciation of the quetzal, but in recent years has also been influenced by other factors such as high transport costs, burdensome financing of export activity and a lack of appropriate tax incentives.[5]

The expansion of domestic demand (3.2%) was driven by private investment (8.8%), while public investment contracted considerably (24.0%). Particularly buoyant headings included machinery and equipment, while investment in construction declined. Total consumption climbed by 2.3% on the strength of private consumption (3.7%), as public consumption dropped considerably (10.1%).

In terms of the various sectors, agriculture (3.4%) was more buoyant than the previous year thanks to increased production of bananas, cardamom, sugarcane and vegetables. The manufacturing industry (2.1%) was also up on 2003, as a result of recovery in the United States and Central American markets. The textile industry posted the strongest expansion (21.4%).

Basic services (7.8%) swelled on the strength of transport, storage and communications. The telecommunications sector turned in a very robust performance associated with an increase of almost 50,000 new telephone lines. Construction activities, on the other hand, slumped (15.7%) owing to a sharp decline in public construction (29.8%), though this was partly offset by growth in private construction (8.8%). Other services expanded by only 1.6%.

(b) Prices, wages and employment

At the end of 2004, the cumulative 12-month variation in the consumer price index was 9.2%, compared with 5.9% in 2003. This exceeded the central bank's annual target of 6%, owing in part to higher international prices for petroleum and petroleum products. According to the central bank, 2.28 percentage points of the 9.2% inflation rate corresponded to imported inflation and 6.95 percentage points, to domestically generated inflation. The bank also estimated that excess imported inflation, attributable to petroleum prices, was 2.34 percentage points. In 2004, food and beverages posted the largest variation (12.7%), while clothing and footwear recorded the smallest (3.5%).

In 2004, the open unemployment rate was 3.1%, compared with 3.4% in 2003. However, the fall in the rate of open unemployment was accompanied by a reduction in the labour force participation rate from 60.9% in 2003 to 56.1% in 2004. The equivalent unemployment rate (including visible underemployment) went from 32% to 29% of the economically active population (EAP) in the same period. In July 2004 an increase in the minimum wage came into effect in agriculture (21%) and other sectors (16%). In real terms, this meant that, in 2004, the minimum wage averaged out at a level similar to that recorded the previous year.

(c) The external sector

In 2004, the trade deficit for goods and services rose for the eighth year in a row, reaching US$ 3.875 billion. The value of merchandise exports posted the highest rate of growth (12.1%) since 1997 thanks to an upturn in prices, although this was insufficient to offset the considerable rise in the value of merchandise imports (16.2%) and the goods trade deficit therefore broadened once again. The non-factor services balance also deteriorated, bringing the negative balance for goods and services to 14.4% of GDP.

The value of merchandise exports (including maquila value added) was US$ 3.43 billion, with a variation of 12.1%. Exports to the rest of Central America and non-traditional sales were more buoyant than in 2003.

Non-traditional exports grew strongly for the third consecutive year (with an annual variation of 15.7%), outpacing traditional sales for the first time. Particularly good performances were recorded in clothing (30%), natural rubber (56%), vegetables (52%) and chemicals (19%), while shrimp, fish and lobster dropped by half.

Traditional exports, on the other hand, picked up by only 3.9%, following three years of decline. This slight upturn was mainly attributable to higher external sales of coffee (10.6%) on account of better prices (as the volume of sales actually fell 13.6%). Higher prices also enabled an upturn of 1.0% in exports of sugar and banana, whose export volumes fell by 0.3 and 6.4%, respectively. Cardamom exports dropped once again (6.5%) due to lower prices (with no change in export volume).

Merchandise imports climbed by 16.2% in 2004, thereby continuing the strong expansion in external purchases observed since 1997. Imports of intermediate goods rose by 18.2%, with particularly strong growth rates in petroleum and fuels (19.8%), which brought the net balance of petroleum trade to stand at US$ 909 million. Imports of consumer goods expanded by 13.3%, with consumer durables (20.2%) more than doubling the rate for consumer non-durables. Imports of capital goods, meanwhile, climbed by 16.3%.

---

[5] Asociación Gremial de Exportadores de Guatemala (AGEXPRONT), *Modelo de desarrollo para Guatemala, quinquenio 2003-2007. Una propuesta para la eliminación de la pobreza*, October, 2002.

The non-factor services account benefited from foreign exchange generated by tourism, which brought in revenues of US$ 777 million (almost as much as total income from traditional exports) with 1.18 million tourist arrivals in 2004. Despite the rise in the number of visitors, the average spending per tourist dropped for the third year running, to US$ 657.

The income balance remained close to its 2003 level. Net payments of profits and interest maintained the same level as in the three previous years (US$ 320 million).

The balance of current transfers stood at US$ 3 billion, over 80% of which corresponded to family remittances. As a result, the balance-of-payments current account deficit was US$ 1.188 billion, which was financed by hefty income on the capital and financial accounts —mostly in the form of short-term capital— to give an overall balance of US$ 609 million.

Honduras

1. General trends

The upturn in the world economy had a positive impact on production in Honduras, where the growth rate increased from 3.5% to 5.0% between 2003 and 2004. The macroeconomic climate was stable, but some indicators deteriorated and showed no sign of improvement throughout the first half of 2005. Inflation rose to 9.2%, thus ending the downward trend that had lasted for several years. The labour situation continued to worsen and unemployment rose to 5.9%. The current account deficit widened to the equivalent of 5.2% of GDP, while public finances strengthened significantly.

In addition to the buoyancy of the international economic environment, other factors helped to boost expectations, among them the signing of an agreement with the International Monetary Fund (IMF), which gave a powerful endorsement to economic policy. Furthermore, the donor countries made important financial commitments under the Poverty Reduction Strategy (PRS) and Honduras was included in the initiative known as the Millennium Challenge Account, a fund created by the Government of the United States. Lastly, the negotiations of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) were successfully concluded.

The monetary programme for 2005 is consistent with the targets established in the agreement with IMF and the goal of improving the macroeconomic climate. Growth is expected to fluctuate between 4% and 4.5% of GDP, and inflation between 6.5% and 7.5%. The central government deficit and the external deficit should decrease to the equivalent of 3% and 2.7% of GDP, respectively. The lower growth projection is attributable to the slowdown in world economic growth and the ambitious inflation target established by the Central Bank of Honduras. In view of the sharp rise in international oil prices in the first half-year, achieving this target will depend on the adoption of a tighter monetary policy than that applied in 2004. The indicators for the first quarter have already revealed a slowdown in economic activity, especially in activity geared to the domestic market.

Further uncertainty surrounds the current process of modernization of the monetary policy and how economic agents will react. The forthcoming elections in November also represent a risk in the fiscal sphere. On the positive side, in April, the country reached completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. This, together with the recent initiative of the Group of Eight, could result in a reduction of almost 50% in external debt.

2. Economic policy

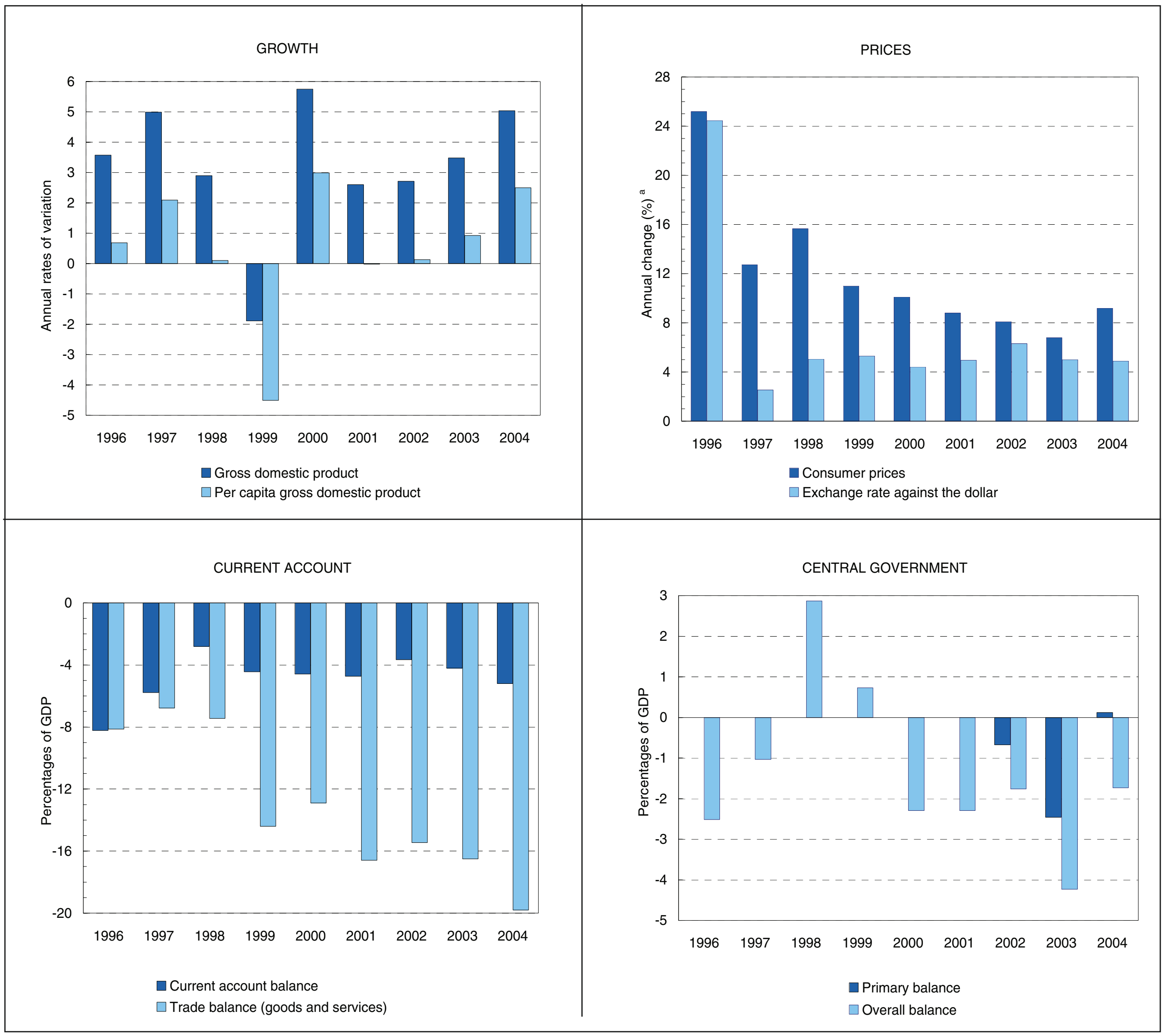
In 2004, the main objectives of macroeconomic policy were fiscal adjustment, financial system reforms, reduction of inflation and stabilization of the exchange rate.

(a) Fiscal policy

In keeping with the three fiscal reforms introduced in the previous biennium, the objective was to reduce

Figure 1

HONDURAS: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

the central government deficit to the equivalent of 3.4% of GDP. This objective was achieved, but the real adjustment was smaller than it seemed, since the 2003 deficit was inflated by the effects of legislation enacted to strengthen the financial position of agricultural producers. The payments resulting from the implementation of this legislation will be made over a ten-year period, but the cost, equivalent to 1.2% of GDP, was recorded as part of the deficit for 2003.

Revenue was up by 8.9% in real terms, owing to the increase in current revenue (9.5%), while tax revenue expanded by 10.4% as a result of the reforms. Direct taxes increased by 24.8%, owing to the taxes on property and net assets, which almost doubled. Income tax collection improved by 19.6%. Income from indirect taxation, however, grew by only 5.8%. This included revenue from taxes on petroleum products, which increased by 11.8%, and the contribution of taxes on foreign trade (9.7%).

Expenditure contracted by 3.1%. Current expenditure declined by 5.4%, while capital expenditure increased by 4.8%. Wages stagnated, in contrast to their strong growth in previous years. The wage bill diminished from 10.5%

of GDP in 2003 to 10% in 2004, in keeping with the target set by IMF. Purchases of goods and services fell by 11.5% and transfers, by 15.8%. Interest payments also decreased by 2.6% owing to forgiveness of interest on external debt granted before Honduras reached completion point.

It should be noted that, following a biennium of negative results, current savings turned positive again in 2004, rising to 1.4% of GDP. The central government deficit was financed with external resources intended for supplementing the budget, while the consolidated public sector, including the central bank, posted a deficit equivalent to 3% of GDP, which represented an improvement of 1.9 percentage points. This was influenced by the positive outturn of the four largest public enterprises, which recorded a positive operating balance equivalent to 2.6% of GDP. The central bank, however, recorded a deficit of over 1% of GDP.

Social policy was implemented as part of the Poverty Reduction Strategy, under which, social spending was raised by 0.6% of GDP to stand at 8.4% of GDP. Social investment was channelled through the Honduran Social Investment Fund and the Family Allowance Programme.

External public debt increased by 8.5% and stood at US$ 5.082 billion, or 68.4% of GDP. Domestic debt declined by 14.8%, after doubling in 2003, owing to a short-term loan to the government, the repayment of which reduced the balance by 0.7% of GDP.

(b) Monetary and exchange-rate policy

The central bank's goals were to lower the rate of inflation to 6.5%-7% and to build up international reserves by US$ 75 million. The instruments deployed for these purposes were open-market operations and foreign exchange auctions. In contrast to the previous year, fiscal consolidation was achieved as programmed, which enabled the central bank to adopt a looser stance. By mid-year, however, the rise in international oil prices put an end to the decline in inflation and the central bank adopted measures to mitigate the effects of this new development. In addition, the accumulation of net international reserves totalling US$ 504 million forced the central bank to issue monetary absorption certificates (CAM), which exceeded the 2003 placements by 5.072 billion lempiras, representing a 30% increase in real terms. By contrast, the net issuance of dollar-denominated absorption certificates was only 10.9 million lempiras.

The money supply expanded by 1.4% in real terms, due basically to a 3.5% contraction of current account deposits. Currency in circulation outside the banking system, however, increased by 8.5%. The money supply in local currency (M2) also swelled, by 8.5%, owing in part to time deposits in local currency (12%). The broad money aggregate (M3) increased by 9.2%, owing to the expansionary effect of foreign currency deposits (11.1%).

Interest rates followed a downward trend, but this was reversed in the second half of the year. Credit activity increased by 15.7%, four points above the expansion recorded in 2003. Thanks to a further strengthening of the financial system, non-performing loans were reduced from 8.7% in the previous year to 6.4%. The loan-loss coverage of the non-performing portfolio doubled over the same period, while the ratio of capital to risk-weighted assets increased from 13% to 14.5%. Lastly, total assets increased from 74.3% to 77.9% of GDP.

After focusing on the approval of its three fiscal reforms in the previous biennium, in 2004 and 2005 the government turned its attention to the financial system. The reforms implemented in 2004 include new legislation on the financial system and amendments to laws governing the functioning of the Central Bank of Honduras, the National Commission on Banks and Insurance and the Deposit Insurance Fund. The current year, 2005, saw the entry into force of a new monetary policy system designed to communicate the central bank's position more clearly to agents. The scheduled changes refer both to operational targets and to central bank instruments.

Net international reserves have continued to increase in 2005; the same is true of remittances, which exceed the 30% growth rate recorded in the previous year. Credit to the private sector has continued to expand at a rate close to 12%.

The objective of the exchange-rate policy in 2004 was to maintain exchange-rate stability through the public foreign-exchange auction system. The benchmark exchange rate reached 18.6 lempiras per United Stated dollar, which represents a nominal depreciation of 5%, while the real adjusted exchange rate, based on the consumer price indices of Honduras and the United States, remained practically unchanged.

(c) Trade policy

The most prominent event of 2004 was the signing of the Dominican Republic- Central America-United States Free Trade Agreement (CAFTA-DR) in May. Ratification began when El Salvador approved the Agreement in December 2004, followed by Honduras and Guatemala in the first quarter of 2005. Central American integration continued to move forward towards customs union on various fronts, including harmonization of more than 90% of the tariff fractions of the common external tariff, increased harmonization of the tax systems and improvements to the relevant legal framework. An important advance in this context was the facilitation of transit for individuals and goods at integrated border crossings.

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Annual growth rates [b]						
Gross domestic product	3.6	5.0	2.9	-1.9	5.7	2.6	2.7	3.5	5.0
Per capita gross domestic product	0.7	2.1	0.1	-4.5	3.0	0.0	0.1	0.9	2.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.5	4.2	-1.9	-8.5	11.7	-0.5	4.9	2.6	7.1
Mining	7.3	4.9	3.7	5.4	1.7	-0.8	4.2	3.2	-0.8
Manufacturing	4.6	6.1	3.4	2.6	5.5	5.2	3.8	3.7	4.2
Electricity, gas and water	15.4	7.6	4.9	2.1	10.6	-1.8	5.6	10.1	5.6
Construction	-11.4	-3.0	5.3	10.5	1.5	-5.2	-14.2	13.8	-4.7
Wholesale and retail commerce, restaurants and hotels	4.5	3.5	3.1	0.7	3.7	3.0	2.9	3.1	4.7
Transport, storage and communications	4.4	4.4	2.7	1.7	5.0	5.3	3.5	3.7	4.0
Financial institutions, insurance, real estate and business services	4.3	7.8	7.2	0.8	2.6	3.4	2.8	2.7	3.8
Community, social and personal services	0.7	5.3	3.3	-0.9	10.5	11.0	6.9	1.4	7.0
Gross domestic product, by type of expenditure									
Consumption	5.4	2.5	5.7	0.4	7.9	5.3	4.8	3.1	4.8
General government	5.3	-1.0	15.4	9.8	15.7	12.1	0.5	0.8	5.6
Private	5.5	2.9	4.5	-0.9	6.8	4.3	5.5	3.5	4.6
Gross domestic investment	-6.3	8.4	1.9	8.1	-2.8	-3.8	-5.8	7.7	11.4
Exports (goods and services)	8.1	1.3	1.6	-11.2	7.4	3.2	4.9	5.3	8.9
Imports (goods and services)	2.4	-1.4	7.5	4.3	3.8	4.0	2.4	7.3	12.5
			Percentages of GDP						
Investment and saving [c]									
Gross domestic investment	31.1	32.2	30.9	34.7	30.7	29.6	25.6	26.9	30.4
National saving	22.9	26.4	28.1	30.2	26.1	24.8	22.0	22.7	25.2
External saving	8.2	5.8	2.8	4.4	4.6	4.7	3.7	4.2	5.2
			Millions of dollars						
Balance of payments									
Current account balance	-335	-272	-148	-241	-276	-303	-241	-292	-391
Merchandise trade balance	-287	-294	-323	-753	-658	-834	-829	-965	-1 267
Exports, f.o.b.	1 638	1 857	2 048	1 756	2 012	1 935	1 977	2 094	2 411
Imports, f.o.b.	1 926	2 150	2 371	2 510	2 670	2 769	2 806	3 059	3 678
Services trade balance	-45	-26	-70	-28	-119	-228	-187	-181	-224
Income balance	-231	-212	-204	-155	-147	-170	-193	-252	-279
Net current transfers	227	260	449	696	648	929	969	1 106	1 379
Capital and financial balance [d]	257	454	-8	53	119	302	304	65	759
Net foreign direct investment	91	122	99	237	282	193	176	247	293
Financial capital [e]	166	333	-107	-185	-163	109	129	-182	466
Overall balance	-79	182	-155	-188	-157	-1	64	-227	368
Variation in reserve assets [f]	13	-308	-230	-442	-32	-147	-214	88	-504
Other financing [g]	66	126	385	630	189	148	150	139	136
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	130.0	119.0	108.8	104.5	100.0	97.1	96.9	98.6	100.0
Terms of trade for goods (index: 2000=100)	145.4	125.5	108.9	107.5	100.0	94.8	92.0	88.0	87.2
Net resource transfer (percentage of GDP)	2.3	7.8	3.3	9.7	2.7	4.4	4.0	-0.7	8.2
Total gross external debt (millions of dollars)	4 121	4 073	4 369	4 691	4 711	4 757	4 922	5 143	5 793
Total gross external debt (percentage of GDP)	101.0	86.4	83.0	86.5	78.2	74.3	74.8	74.0	76.9
Net profits and interest (percentage of exports) [i]	3.5	3.2	2.9	2.0	2.8	4.3	4.3	6.3	6.8
			Average annual rates						
Employment									
Labour force participation rate [j]	52.2	53.1	52.9	55.7	...	52.5	51.7	50.0	50.6
Open unemployment rate [k]	4.5	3.6	3.5	3.5	...	4.1	3.9	5.3	5.9
Visible underemployment rate [k]	2.4	3.0	2.1	2.7	...	4.4	3.9	6.4	6.9

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	25.2	12.7	15.7	11.0	10.1	8.8	8.1	6.8	9.2
Variation in nominal exchange rate (December-December)	24.5	2.5	5.1	5.3	4.4	5.0	6.3	5.0	4.9
Variation in real minimum wage	-4.0	6.3	1.8	-3.0	3.1	2.5	2.1	8.6	0.8
Nominal deposit rate [l]	...	21.3	18.6	19.4	15.9	14.5	13.7	11.5	11.1
Nominal lending rate [m]	...	32.1	30.6	30.2	26.8	23.8	22.7	20.8	19.9
				Percentages of GDP					
Non-financial public sector									
Current income	29.5	29.4	31.8	32.1	29.7	31.9	30.8	31.9	33.1
Current expenditure	22.8	22.8	22.9	22.6	24.4	27.1	26.6	29.0	27.8
Current balance	6.7	6.5	8.9	9.5	5.3	4.8	4.2	2.9	5.3
Net capital expenditure	8.6	7.2	6.3	8.6	6.6	6.1	6.1	7.3	7.3
Primary balance	...	...	...	...	...	...	-0.7	-2.5	0.1
Overall balance	-2.5	-1.0	2.9	0.7	-2.3	-2.3	-1.8	-4.2	-1.7
Public sector debt	90.3	80.9	75.0	78.8	66.1	64.0	65.8	69.5	68.4
Domestic	...	...	...	...	3.1	3.1	3.2	5.9	4.4
External	90.3	80.9	75.0	78.8	63.0	60.9	62.6	63.7	64.0
Interest payments (percentage of current income)	...	...	...	...	...	...	3.5	5.6	5.6
Money and credit [n]									
Domestic credit [o]	23.3	24.1	31.0	33.1	33.4	35.3	35.6	36.3	37.7
To the public sector	0.9	-0.1	-2.3	-4.8	-4.6	-3.5	-3.0	-2.3	-0.8
To the private sector	22.3	24.1	33.4	37.9	38.0	38.9	38.7	38.6	38.5
Liquidity (M3)	29.0	35.0	40.8	43.3	45.3	46.7	48.6	49.3	50.5
Currency in circulation and local-currency deposits (M2)	22.7	27.2	32.2	33.2	34.7	34.7	34.6	34.7	35.3
Foreign-currency deposits	6.3	7.8	8.6	10.1	10.6	12.0	14.0	14.6	15.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1978 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment and underemployment rates as percentages of the economically active population; nationwide total. [l] Weighted average rate on time deposits. [m] Weighted average rate on loans. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. Production, employment and prices

The monetary programme for 2004 was aimed at achieving economic growth of between 3.5% and 4%. However, the improvement in economic conditions boosted growth to 5% and, for the second consecutive year, investments were more buoyant than consumption.

(a) Economic activity

Overall demand grew by 6.9% in 2004, a half point ahead of domestic demand. The buoyancy of exports and imports was reflected in growth rates of 8.9% and 12.5%, respectively, while gross fixed capital formation almost doubled to stand at 15.7%. Since investment in construction showed a negative growth rate, the increase in aggregate investment corresponded to the machinery and equipment category. These were mainly private investments, since public investment was flat. Growth in consumption lagged behind the expansion of GDP.

Construction recorded a contraction of 4.7%, partly due to the sharp rise in the cost of materials such as cement and steel, which triggered a 0.8% decline in mining and quarrying activity.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars) [b]	369	348	310	316	408	293	367	345	476	...
Merchandise imports, c.i. f. (millions of dollars)	756	779	835	898	925	624	985	1 076	1 014	...
International reserves (millions of dollars)	1 450	1 454	1 395	1 430	1 501	1 625	1 695	1 970	2 068	...
Real effective exchange rate (index: 2000=100) [c]	97.5	98.5	98.8	99.5	100.0	99.7	99.6	100.9	101.0	100.5 [d]
Consumer prices (12-month percentage variation)	8.7	7.2	7.3	6.8	7.3	8.3	8.4	9.2	9.5	9.0
Average nominal exchange rate (lempiras per dollar)	17.04	17.22	17.46	17.67	17.86	18.10	18.33	18.54	18.71	18.84
Nominal interest rates (annualized percentages)										
Deposit rate [e]	12.2	11.5	11.2	11.1	11.3	11.2	11.0	10.9	11.0	18.9 [f]
Lending rate [g]	21.5	20.9	20.5	20.2	20.1	20.0	19.7	19.6	19.3	11.0 [f]
Interbank interest rate	7.3	7.3	8.0	8.7	8.3	7.5	7.5	7.7	7.5	7.5
Domestic credit (variation from same quarter of preceding year) [h]	10.4	14.7	15.9	18.4	18.4	19.0	16.9	15.7	14.9	...
Non-performing loans as a percentage of total credit [i]	11.9	13.5	10.9	9.6	9.7	9.4	8.6	6.9	6.9	7.2 [f]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Does not include maquila activities. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Weighted average rate on time deposits. [f] Data for April. [g] Weighted average rate on loans. [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Refers to total credit extended by the banking system.

The manufacturing industry expanded by 4.2%, half a percentage point more than in 2003. The most dynamic branch was the textiles and garment industry (9.2%), thanks to the upturn in maquila activity. Food, beverages and tobacco grew by 4.1%, whereas other subsectors showed lower rates of expansion.

The agricultural sector experienced a 7.1% upturn, thanks largely to the influence of traditional export crops. Banana production expanded by 19%, fifteen points more than in 2003. Following a 7.6% contraction, coffee production climbed by 11% and sugar cane was up by 10%, also recovering from a downturn in 2003. Crops for domestic consumption showed diverging trends, however: paddy rice and banana showed marked increases, whereas bean and corn production diminished.

Electricity, gas and water production expanded by 5.6%, while the transport, storage and communications sector grew at a slower rate (4.0%), as did commerce, restaurants and hotels (4.7%). The sector of financial institutions, insurance, real state and business services increased by 3.8%, while community, social and personal services were up by 7%. In sectoral terms, public administration and defence recorded strong growth (11.9%), reflecting the government's decision to prioritize security.

For the second consecutive year, the value added of maquila showed a double digit increase, this time of 17%. The country became the third largest exporter of made-up garments to the United States, surpassed only by China and Mexico, while the number of workers in the industry increased from 123,000 to 131,000.

The agricultural production index in the first quarter of 2005 was 4.3%, almost three points less than in 2004, while the industrial production index recorded a decline of almost 7%. Licensed construction continued to shrink (25.9%), giving rise to a slowdown in economic activity in 2005.

(b) Prices, wages and employment

Inflation, based on the consumer price index, showed a 9.2% variation up to December 2004, compared with 6.8% in 2003, owing to the rise in international oil prices and adverse weather conditions. The annual average inflation rate increased much less, since it stood at 8.1% in 2004, compared with 7.7% in 2003.

The rise in oil prices had an impact on costs of housing, water, electricity, gas and other fuels (10.3%) and transport (14.8%). There was also an escalation in the cost of education services (12.4%), which pushed up inflation further. Other categories recorded lower than average increases, in particular, communications, which increased only slightly (2.9%). Cumulative inflation to

April 2005 amounted to 3.7%, while the year-on-year variation was 9.4%.

The wholesale price index showed a sharper deterioration, moving from 4.7% in 2003 to 12.7% in 2004. The steepest rise occurred in national products (13.8%), while the variation in import prices was lower (9.9%).

Nominal minimum wages were raised by 9.7% on average, but, since the adjustment took effect in April, the real average minimum wage (deflated by average annual CPI variation) showed a slight decrease of 0.76%.

The labour market situation continued to deteriorate, notwithstanding the considerable expansion in economic activity. The national open unemployment rate increased from 5.1% in 2003 to 5.9% in 2004. In Tegucigalpa, the rate remained high at around 11%, while in San Pedro Sula, it moved from 6.7% to 8.4% in the same period. Underemployment also worsened, since the rate rose from 33.1% to 36.4%.

(c) The external sector

Robust external demand was reflected in a 13.5% increase in exports, but imports increased even further (18.7%). The current-account balance-of-payments deficit widened to 5.2% of GDP, while the terms of trade continued to deteriorate. The financial account recorded net income of US$ 730 million, partly due to the strong inflow of foreign direct investment.

Merchandise exports recorded their best performance (15.1%) since 1995. This trend included all the major categories, but the strongest increase came from traditional exports, which, after three years of decline, soared by 38%. The export value of bananas swelled by 57%, reflecting a favourable trend in both price and volume, following a 23% contraction in 2003. A similar pattern was observed for coffee exports, which shot up by 37.4%, as well as for sugar, silver and lead exports, which posted two-digit increases.

Non-traditional exports grew by 3.7%, half the rate recorded in the previous year. Pineapple and soaps and detergents, which expanded by one third, were the only two categories to perform strongly, while exports of other non-traditional exports stagnated or grew very slightly despite the increase in export volumes.

Booming economic activity and, in particular, the strong expansion of investments translated into a major increase in merchandise imports (20%). Consumer goods expanded by 5.8%, like in 2003, and the same occurred with imports of raw materials and intermediate goods, which were even more buoyant (17.8%). In this context, the oil bill increased by a fourth, while capital goods reversed their downward trend as they rocked by 54.2%, following a decline of 3.6% in 2003.

Merchandise exports were up by 21.2% in the first four months of 2005, eight points more than a year earlier. Export values climbed by 85% for bananas, 63% for tilapia and 31% for coffee. At the same time, merchandise imports rose by 13.2%, twelve points less than in 2004. Barring fuel purchases, which showed a 30% increase due to the high international price for oil, imports grew by only 10%. If this trend continues, the outcome may be a reduction in the external deficit in 2005.

The services trade deficit widened by US$ 40 million in 2004, despite a 13% increase in income from tourism. This, together with the widening of the merchandise deficit, was reflected in an increase in the aggregate trade deficit from US$ 1.145 billion to US$ 1.490 billion. Like other components of the current account, the income balance showed a deterioration (US$ 25 million). The only component to record a surplus was current transfers, thanks to family remittances, which rose by 31.9% to stand at US$ 1.135 billion or 15% of GDP.

The financial account recorded net income of US$ 730 million, over 10 times more than in 2003. Foreign direct investment totalled US$ 293 million, thanks to projects in the energy, telecommunications and maquila sectors. Net long-term capital inflows amounted to US$ 687 million, compared with just US$ 140 million in 2003. Loans to the private sector stood at US$ 137 million, loans to the public sector, represented US$ 279 million and loans to banks, amounted to US$ 66 million. Short-term inflows were positive (US$ 43 million) in 2004, compared with the negative figure recorded in 2003 (-US$ 80 million).

Mexico

1. General trends

In 2004, the Mexican economy grew by 4.4%, which was the highest rate since 2000 and translated into a considerable upturn in per capita GDP, following three years of sluggish performance. Aggregate demand swelled by 6% as a result of increased buoyancy in domestic and external demand. Exports were boosted by an upswing in manufacturing production in the United States, while consumption was strengthened by a rise in employment and credit and increased remittances. The improved economic outlook revived investment following a three-year downtrend. The increased pace of production activity was reflected in imports, resulting in a widening of the trade deficit. Higher revenues from petroleum exports and current transfers from abroad (in excess of US$ 17 billion) helped to reduce the balance-of-payments current account deficit to 1.1% of GDP, its lowest level since 1996.

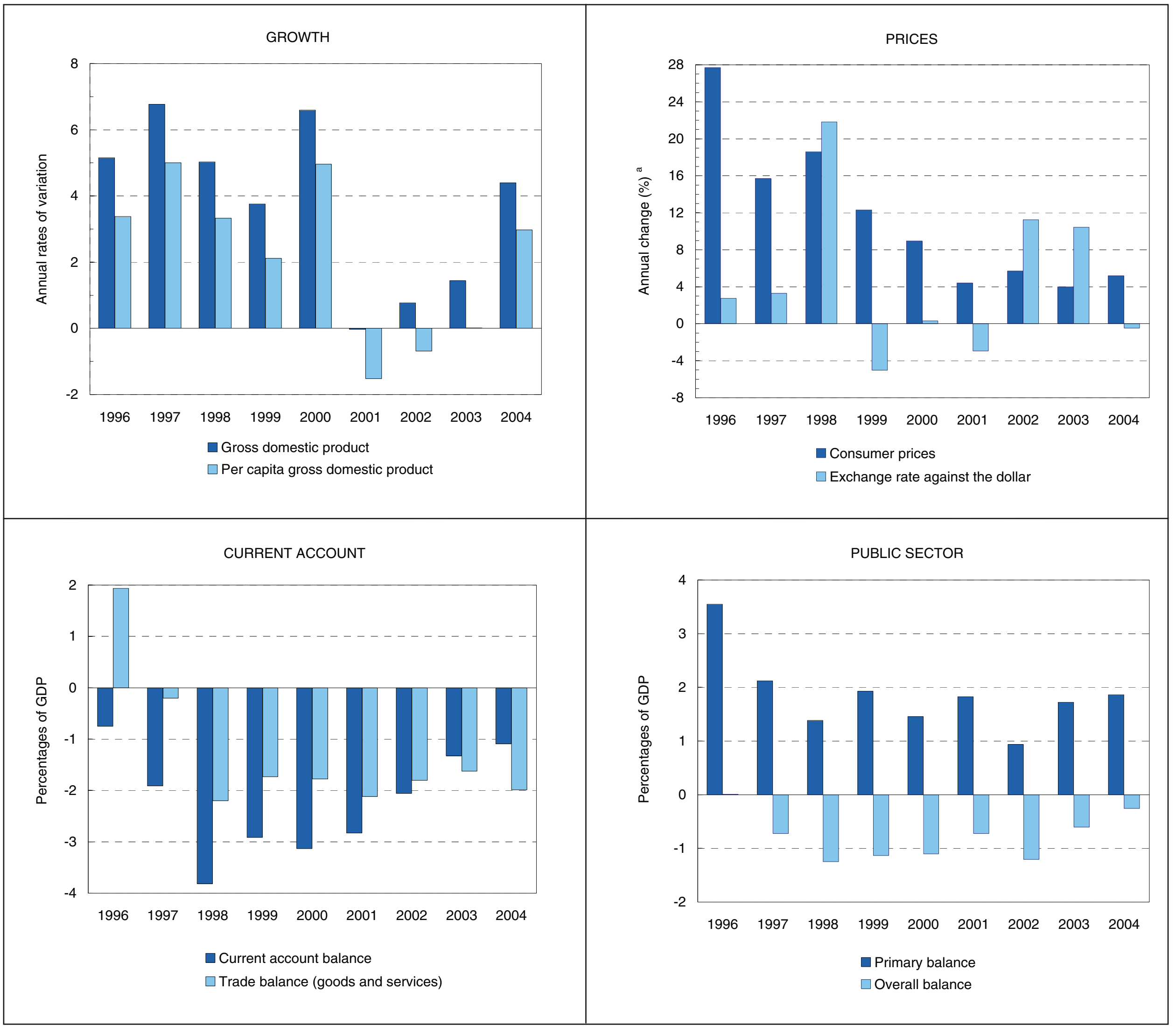
Economic policy continued to be guided by the principles of fiscal discipline and monetary stringency in the context of a floating exchange rate. Inflation exceeded the government's target, as it reached 5.19%, owing to adverse weather conditions affecting agriculture, increased rates for public services and high international prices for certain raw materials and petroleum. Oil revenues strengthened public finances and made it possible to increase expenditure and achieve the fiscal deficit target of 0.26% of GDP.

After falling in the first few months of 2004, interest rates mirrored the uptick observed in international rates. The benchmark interest rate, which is the rate on 28-day treasury bills (CETES), rose from 4.95% in the final week of January 2004 to 8.5% in December, encouraging foreign portfolio investment and contributing to a 2.6% real appreciation of the Mexican peso against the dollar.

Production was buoyant across all the sectors, which pushed up formal employment by 1.3% following three years of job losses, although this was a fairly subdued response to economic growth. Much of the labour supply was absorbed by informal employment, and the open unemployment rate rose from 3.2% in 2003 to 3.8% in 2004. Unit labour costs dropped again, continuing the trend first observed in 2002.

In the first quarter of 2005, the Mexican economy grew by 2.4%. This was less than the 3.9% recorded for the year-earlier period, reflecting the slowdown in the United States. In 2005, GDP is expected to grow by 3.6% and inflation will come in at around 3.9%.

Figure 1
MEXICO: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2. Economic policy

The core objective of economic policy was again to reduce inflation to levels similar to those in the United States.

(a) Fiscal policy

Budgetary revenues were 10% higher than the estimates formulated by the government at the beginning of the year, thanks to a 14.5% real increase in oil earnings. This revenue came to represent 36.1% of budgetary income, which was the highest figure recorded since 1987 and facilitated achievement of the fiscal target.

Non-petroleum tax revenue edged up by 0.8% in real terms. There were increases of 7.1% in receipts from value-added tax (VAT), 4.7% in taxes on imports and 1%

in the special tax on production and services, while income tax receipts decreased by 2.2%. In terms of GDP, non-petroleum tax revenue stood at 9.4%, which was four tenths of a percentage point lower than the three previous years. The income of non-petroleum enterprises and agencies rose by 1.8% in real terms, to 4.1% of GDP, as a result of increases in electricity rates and sales of the Federal Electricity Commission (CFE), plus higher contributions paid to the social security institutions, namely the Mexican Social Security Institute (IMSS) and the Social Service Institute for State Workers (ISSTE).

The level of non-recurrent government income permitted an in increase public spending (4.2% in real terms and 10.1% more than estimated) without endangering compliance with the fiscal target. Expenditure represented 23.5% of GDP, four tenths of a percentage point less than in 2003. In real terms, programmable spending rose by 3.9% as a result of lower outlays for personal services (including the voluntary separation programme for civil servants) and a 79% increase in capital expenditure. There were rises in transfers to states for social infrastructure development, infrastructure investment by Petróleos Mexicanos (PEMEX) and resources in the oil revenue stabilization fund.[1] Investment in PEMEX and CFE projects through the mechanism known as Projects with a Deferred Impact on Public Expenditure Recording (PIDIREGAS) rose to 18.3% in real terms, which helped to maintain the buoyancy of public investment, although less than in the previous biennium.

The public sector's financing requirements, which encompass all of its activities regardless of whether they are implemented by public or private entities, were equivalent to 1.85% of GDP, or 2.52% excluding non-recurrent public sector income that affects those requirements.

The unconsolidated net public-sector debt stood at 35% of GDP, which was 2.9 percentage points less than in 2003, thanks to a reduction in all the components (domestic and external debt plus additional items) except PIDIREGAS debt, which represented 5.24% of GDP (0.45 tenths of a percentage point more than in 2003).

(b) Monetary policy

As in previous years, the main aim of monetary policy was to keep inflation within a range of one percentage point on either side of the target of 3%. The principal instrument of monetary policy is the "corto", which is employed to influence nominal interest rates indirectly by setting a target for commercial banks' daily current-account balances in the central bank.

To offset the inflationary effects of international price increases on a number of raw materials, as well as potential pressure from aggregate demand, the central bank raised the corto several times, from 25 million pesos in January to 69 million in December. In addition, at the end of the year it required financial institutions to create a monetary regulation deposit of 50 billion pesos (about US$ 4.386 billion) as an additional measure to tighten liquidity.

The tight monetary policy pushed up interest rates. The interest rate on 28-day treasury bills (CETES), which had fallen to 4.69% in the last week of January 2004, climbed to 8.61% in the last week of December. In real terms, the average annual yield on CETES was 1.8%, despite which the real yield on bank bills was negative by 2%. In any event, the tight monetary stance did not affect the upswing in gross fixed capital formation over the year.

The money supply swelled by 8.75% in real terms. Mexico has been gradually remonetizing its economy since the 1995 crisis, and the monetary base expanded from 3.61% of GDP to 3.72%. The broadest monetary aggregate (M4, which includes all private-sector financial savings) grew by 7.98% in real terms to represent 48.8% of GDP.

Thanks to an upturn in bank credit, the domestic financing of the non-financial private sector rose by 9.6% in real terms, compared with 0.4% in 2003. Commercial bank credit for consumer and mortgage loans were significant components of this trend (up 42.2% and 24.9%, respectively), while business lending by commercial banks also picked up (18%). Total corporate credit from bank and non-bank institutions declined, however, by 0.4%, compared with a 1.8% decrease recorded in 2003. Non-bank financial intermediaries continued to expand their operations (18.6%). Prominent among these were institutions known as limited purpose financial companies (SOFOLES), which specialize in mortgage lending, and whose share of total SOFOLE and commercial bank mortgage lending now stands at 45%.

(c) Exchange-rate policy

Generally speaking, there was a strong supply of United States dollars in the economy in 2004, owing to a high level of remittances, FDI and buoyant hydrocarbons exports. The foreign-exchange market experienced short-lived periods of sharp volatility in the course of the year,

[1] Congress ruled that part of the PEMEX tax burden for 2004 would be directly invested in capital infrastructure, i.e., operations linked to gas extraction, exploration, refining and petrochemicals.

Table 1

MEXICO: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	5.2	6.8	5.0	3.8	6.6	0.0	0.8	1.4	4.4
Per capita gross domestic product	3.4	5.0	3.3	2.1	5.0	-1.5	-0.7	0.0	3.0
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	3.8	0.2	3.0	1.5	0.4	5.9	-0.9	4.1	4.0
Mining	8.1	4.5	2.7	-2.1	3.8	1.5	0.4	3.7	2.5
Manufacturing	10.8	9.9	7.4	4.2	6.9	-3.8	-0.7	-1.3	3.8
Electricity, gas and water	4.6	5.2	1.9	7.9	1.0	12.0	1.0	1.6	2.3
Construction	9.8	9.3	4.2	5.0	4.2	-5.7	2.1	3.3	5.3
Wholesale and retail commerce, restaurants and hotels	4.8	10.7	5.6	3.1	12.2	-1.2	0.0	1.6	4.9
Transport, storage and communications	8.0	9.9	6.7	7.8	9.1	3.8	1.8	5.0	9.7
Financial institutions, insurance, real estate and business services	0.6	3.7	4.6	3.6	5.5	4.5	4.2	3.9	4.6
Community, social and personal services	1.0	3.3	2.9	2.1	2.9	-0.3	0.9	-0.6	1.7
Gross domestic product, by type of expenditure									
Consumption	1.8	6.0	5.0	4.4	7.4	1.9	1.4	2.1	4.7
General government	-0.7	2.9	2.3	4.7	2.4	-2.0	-0.3	0.8	-1.2
Private	2.2	6.5	5.4	4.3	8.2	2.5	1.6	2.3	5.5
Gross domestic investment	25.7	24.8	10.5	4.0	11.5	-3.4	-1.4	-4.0	1.8
Exports (goods and services)	18.2	10.7	12.1	12.4	16.4	-3.8	1.6	2.7	11.5
Imports (goods and services)	22.9	22.7	16.6	14.1	21.5	-1.6	1.5	0.7	10.2
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	23.1	25.9	24.3	23.5	23.7	20.9	20.6	20.6	21.8
National saving	22.4	24.0	20.5	20.6	20.6	18.1	18.6	19.2	20.7
External saving	0.8	1.9	3.8	2.9	3.1	2.8	2.1	1.3	1.1
	Millions of dollars								
Balance of payments									
Current account balance	-2 500	-7 666	-16 073	-13 999	-18 188	-17 579	-13 347	-8 453	-7 394
Merchandise trade balance	6 533	623	-7 915	-5 584	-8 003	-9 617	-7 633	-5 779	-8 811
Exports, f.o.b.	96 002	110 431	117 459	136 391	166 455	158 780	161 046	164 766	187 999
Imports, f.o.b.	89 469	109 808	125 374	141 975	174 458	168 396	168 679	170 546	196 810
Services trade balance	-94	-1 433	-1 350	-2 737	-2 323	-3 558	-4 048	-4 601	-4 649
Income balance	-13 473	-12 106	-12 820	-11 992	-14 856	-13 743	-11 934	-11 931	-10 977
Net current transfers	4 534	5 250	6 012	6 313	6 994	9 338	10 268	13 858	17 044
Capital and financial balance [d]	4 448	28 126	12 572	18 249	25 314	24 904	20 436	17 891	11 452
Net foreign direct investment	9 186	12 831	11 897	13 055	16 075	23 317	14 396	9 879	13 112
Financial capital [e]	-4 738	15 295	675	5 194	9 239	1 587	6 041	8 011	-1 660
Overall balance	1 948	20 460	-3 501	4 250	7 126	7 325	7 090	9 438	4 058
Variation in reserve assets [f]	-1 805	-10 513	-2 118	-596	-2 862	-7 325	-7 090	-9 438	-4 058
Other financing [g]	-144	-9 948	5 619	-3 654	-4 265	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	138.5	119.9	119.0	108.8	100.0	93.4	92.9	104.5	109.5
Terms of trade for goods (index: 2000=100)	90.8	89.5	90.6	99.3	100.0	97.4	97.9	98.8	101.6
Net resource transfer (percentage of GDP)	-2.8	1.5	1.3	0.5	1.1	1.8	1.3	0.9	0.1
Total gross external debt (billions of dollars)	157.2	149.0	160.3	166.4	148.7	144.5	134.7	132.0	130.5
Total gross external debt (percentage of GDP)	47.3	37.2	38.1	34.6	25.6	23.2	20.8	20.7	19.3
Net profits and interest (percentage of exports) [i]	3.8	3.1	4.1	2.4	4.0	3.7	2.3	2.4	2.3
	Average annual rates								
Employment									
Labour force participation rate [j]	55.4	56.2	56.5	55.8	56.3	55.6	55.1	55.6	56.4
Open unemployment rate [k]	5.5	3.7	3.2	2.5	2.2	2.5	2.7	3.3	3.8
Visible underemployment rate [k]	16.0	14.8	12.2	11.3	11.7	11.1	10.0	10.5	11.6

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	27.7	15.7	18.6	12.3	9.0	4.4	5.7	4.0	5.2
Variation in the national producer price index (December-December)	25.3	10.5	17.5	12.5	6.4	1.3	9.2	6.8	8.0
Variation in nominal exchange rate (December-December)	2.8	3.3	21.8	-5.0	0.3	-2.9	11.2	10.4	-0.5
Variation in average real wage	-9.9	-0.6	2.8	1.5	6.0	6.7	1.9	1.3	0.1
Nominal deposit rate [l]	...	20.0	22.4	20.9	14.6	11.0	6.2	5.2	5.4
Nominal lending rate [m]	...	22.1	26.4	23.7	16.9	12.8	8.2	6.9	7.2
				Percentages of GDP					
Public sector									
Budgetary revenues	23.0	23.1	20.4	20.8	21.6	21.8	22.2	23.2	23.2
Programmable current spending	12.0	12.8	12.4	12.5	13.0	13.3	13.8	14.6	13.7
Primary balance	3.6	2.1	1.4	1.9	1.5	1.8	0.9	1.7	1.9
Overall balance	0.0	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6	-0.3
Net public debt [n]	38.2	31.1	33.5	30.1	27.0	25.8	27.5	27.6	26.1
Domestic	7.6	8.6	9.8	11.0	12.3	13.1	14.5	14.7	14.4
External	30.6	22.5	23.7	19.1	14.7	12.6	13.0	12.9	11.7
Money and credit [o]									
Domestic credit [p]	...	38.3	39.9	37.2	37.0	37.5	36.6	36.6	35.5
To the public sector	...	15.9	16.6	17.2	19.1	20.0	19.2	19.5	19.2
To the private sector	...	22.4	23.3	20.0	17.9	17.5	17.4	17.1	16.3
Liquidity (M3)	35.1	36.3	38.1	40.2	40.1	44.0	46.3	47.1	48.0
Currency in circulation and local-currency deposits (M2)	33.8	35.1	36.8	38.8	38.7	42.6	44.6	45.6	46.6
Foreign-currency deposits	1.3	1.3	1.3	1.4	1.4	1.5	1.6	1.4	1.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, urban areas. [k] Unemployment and underemployment rates as percentages of the economically active population, urban areas. [l] Cost of term deposits in local currency in the multibanking system. [m] Lending rate published by IMF. [n] Refers to (consolidated) net debt reported by the Banco de México. [o] The monetary figures are annual averages. [p] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

mainly as a result of international interest-rate hikes (particularly in the United States) and expectations of further increases. The rise in domestic rates helped to stabilize the price of the peso in relation to the dollar, which resulted in an average nominal depreciation of 4.4% and a slight real appreciation of 2.6%.

Net international reserves swelled by US$ 4.058 billion to reach US$ 61.493 billion at the end of 2004, despite the central bank's continued use of the mechanism it has employed since May 2003 to slow the build-up of international reserves, by auctioning a fixed amount of dollars daily. In 2004, US$ 6.712 billion were sold in this way.

3. Production, employment and prices

(a) Economic activity

The manufacturing sector expanded by 3.8%, as a result of strong growth in base metals (6%); non-metal mineral products (5.2%); metal products, machinery and equipment (up by 5.1% following three years of decline); and chemicals and petroleum products (3.8%). To a lesser extent, production also improved in the segments of paper

Table 2
MEXICO: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	2.5	0.1	1.0	2.1	3.9	4.1	4.6	4.9	2.4	...
Merchandise exports, f.o.b. (millions of dollars)	39 051	40 245	41 543	43 927	43 193	32 662	47 874	49 543	46 827	...
Merchandise imports, f.o.b. (millions of dollars)	39 189	41 891	42 972	46 493	43 718	33 083	50 013	54 918	48 772	...
International reserves (millions of dollars)	51 096	52 899	51 418	56 086	58 406	58 407	56 887	61 496	61 363	60 655
Real effective exchange rate (index: 2000=100) [c]	104.0	101.7	104.0	108.6	106.5	110.5	111.0	109.9	108.9	107.8 [d]
Urban unemployment rate	2.8	3.0	3.8	3.5	3.9	3.7	4.1	3.5	3.9	4.0
Consumer prices (12-month percentage variation)	5.6	4.3	4.0	4.0	4.2	4.4	5.1	5.2	4.4	4.3
Average nominal exchange rate (pesos per dollar)	10.81	10.46	10.70	11.18	10.98	11.38	11.45	11.33	11.18	10.96
Average real wage (variation from same quarter of preceding year)	1.1	1.0	2.2	1.2	1.4	0.5	-0.2	-1.3	-0.2	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	6.9	5.4	3.9	4.3	4.5	5.0	5.6	6.5	7.2	7.9
Lending rate [f]	9.8	6.9	5.1	5.9	6.0	6.7	7.5	8.6	9.4	10.0 [d]
Interbank interest rate	9.7	6.8	5.1	5.8	5.9	6.7	7.5	8.5	9.4	10.0
Sovereign bond spread (basis points)	291	237	212	199	183	215	188	166	180	168
Stock price index (in dollars, December 2000=100)	87	105	111	123	148	141	149	183	178	198
Domestic credit (variation from same quarter of preceding year) [g]	12.8	8.7	10.7	6.1	8.0	8.4	5.2	8.6	7.0	9.4 [h]
Non-performing loans as a percentage of total credit [i]	4.6	4.2	3.7	3.2	3.2	3.0	2.7	2.5	2.4	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Cost of term deposits in local currency in the multibanking system. [f] Lending rate published by IMF. [g] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [h] Data for April. [i] Refers to total credit extended by the multibanking system.

(1.9%); textiles and clothing (1.6%); timber (0.6%); and other manufacturing industries (2.6%).

Construction continued to grow (5.3%), partly thanks to housing projects that have benefited from the upturn in credit (particularly non-bank loans). Construction also received a boost from water, irrigation and sanitation projects and petroleum extraction and petrochemical operations, while construction activity in the electricity and transport sectors declined. There was also an improvement in the performance of the mining industry (2.5%) and the generation of electricity, gas and water (2.3%), although the latter waned in the last quarter of 2004.

Automobile production contracted for a fourth consecutive year (1.1%). The sector's exports also dropped 5.9% due the problems faced by United States companies in terms of foreign competition, mainly from Asia and Europe. Domestic vehicle sales, on the other hand, were boosted by the availability of financing from banks and motor vehicle distributors, rising by 12.1% (the highest rate in four years).

Agriculture grew by 4%, the highest rate since the 7.3% recorded in 1990. In the first half of the year, agricultural production benefited from favourable weather conditions, while excessive rainfall during the rest of the year marred the supply of certain fruit and vegetables on the domestic market. In the livestock sector, beef, pork and poultry production, eggs and milk all performed well.

Services, which represent 65% of GDP, expanded by 4.8%. The increase was headed by transport, storage and communications (9.7%); followed by commerce, restaurants and hotels (4.9%); financial services, insurance and real estate (4.6%); and community, social and personal services (1.7%).

Private consumption, which accounts for 73% of GDP, climbed by 5.5%, which was 2.5 times higher than the average for the previous three years. This, in turn, bolstered demand. Another factor in the upswing was a real increase of 18.5% in bank and non-bank household credit, mainly in the form of consumer loans. Bank loans (which represent 59% of consumer credit) were up 39.1% in real terms while non-bank credit rose by 7.9%.

Following two years of decline and one of meagre growth, fixed gross capital formation increased by 7.5% (the highest rate since 1999) to stand at 19.8% of GDP. The main driving force behind this was private investment, after three years of contraction. In particular, investment in machinery and equipment expanded by 9.7% and both private and public construction remained buoyant. Growth in total public investment slowed for the second year in a row, although it still posted a significant rate of 3.6%. The bulk of public investment (87%) went to construction.

(b) Prices, wages and employment

The increase in the consumer price index (5.19%) was mainly due to higher prices of raw materials (especially foods) and price adjustments for public transport at the beginning of the year and for certain fruits and vegetables in the second half of the year.

Non-core inflation stood at 8.2%, as a result of increases for goods with administered and negotiated prices (7.51%), particularly domestic gas, electricity, agricultural products including tomatoes, poultry, beef and eggs (10.11%) and education (7.5%). Core inflation was 3.8% (0.14 percentage points above the 2003 level). This was attributable to increases in processed food prices, which were, in turn, partly offset by slower rises in the price of services.

The formal labour market was slow to respond to the upturn in output. The number of jobs registered with the Mexican Social Security Institute (IMSS) increased by only 1.3%, indicating that the average number of jobs in 2004 was 1% lower than in 2000. Employment in the manufacturing sector dipped by 2.6%, while it rose by 4.7% in the maquila export sector following three years of decline.

The open unemployment rate climbed from 3.25% to 3.75% in 2004, while permanent employment edged up by a mere 1.2% after falling for three straight years. This suggests that the informal sector continues to absorb considerable proportions of the labour force, given that around 1.2 million people are estimated to join the workforce each year. The economically active population currently numbers 41.1 million people, of whom over a quarter (11.5 million) are thought to work informally (mainly in the tertiary sector). The National Institute of Statistics, Geography and Informatics (INEGI) estimates that informal activity accounts for around 13% of output.

Productivity per worker rose in the main production sectors: by 6.3% in manufacturing; 2.4% in the maquila industry; and by 7.9% in commerce. Real wages remained flat in manufacturing, fell by 0.2% in the maquila sector and climbed 2.7% in commerce. Continuing the trend observed since 2002, this meant that unit labour costs dropped in all sectors: 5.8% in manufacturing, 2.6% in maquila activity and 4.8% in commerce.

(c) The external sector

The balance-of-payments current-account deficit stood at US$ 7.394 billion, or 1.1% of GDP. A prominent feature was the upswing in external demand, which bumped up both petroleum and non-petroleum exports. Yet the merchandise trade balance was negative, since imports increased following a virtual standstill. This deficit was offset by a strong rise in remittances.

Following three years of inertia, the total value of merchandise exports climbed to US$ 188 billion, which surpassed the level reached in 2000 for the first time. The value of petroleum exports climbed by 27%, mainly thanks to higher prices (US$ 31.02 per barrel —the highest in 23 years), since the volume sold was only 1.7% more than the previous year.

Non-petroleum exports amounted to over US$ 164 billion. Almost all the subsectors recorded increases except exports of passenger cars, which declined by 5.7%. Mining and quarrying exports swelled by 82%. Particularly notable were the increases in exports of crude copper (148%) and agricultural products, which were up 13%, mainly thanks to increased sales of fresh vegetables, melon, watermelon, other fresh fruit and livestock.

Manufacturing exports (84% of the total) climbed by 12% to almost US$ 158 billion. Good performances were recorded in sales of metal products, machinery and equipment (12%) —which accounted for 63% of manufacturing exports— and petrochemical products (69%), steel (45%), metal mining (39%) and petroleum products (21%). The textile sector posted an upturn of 2% following three years of decline, and the exports of the timber industry were up 11%. Food, beverages and tobacco continued to expand (12%).

Despite this, Mexico's exports continued to lose competitiveness and market share in the United States, the country's main export destination. The value of total United States imports grew by 17% in the year, with China's market share expanding from 12.1% in 2003 to 13.4% in 2004, while Mexico's shrank from 11.0% to 10.6%.

The growth of exports and domestic spending fuelled imports, which represented almost US$ 197 billion (14% more than in 2003). As a result, the merchandise trade deficit widened by more than 50%, to stand at US$ 8.811 billion. There were major increases in the three main categories of imports: consumer goods (18%), intermediate goods (16%) and capital goods (12%). The recovery of maquila exports bolstered imports of intermediate goods (which represent 76% of imports), which rose by 15%. Purchases of capital goods (11% of imports) expanded following three consecutive years of decline. Prominent among imports of consumer goods were television sets, electrical and electronic appliances, gasoline and automobiles.

Imports of agricultural goods rose at a slower rate than the previous year (7.9%, compared to 9.1% in 2003). The fastest-growing were sorghum (6.1%) and soybean (3.7%), while imports of beef cattle continued to slide (47%).

Mexico's imports from China have increased considerably since 1996. Chinese imports rose from 1.1% of Mexico's total imports in 1996 to 13% in 2004, while imports from the United States dropped from 75.5% to 56.2% in that period. Chinese imports have hurt production in several industries, and they are often alleged to be associated with smuggling and unfair trade practices.

Current transfers from abroad climbed by 25% to stand at over US$ 17 billion. This was equivalent to 2.6% of GDP, which was double the income from tourism or 80% of hydrocarbon exports, representing a similar amount to foreign direct investment income. These transfers fuelled consumption in many households, particularly in rural areas.

The financial account recorded income of US$ 13.692 billion, which was 24% more than in 2003. There was an increase in flows of FDI and portfolio investment, while external debt declined (both in the public and private sectors) and assets held abroad by Mexican residents expanded. Income from foreign direct investment amounted to US$ 16.602 billion, 48% of which corresponded to new investments, 15% to reinvestment of profits and 37% to accounts with the parent company. Within total FDI, 25% corresponded to the purchase of Mexican-owned Bancomer shares by the Spanish group BBVA, for US$ 4.2 billion. The manufacturing sector absorbed 52% of FDI; financial services, 29.9%; transport and communications, 7.8%; and commerce, 5.6%. The main investors were the United States (48%); Spain (34.7%); Switzerland (7.2%), Canada (2.1%); Germany (2.1%) and the Netherlands (1.5%).

Portfolio investment surged from US$ 779 million in 2003 to US$ 2.671 billion in 2004, in response to attractive returns on the money market, which brought in a total of US$ 5.193 billion. This revenue offset an outflow of US$ 2.522 billion from the equity market. Mexican-held assets abroad, in the form of bank balances and direct investment, swelled by US$ 4.588 billion.

Nicaragua

1. General trends

In 2004 the Nicaraguan economy continued the recovery begun in 2003, after two years of lacklustre growth. Progress was made towards consolidating overall macroeconomic stability in the framework of the three-year programme signed with the International Monetary Fund (IMF) in 2002. Real GDP increased by 5.1% and per capita GDP, by 2.5%, following two years of decline. This performance was driven by buoyant exports and an expansion of domestic demand engendered by higher investment (especially in the public sector).

The open unemployment rate dropped from 7.7% to 6.5%. Real average income grew by only 0.3%, however, due to an uptick in inflation (which reached 9.3%) caused mainly by rising international prices for petroleum and a number of industrial commodities.

Although the fiscal deficit narrowed, increased financial resources made it possible to step up public spending on investment and poverty reduction efforts, as well as to lower the level of indebtedness to the financial sector (particularly the central bank). Monetary policy was fairly expansionary. In order to contain inflationary pressure, and given the high rate of exchange-rate pass-through to prices, the authorities reduced the devaluation rate from 6% to 5%. Bank deposits and credit levels surged, while real interest rates continued to trend downwards.

In the external sector, the balance-of-payments current-account deficit narrowed slightly, which combined with higher capital inflows to swell international reserves.

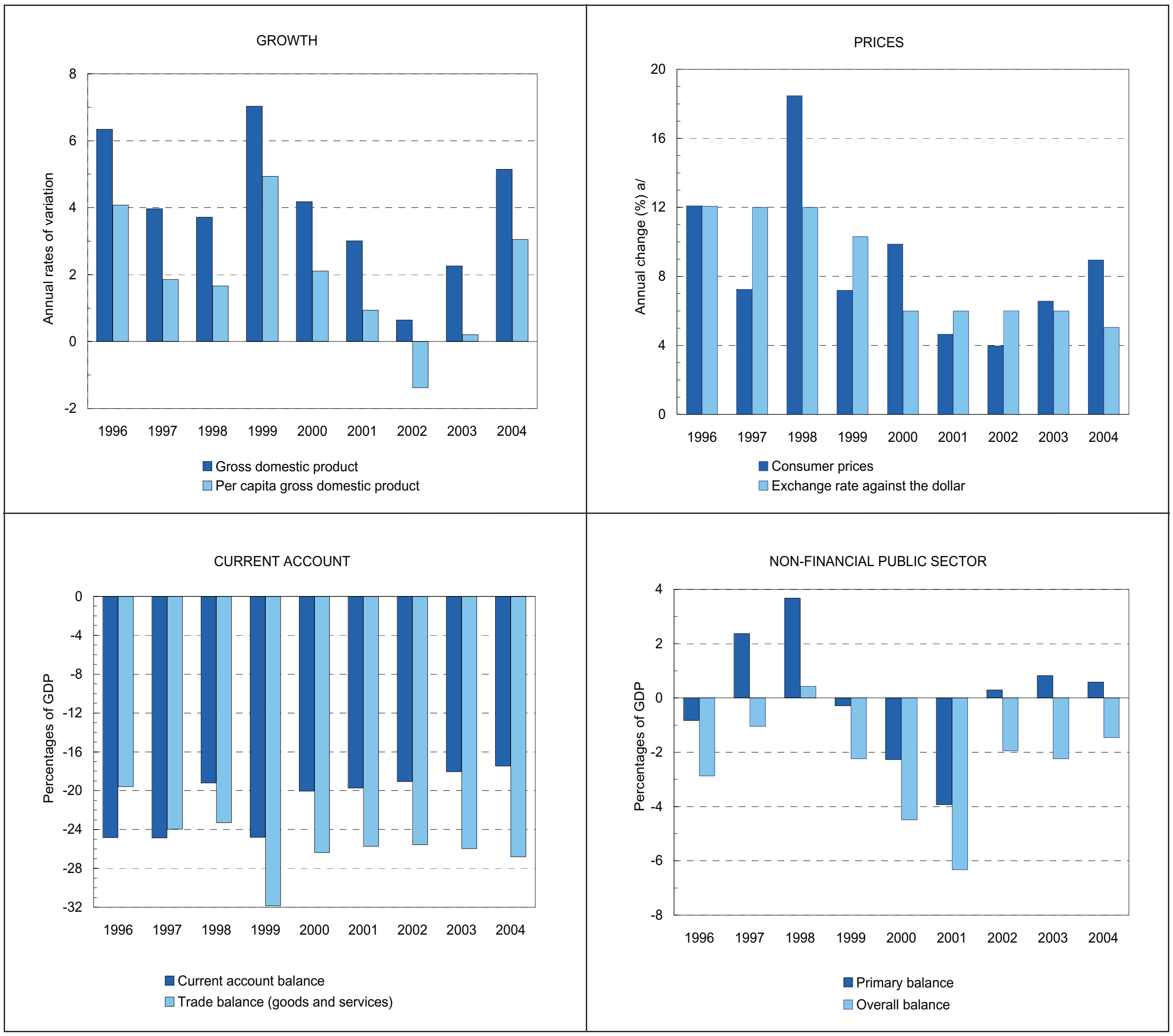
In March, Nicaragua reached completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. This enabled the cancellation of 18% of the balance of the country's external public debt, which thus stood at US$ 5.391 billion at the end of the year (the lowest level in 20 years).

ECLAC projects real GDP growth of between 3.5% and 4% in 2005, while inflation is expected to come in at 8.5%-9%. The devaluation rate will probably remain at 5%. In a pre-electoral year, the fiscal deficit is likely to widen slightly, while the balance-of-payments current-account deficit will narrow to 17% of GDP.

2. Economic policy

In the context of a deteriorating political climate and serious governance problems, intensified electioneering could affect economic performance in 2005. Much will depend on the outcome of political disputes that have hampered the approval of the 2005 budget and prevented the presentation of a proposal to negotiate a new economic programme with the International Monetary Fund (IMF), particularly as regards delayed structural reforms. In these circumstances, a number of international financial institutions and donor countries have warned that the provision of resources will be contingent upon the continuity of the IMF programme. A sharp drop in income from those sources would require a major fiscal and monetary adjustment, which would reduce liquidity, push up interest rates and have a recessionary impact.

Figure 1
NICARAGUA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

In 2004, the government's economic programme aimed to stimulate growth in a context of macroeconomic stability, by deploying a prudent and more transparent fiscal policy, gradually reducing the domestic debt stock and building up international reserves.

Nicaragua's achievements in terms of growth and macroeconomic stability stood in contrast with its limited progress in structural reform, due to lack of parliamentary support for the initiatives of the executive branch. This prevented the adoption of important legislative proposals, such as the extension of legal protection to officials of the superintendency of banks and other financial institutions and a fiscal responsibility act. As regards pension system reform, the authorities suspended the introduction of a system based on privately administered personal retirement-savings accounts until the fiscal implications have been clearly worked out.

(a) Fiscal policy

The outcome of Nicaragua's fiscal policy will be a key determinant of its macroeconomic performance in 2005.

The country's IMF programme has not been reviewed since October 2004, with one of the main obstacles being the National Assembly's decision to raise the budgetary expenditure ceiling for 2005. Following the approval of tax reforms in June, however, the central government deficit should be close to the previous year's figure.

In 2004, the central government deficit narrowed without sacrificing spending on public investment or on Nicaragua's poverty reduction strategy. This was achieved mainly thanks to higher tax receipts (generated by the reforms implemented in 2002 and 2003), improved tax administration and a reduction in public debt servicing. An increase in international assistance in the form of grants and soft loans, as well as non-recurrent income from the sale of shares in the Nicaraguan Telecommunications Company (ENITEL), also helped to narrow the fiscal deficit. The management of public finances, especially the reduction in net government borrowing from the central bank, thus facilitated the fulfilment of monetary policy targets.

The central government's current revenues expanded by 20.5% and the tax burden rose to 16.3% of GDP (which was higher than the 15.7% recorded the previous year). This was in addition to grants, which remained at 3.3% of GDP. Consequently, total revenue rose from 19.5% of GDP in 2003 to 20.1% in 2004. The fastest-growing revenue items were income tax, value added tax and customs duties.

Total expenditure remained constant at 22.3% of GDP. This reflected two factors. The first was a dip in current expenditure from 14.1% of GDP to 12.9%, which was mainly because of a drop in interest payments, from 3.1% to 2.0% of GDP, following the cancellation of a large part of the external debt. The second was the reduction in interest rates paid on central bank paper issued to control the monetary base and bail out the banking system during the crisis of 2000-2001. Despite strongly rising capital expenditure (24.3%), the fiscal deficit therefore shrank from 6.1% of GDP in 2003 to 5.4% in 2004 (not including grants). The improvement is smaller (from 2.8% of GDP to 2.2%), however, when grants are factored in. Notably, the government transferred the equivalent of 4.4% of GDP to the central bank, but external financing rose again to stand at 6.1% of GDP.

In 2004, the external public debt fell to US$ 5.391 billion, which was 18% lower than the balance at the end of 2003. By the end of 2004, Nicaragua had negotiated debt relief for US$ 3.826 billion in the framework of the HIPC Initiative, and US$ 3.652 billion had been written off out of a total of US$ 6.328 billion in scheduled relief.

(b) Monetary policy

In 2005, monetary policy will be directed towards keeping prices stable, improving the central bank's financial position and building up international reserves. Monetary policy was slightly expansionary in 2004. The main aims were to ensure that international reserves remained at a level conducive to the maintenance of exchange-rate stability as an anchor against inflation, and to reduce the central bank's domestic debt in order to improve its operating balance and increase liquidity in the banking sector, thus narrowing interest-rate spreads.

The fiscal adjustment swelled net international reserves through transfers of resources from the government to the central bank. This was in addition to access to external resources to finance the overall balance-of-payments deficit. As international reserves expanded, the central bank's domestic debt continued to shrink, which reduced its liabilities and lowered the cost of refinancing. The injection of liquidity also helped to bring down real interest rates.

Liquidity climbed by 18%, which exceeded the 15.8% growth rate of nominal GDP. This shifted the pattern of credit to the private sector, which picked up by 30%. Almost 60% of new loans consisted of consumer credits. Business loans and personal and credit card lending were up, and the remainder went mainly to the mortgage sector (19%).

(c) Exchange-rate policy

In 2005, the authorities will continue to apply daily mini-devaluations of the local currency consistent with a pre-announced annual rate, or crawling-peg system. In 2004, the central bank lowered the devaluation rate from 6% to 5% on the grounds that slower annual devaluation would help to ease inflationary pressures, given the strong link between inflation and the annual rate of devaluation. However, this measure did not affect the real exchange rate, which remained practically constant.

(d) Other policies

As regards structural reform, significant developments in 2005 were the adoption of the Tax Code, the submission of a financial administration bill to the executive branch, and the presentation of a final proposal for reforming the pensions system. In addition, the rules governing financial activity were changed with a view to strengthening bank supervision and bolstering the deposit guarantee fund (FOGADE).

Trade policy continued to be directed towards increasing economic openness in 2004. Nicaragua approved the entry of the Dominican Republic into the free trade agreement between Central America and the United States and participated in efforts to expedite the trade integration process in Central America.

Table 1

NICARAGUA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	6.3	4.0	3.7	7.0	4.2	3.0	0.6	2.3	5.1
Per capita gross domestic product	4.1	1.9	1.7	4.9	2.1	0.9	-1.4	0.2	3.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	9.4	-0.6	-0.4	6.5	12.6	2.1	-0.6	2.9	6.0
Mining	22.6	16.1	36.2	19.1	-14.9	4.8	13.0	-8.4	19.7
Manufacturing	7.6	7.6	-0.3	5.0	6.0	6.6	1.6	2.5	6.6
Electricity, gas and water	3.8	4.9	11.0	0.1	-0.2	0.1	19.8	5.2	5.1
Construction	-1.4	-8.6	-1.4	39.1	0.3	0.2	-14.5	3.9	10.7
Wholesale and retail commerce, restaurants and hotels	8.1	5.6	7.2	10.3	4.0	3.9	-2.0	2.5	5.9
Transport, storage and communications	9.0	3.9	6.5	9.2	2.0	0.4	4.3	3.1	3.2
Financial institutions, insurance, real estate and business services	4.1	6.3	8.4	7.6	3.9	1.6	5.9	4.3	8.4
Community, social and personal services	-0.5	3.8	2.6	4.7	-2.6	0.5	11.8	1.9	1.6
Gross domestic product, by type of expenditure									
Consumption	3.4	3.7	4.7	4.5	3.8	2.4	8.4	3.7	3.3
General government	1.8	-4.1	4.4	8.2	3.7	-4.5	-1.9	3.0	2.8
Private	3.6	4.6	4.7	4.1	3.8	3.2	9.5	3.7	3.3
Gross domestic investment	21.3	23.6	4.3	31.2	-13.1	-6.0	-16.1	-5.5	9.8
Exports (goods and services)	16.2	14.4	5.8	12.3	12.5	10.8	-6.5	7.9	15.8
Imports (goods and services)	12.9	22.1	7.2	20.7	-5.3	0.1	1.4	4.4	9.4
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	25.8	31.2	31.0	39.6	33.4	31.0	26.1	26.1	28.4
National saving	0.9	6.3	11.8	14.8	13.3	11.2	7.0	8.0	11.0
External saving	24.8	24.8	19.2	24.8	20.0	19.7	19.1	18.1	17.5
	Millions of dollars								
Balance of payments									
Current account balance	-825	-841	-687	-928	-792	-797	-767	-749	-795
Merchandise trade balance	-527	-728	-749	-1 071	-921	-910	-918	-972	-1 112
Exports, f.o.b.	595	745	761	749	881	708	681	749	910
Imports, f.o.b.	1 122	1 473	1 510	1 820	1 802	1 617	1 599	1 720	2 022
Services trade balance	-124	-83	-84	-120	-122	-129	-112	-106	-110
Income balance	-324	-265	-185	-197	-202	-240	-200	-191	-192
Net current transfers	150	235	331	460	453	483	462	519	619
Capital and financial balance [d]	77	548	285	533	336	525	575	575	717
Net foreign direct investment	120	203	218	337	267	150	204	201	250
Financial capital [e]	-43	344	66	196	69	375	371	373	467
Overall balance	-748	-293	-402	-395	-456	-272	-192	-175	-78
Variation in reserve assets [f]	-53	-173	30	-157	17	119	-72	-52	-161
Other financing [g]	801	466	372	552	439	153	264	226	239
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	99.8	101.2	101.3	101.9	100.0	101.1	103.1	107.2	109.1
Terms of trade for goods (index: 2000=100)	84.4	82.0	79.6	95.3	100.0	88.4	87.0	84.1	82.5
Net resource transfer (percentage of GDP)	16.7	22.1	13.2	23.7	14.5	10.8	15.9	14.7	16.8
Gross external public debt (millions of dollars)	6 094	6 001	6 287	6 549	6 660	6 374	6 363	6 596	5 391
Gross external public debt (percentage of GDP)	183.5	177.4	176.0	175.0	168.5	157.8	158.0	159.0	118.3
Net profits and interest (percentage of exports) [i]	6.2	5.9	6.2	6.5	6.3	8.3	7.9	7.6	6.7
	Average annual rates								
Employment									
Labour force participation rate [j]	48.9	...	...	...	...	…	57.5	...	...
Open unemployment rate [k]	16.0	14.3	13.2	10.7	8.3	11.3	11.6	10.2	9.3
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	12.1	7.3	18.5	7.2	9.9	4.7	4.0	6.6	8.9
Variation in nominal exchange rate (December-December)	12.1	12.0	12.0	10.3	6.0	6.0	6.0	6.0	5.0
Variation in average real wage	-3.8	3.7	4.0	4.0	0.0	1.0	3.5	1.9	-2.2
Nominal deposit rate [l]	...	...	...	...	...	11.6	7.8	5.6	4.7
Nominal lending rate [m]	...	...	...	...	...	18.6	18.4	15.5	13.5

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
					Percentages of GDP				
Non-financial public sector									
Current income	18.6	20.2	22.2	20.7	19.4	19.1	21.2	22.6	23.3
Current expenditure	15.3	15.6	16.3	15.5	16.6	18.7	20.7	22.0	21.3
Current balance	3.1	4.5	5.8	5.1	2.8	0.3	0.5	0.6	2.0
Net capital expenditure	11.7	8.8	7.6	12.7	11.8	10.5	5.6	6.6	7.1
Primary balance	-0.8	2.4	3.7	-0.3	-2.3	-3.9	0.3	0.8	0.6
Overall balance	-2.9	-1.0	0.4	-2.2	-4.5	-6.3	-1.9	-2.2	-1.5
Public sector debt	144.4	207.9	198.3	187.5	177.5	180.5	193.9	193.4	147.6
Domestic	15.0	85.5	72.9	67.4	63.2	66.8	81.3	79.2	69.9
External	129.4	122.4	125.4	120.2	114.3	113.7	112.6	114.1	77.7
Interest payments (percentage of current income)	11.0	16.9	14.7	9.4	11.4	12.6	10.6	13.6	8.8
Money and credit [n]									
Domestic credit [o]	14.6	18.6	21.7	26.0	29.3	24.3	19.3	21.3	23.8
To the public sector	-2.1	-0.2	-0.8	-1.3	-0.7	-0.5	-0.5	-0.3	0.8
To the private sector	16.7	18.8	22.5	27.3	30.0	24.8	19.8	21.5	23.0
Liquidity (M3)	25.6	34.7	37.7	39.5	37.3	38.2	40.0	41.3	42.1
Currency in circulation and local-currency deposits (M2)	10.2	13.4	13.3	14.5	12.8	12.7	12.1	13.2	14.1
Foreign-currency deposits	15.5	21.3	24.4	24.9	24.5	25.5	27.9	28.1	28.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment rate as a percentage of the economically active population, urban total. Up to 1999 the figures refer to the nationwide total. [l] Weighted average rate on 30-day deposits. [m] Weighted average rate on short-term loans. [n] The monetary figures are end-of-period balances. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. The main variables

(a) Economic activity

In 2004, real GDP growth was 5.1%, more than doubling the 2.3% recorded in 2003. The upswing in GDP growth contributed to an increase in real per capita GDP, which was up 2.5%.

The strong economic expansion was attributable to several factors. These included the revival of the world economy, especially the recovery in the United States and the countries of the Central American Common Market (CACM). This boosted external demand for Nicaraguan goods and services, which in turn stimulated production of agricultural and industrial products for export, such as coffee, sugar, sesame, seafood, meat, beef on the hoof, food and beverages, textiles and clothes, footwear and chemicals. The tourist sector also performed well.

Domestic demand picked up (4.4%) thanks to the upturn in investment (particularly in the public sector) and a rise in private consumption. Gross fixed capital formation in the public sector increased, thanks to implementation of projects related to infrastructure, education and health. The rise in private investment was used for trade and property, telecommunications and industry. Simultaneous increases in real available income, family remittances and credit availability contributed to the expansion of private consumption.

The main branches of economic activity —agriculture, manufacturing, construction, commerce and financial services, which, combined, represent 70% of GDP— expanded at rates that exceeded average growth for the economy as a whole. The monthly index of economic activity continued to show an upward trend in March 2005. In the first quarter of 2005, the index rose by 5.7%,

Table 2

NICARAGUA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	152	152	148	152	187	129	188	184	219	...
Merchandise imports, c.i.f. (millions of dollars)	456	443	464	524	506	393	531	624	613	...
International reserves (millions of dollars)	436	508	489	502	571	613	601	668	640	...
Real effective exchange rate (index: 2000=100) [b]	104.6	106.8	107.9	109.6	108.7	108.0	109.2	110.4	111.7	108.6 [c]
Consumer prices (12-month percentage variation)	5.1	5.3	4.7	6.6	8.4	7.7	9.0	8.9	8.4	9.7
Average real wage (variation from same quarter of preceding year)	14.8	15.0	15.2	15.4	15.6	15.8	16.0	16.2	16.2	16.3
Average nominal exchange rate (córdobas per dollar)	3.53	1.45	1.75	0.96	-1.64	-1.48	-2.34	-3.03	-1.03	...
Nominal interest rates (annualized percentages)										
Deposit rate [d]	6.6	6.1	4.9	4.6	4.8	4.9	4.8	4.4	3.9	3.9
Lending rate [e]	17.1	16.1	14.5	14.5	14.6	12.9	13.4	13.1	13.0	12.9
Domestic credit (variation from same quarter of preceding year) [f]	17.3	12.2	28.7	29.3	27.8	34.4	27.2	34.2	...	...
Non-performing loans as a percentage of total credit [g]	3.5	3.9	3.3	2.7	2.6	2.5	2.5	2.1	2.2	2.3 [h]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Data to May. [d] Weighted average rate on 30-day deposits. [e] Weighted average rate on short-term loans. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by the banking system. [h] Data for April.

which was more than the 4.6% recorded for the year-earlier period. This was mainly due to the buoyancy of the sectors mentioned above, which, together, contributed 5.5 percentage points to the annual average increase in the index.

(b) Prices, wages and employment

Inflation, which is calculated on the basis of the consumer price index (CPI), rose from 6.5% in 2003 to 9.3% in 2004. This acceleration reflected short-term factors such as a rise in prices for fuel, transport and certain agricultural goods, especially basic grains.

In May 2005, cumulative inflation stood at 5.4%, which was higher than the 5.1% recorded in May 2004. Year-on-year inflation rose from 8.5% to 9.6%. This increase was mostly due to high international prices for main raw materials (especially petroleum).

The country's economic growth has helped to boost the level of employment. According to the household survey conducted to measure urban and rural employment in November 2004, open unemployment dropped from 7.7% to 6.5%. Between November 2003 and November 2004, the employed population expanded by 56,000 and the number of unemployed declined by almost 22,000. Some of these positive findings appear to be associated with the low growth rate of the economically active population, however. An increase in the minimum wage, public-sector pay adjustments and lower wages in the private sector translated into a modest upturn in the real average wage (0.3%).

In June 2004, an 8.8% increase in the official minimum wage was approved for most sectors of the economy. Wages for civil servants were raised by 10%.

(c) The external sector

In 2004, the larger trade gap resulted in a current-account deficit of US$ 795 million, which was an increase of almost 6%. As a proportion of GDP, however, the deficit narrowed slightly from 18.1% to 17.5%. This was attributable to a considerable upswing in income from the maquila industry and tourism, and a sharp rise in current transfers, especially family remittances, which were equivalent to 11.4% of GDP and 36.7% of the deficit on the trade and income accounts. Increased official and private capital inflows (including foreign direct investment), together with disbursements made to offset the balance-of-payments deficit, were sufficient to finance the current-account deficit. Moreover, this led to a build-up of US$ 451 million in net international reserves held by the central bank, which nevertheless remain somewhat low.

FDI amounted to US$ 250 million, which was 24.2% up on 2003. However, this represented only 5.5% of GDP and 31.4% of the current-account deficit. Most of this investment went to commerce, tourism, telecommunications and construction, whose activities benefit from incentives under legislation adopted to promote tourism and exports (these sectors traditionally involve lower costs and investment risks and offer higher profitability and relatively short capital recovery periods).

The merchandise trade deficit remained very high, at 24.4% of GDP. Exports, including net exports from the free zones, grew by 21.5%, while imports rose by 17.5%.

Merchandise exports (f.o.b.), including US$ 490.7 million from firms in the free-trade zones, stood at US$ 1,246,300,000, or 27.3% of GDP. This considerable upswing was mainly thanks to external sales of traditional products including coffee, sugar, sesame, seafood, meat and beef on the hoof. In the industrial category, the fastest growing exports were food and chemicals. Exports by companies operating under the free-zone regime, which deal mainly in textiles and clothing, maintained the brisk rate of growth seen in recent years. In addition, the number of firms in the free zones increased, and they created more jobs. This was thanks to rising demand in the United States market and the fact that a number of companies, attracted by lower labour costs, relocated their operations from Guatemala and El Salvador to Nicaragua. Value added in the maquila industry rose to US$ 144 million (an increase of 8.4%).

The rise in merchandise imports (c.i.f.), which reached a value of US$ 2,212,200,000, or 48.6% of GDP, was largely due to the upswing in the economy and steadily expanding consumption. The fastest growing imports were raw materials and intermediate goods (21%), primarily thanks to increased purchases of petroleum, fuel and lubricants (29.7%). Imports of raw materials for industry and construction also climbed. Imports of capital goods expanded by 12.6% on the strength of higher investment in construction and services, especially in health, energy and telecommunications. Consumer goods imports showed considerable growth (16.1%), sustained mainly by higher family remittances and more readily available credit. Food products (particularly rice and maize), along with medicines and pharmaceutical products, were also imported to make up for domestic market shortages.

In March, the cumulative balance-of payments current-account deficit for 2005 increased considerably (60%), mainly due to a widening trade deficit (25.5%). A steep rise in exports (17%) was outpaced by the expansion in imports (21.3%), which was mainly attributable to purchases of petroleum and petroleum products.

Panama

1. General trends

Panama's economy grew 6.2% in 2004, on the back of buoyant external demand and a fiscal stimulus to domestic demand. Inflation remained low and the rate of unemployment eased back. The State's financial position weakened and the external deficit broadened to 8.5% of GDP.

Both the sectors traditionally associated with external demand —the Panama Canal, the Colón Free Zone and the international banking centre— and other international service sectors (ports, tourism, telecommunications and rail transport) played a part in the strong expansion of output. The outgoing government had deployed fiscal policy instruments to boost the economy during the electoral process of 2004, which worsened the State's financial position. The new government taking office in September therefore abandoned the fiscal deficit target of under 2% of GDP.

The incoming government's election by a large margin made for very optimistic economic projections, on the strength of which it gained approval in February 2005 for a fiscal reform, despite stiff opposition to a number of the adjustment measures this involved. Other major government projects in 2005 include a reform of the social security system, the conclusion of free trade negotiations with the United States and a referendum on the widening of the Panama Canal.

In 2005, the sectors that have traditionally driven the Panamanian economy continued to be fuelled by external demand, making a growth rate of around 4.5% likely for the year. The rate of inflation will register a larger variation, and the fiscal deficit could narrow from the equivalent of 5% of GDP to 3.6%. Domestic demand is also likely to dip, as a result of the fiscal adjustment and a slowing in construction, at least until work begins on widening the Panama Canal and upgrading sanitation in the Bay of Panama, which is scheduled to commence in 2006. Sectors linked to international trade remained buoyant and GDP increased by 6.5% in the first quarter of 2005.

2. Economic policy

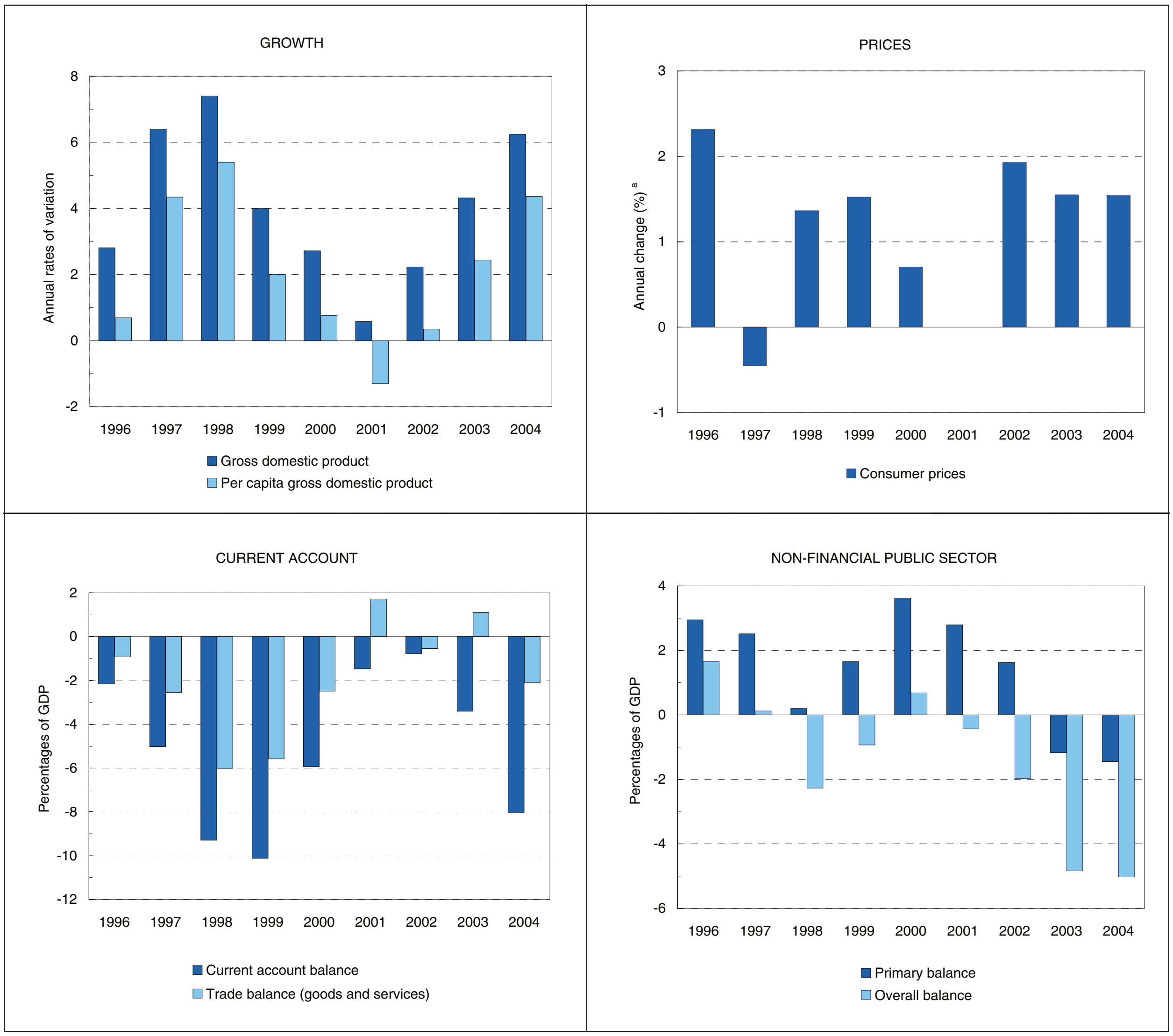
In 2004 the main objective of economic policy was to provide stimulus to the economy through fiscal policy. The new government opted instead to concentrate on fiscal rehabilitation. Other key areas of economic policy were efficient public debt management and the continuation of trade liberalization through the conclusion of free trade agreements.

(a) Fiscal policy

Since fiscal policy had been successful in stimulating economic reactivation in 2003, it continued to be deployed for this purpose into 2004. To that end, the government used proceeds from the sales of assets reverted from the Canal area and drew on resources from part of the Development Trust Fund and profits earned in public debt buy-back operations, channelling some of these monies into temporary incentives for the construction sector. Lastly, only part of the announced containment in budgeted expenditure (totalling US$ 360 million) was made effective.

The new government's priorities were to consolidate the fiscal position and improve transparency. As part of this, it was decided to change the methodology used to

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

compile the fiscal accounts to a more orthodox model. The new method of calculation does not include the anticipated dividends of the National Bank of Panama, the financial results of the Panama Canal Authority, or the savings made through public debt buy-back operations. In the new accounts, the non-financial public sector deficit came in at US$ 691 million, or the equivalent of 5.0% of GDP, compared to 2.8% using the previous methodology. The new government also inherited almost US$ 500 million in accounts payable. This floating debt was quickly whittled down, however, and in March 2005 stood at only US$ 35 million.

The central government deficit widened to 3.8% of GDP in 2003 and 5.6% in 2004. This was due to the fact that revenues rose only 1.8% in real terms while expenditures jumped by 12.6%. The buoyancy of economic activity boosted tax income by 6.8%. Revenues from direct taxes were up 7.6% and from indirect taxes, 5.2%. Non-tax revenues, by contrast, dropped by 2.8%. Tax income from the Panama Canal was 31% higher than the previous year, but dividends from other public enterprises declined by 58%.

Current spending was up by 12.7%, chiefly due to an increase in transfers (31%) and purchases of goods and services (15.3%). Interest payments on the debt, which accounts for a fifth of spending, rose by 5.5%, while capital expenditures expanded 11.7%. The central government's current savings deficit widened from US$ 118 million to US$ 330 million.

Data from the first four months of 2005 show an increase of 19% in current income, which augurs well for the fiscal position. The cut in fuel tax, a temporary measure implemented to absorb part of the increase in the international price of petroleum, will erode fiscal income, however.

The government continued to take an active approach to public debt management, focusing particularly on domestic debt, with a view to strengthening the domestic capital market. Consolidated domestic debt —not including the Social Security Fund (CSS)— rose by 40%, moving from 10.1% of GDP in 2003 to 13.3% in 2004. External public debt rose from 50.6% to 52.6% of GDP over this period.

The balance on the public debt increased by US$ 716 million, which represented an increase of 11%. During the year Panama issued global bonds for US$ 250 million maturing in 2034, re-opened its 2023 global bond for a further US$ 326 million and issued a global bond maturing in 2015 for US$ 600 million. This last issue was aimed at taking advantage of the prevailing favourable market conditions in order to pre-finance the 2005 budget.

(b) The International Banking Centre and credit policy

In contrast to the previous biennium, the International Banking Centre turned in a good performance in 2004. Favourable external conditions, particularly the robust growth seen in the South American economies, helped to revive external operations. This was accompanied by the Panamanian economy's increasing rate of expansion starting in the second semester of 2003.

The total assets of the International Banking Centre rose 7%, from US$ 32.305 billion in 2003 to US$ 34.604 billion in 2004. The assets held in the national banking system expanded by 10%, while the assets in international licence banks shrank by 8%. Net profits climbed 19.8%, the liquidity in the system was equivalent to 30% of deposits and the ratio of capital to risk-weighted assets was 17.8%. The non-performing portfolio decreased from 2.5% in 2003 to 1.7% and the portfolio in arrears represents 1.8% of the total. Lastly, time and savings deposits went up 11% after contracting for two years in a row.

Total credit extended by the national banking system expanded strongly (11.4%). Domestic credit to the private sector rose 9.2% and to the public sector, 60%. Panama's interest rate trends ran contrary to international tendencies in 2004. The drop in nominal lending rates was most pronounced in mortgage lending (the benchmark rate dropped by 100 basis points) and in corporate credits (where it dropped 50 basis points). Deposit rates remained largely unchanged.

The authorities also continued the drive to consolidate a modern legal framework for bank regulation and supervision, in order to ensure the stability of the banking system and, in particular, to combat money laundering and terrorism and prevent the regional spread of these illegal activities. In relation to this last point, the superintendency engaged in cross-border inspections, in what is becoming a more common practice within the Central American Isthmus. The banking sector is now preparing for new standards due to come into force imminently to comply with the New Basel Capital Accord (Basel II).

(c) Trade policy

Trade policy continued to be directed at deepening Panama's integration into the world economy through trade liberalization. In 2004 negotiations were begun with Singapore and with the United States, which is Panama's largest trading partner. The talks with Singapore were concluded in the first semester of 2005, but those with the United States stalled over certain problems to which solutions satisfactory to both parties have yet to be found. In the first quarter of 2005 an agreement was reached with Mexico on the reciprocal promotion and protection of investment and a partial accord was arrived at with Colombia extending tariff preferences for a number of goods.

3. The main variables

(a) Economic activity

The growth rate of 6.2% was the highest recorded since 1998. In contrast to the preceding biennium, when the domestic component drove overall demand, in 2004 external demand resumed its traditional role as the main engine of growth. Gross domestic investment climbed 15%, largely thanks to the expansion of construction, although

Table 1

PANAMA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	2.8	6.4	7.4	4.0	2.7	0.6	2.2	4.3	6.2
Per capita gross domestic product	0.7	4.3	5.4	2.0	0.8	-1.3	0.4	2.4	4.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.1	4.5	6.0	1.0	9.8	6.5	3.3	4.6	2.4
Mining	-16.3	80.8	26.1	23.9	-10.6	-4.1	18.7	25.2	33.7
Manufacturing	-1.3	3.3	2.2	1.1	-7.2	-6.3	-2.6	-1.6	2.6
Electricity, gas and water	17.7	6.2	-2.5	12.0	9.3	-4.7	6.9	1.7	8.8
Construction	-4.1	6.7	11.9	36.0	1.3	-21.8	-7.1	32.5	16.0
Wholesale and retail commerce, restaurants and hotels	-1.0	12.1	6.8	-3.9	3.8	3.7	-0.9	0.9	10.6
Transport, storage and communications	2.5	10.0	14.6	6.7	12.5	2.5	2.0	13.6	11.6
Financial institutions, insurance, real estate and business services	8.2	5.2	7.8	5.8	5.9	-0.5	-0.2	0.2	3.4
Community, social and personal services	2.6	3.1	4.2	3.7	-0.4	3.9	4.5	1.9	3.1
Gross domestic product, by type of expenditure									
Consumption	7.9	6.8	16.1	0.6	0.2	3.9	7.3	0.9	4.1
General government	3.4	-0.6	4.7	1.5	1.8	8.1	9.1	3.1	1.5
Private	9.1	8.5	18.5	0.4	-0.1	3.1	6.9	0.4	4.7
Gross domestic investment	6.1	4.2	10.9	3.5	-9.2	-24.2	-5.4	19.0	15.2
Exports (goods and services)	-9.4	7.4	-0.9	-12.4	18.5	0.3	-2.5	-0.9	16.8
Imports (goods and services)	-4.1	7.0	7.8	-14.7	10.3	-4.3	0.7	-1.6	17.5
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	26.7	25.7	27.2	25.8	24.1	17.6	15.8	19.1	16.3
National saving	24.6	20.7	17.9	15.7	18.2	16.2	15.0	15.7	7.9
External saving	2.2	5.0	9.3	10.1	5.9	1.5	0.8	3.4	8.4
				Millions of dollars					
Balance of payments									
Current account balance	-201	-507	-1 016	-1 159	-689	-174	-96	-437	-1 104
Merchandise trade balance	-644	-685	-1 296	-1 340	-1 143	-696	-1 035	-1 113	-1 585
Exports, f.o.b.	5 823	6 670	6 332	5 288	5 839	5 992	5 315	5 049	5 886
Imports, f.o.b.	6 467	7 355	7 627	6 628	6 981	6 689	6 350	6 162	7 471
Services trade balance	558	428	638	701	854	899	968	1 254	1 295
Income balance	-249	-400	-517	-691	-577	-602	-272	-820	-1 042
Net current transfers	135	151	159	171	177	226	244	241	228
Capital and financial balance [d]	467	850	911	1 350	613	818	242	284	709
Net foreign direct investment	416	1 299	1 203	864	700	405	99	792	1 012
Financial capital [e]	52	-449	-292	485	-87	413	143	-507	-303
Overall balance	267	343	-105	191	-77	644	146	-153	-395
Variation in reserve assets [f]	-298	-611	20	-185	108	-633	-138	163	396
Other financing [g]	31	268	85	-7	-32	-11	-8	-10	-1
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	100.6	102.5	100.1	100.7	100.0	103.0	102.1	105.0	110.2
Terms of trade for goods (index: 2000=100)	105.5	103.9	104.7	104.6	100.0	102.7	101.6	97.2	95.3
Net resource transfer (percentage of GDP)	2.7	7.1	4.4	5.7	0.0	1.7	-0.3	-4.2	-2.4
Gross external public debt (millions of dollars)	5 069	5 051	5 180	5 412	5 604	6 263	6 349	6 504	7 219
Gross external public debt (percentage of GDP)	54.4	50.1	47.4	47.2	48.2	53.0	51.7	50.6	52.6
Net profits and interest (percentage of exports) [i]	5.5	6.1	7.8	10.1	7.4	7.3	2.6	9.4	11.1
				Average annual rates					
Employment									
Labour force participation rate [j]	60.6	61.5	62.2	62.8	59.9	60.5	62.6	62.8	63.3
Unemployment rate [k]	14.3	13.4	13.6	11.8	13.5	14.0	13.5	13.1	11.8

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	2.3	-0.5	1.4	1.5	0.7	0.0	1.9	1.5	1.5
Variation in real minimum wage	4.3	-1.3	2.7	3.4	3.8	7.0	-1.2	0.7	0.9
Nominal deposit rate [l]	...	...	...	...	...	6.8	5.0	4.0	2.2
Nominal lending rate [m]	...	...	...	...	...	10.6	9.2	8.9	8.2
				Percentages of GDP					
Non-financial public sector									
Current income	24.4	23.9	23.0	23.8	25.3	24.8	23.2	21.9	21.6
Current expenditure	19.6	20.8	20.7	21.0	22.1	22.7	22.9	23.0	23.2
Current balance	4.8	3.1	2.3	2.8	3.2	2.1	0.3	-1.1	-1.6
Net capital expenditure	3.1	3.7	5.1	3.8	2.5	2.5	2.3	3.8	3.5
Primary balance	2.9	2.5	0.2	1.7	3.6	2.8	1.6	-1.2	-1.5
Overall balance	1.7	0.1	-2.3	-0.9	0.7	-0.4	-2.0	-4.8	-5.0
Public sector debt	73.5	67.1	64.8	67.2	66.5	71.1	69.4	67.3	72.6
Domestic	19.1	17.0	15.9	18.6	18.3	18.1	17.7	16.8	20.1
External	54.4	50.1	48.9	48.6	48.2	53.0	51.7	50.6	52.6
Interest payments (percentage of total income)	5.3	9.6	10.4	10.6	11.3	12.6	14.9	16.4	16.4
Money and credit									
Domestic credit [n]	65.8	67.9	75.8	86.4	95.3	99.1	92.8	86.2	82.4
To the public sector	1.3	0.7	1.1	1.0	1.4	1.2	1.4	2.9	2.8
To the private sector	64.5	67.2	74.7	85.4	93.9	98.0	91.4	83.3	79.6
Liquidity (M3) [o]	59.5	63.2	65.9	68.2	74.0	79.8	76.6	76.5	77.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] As of 1997, based on figures in local currency at constant 1996 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment rate as a percentage of the economically active population; nationwide total. Includes hidden unemployment. [l] Six-month deposits in the local banking system. [m] One- to five-year loans for commercial activities in the local banking system. [n] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [o] End-of-period figures.

growth in the machinery and equipment subsector, at over 11%, was far from negligible. Both public and private investment posted double-digit growth rates. Consumption rose by 4%, driven by private consumption.

Agriculture, livestock, forestry and fishing recorded an expansion of 2.4%. Production of fruit for export, including pineapples, melons and watermelons, increased particularly sharply (40%). Other crops such as coffee, maize and sugar cane also performed well, though rising at more moderate rates. Banana production fell back 1.1% as a result of phytosanitary problems. Production of rice went down by 35%. Output was up in the segments of beef livestock (2.7%), pork (6.9%) and poultry (12.7%). The fishing segment, meanwhile, expanded a mere 1.5%.

Mining and quarrying was the most dynamic sector, with a growth rate of 34%. Construction expanded by 16%, thanks to a large number of residential projects, port works and highway upgrading, the conclusion of the Centenary Bridge and the expansion of shopping centres.

After having contracted for four straight years, manufacturing posted an upturn of 2.6%. The production of inputs for construction reaped the benefits of that sector's expansion. The clothing and footwear segments contracted, as did fish processing and dairy products. In contrast to the downturn in the generation of thermal energy, hydroelectric energy performed exceptionally well, surging by 35% thanks, in part, to the Estí hydroelectric plant's entry into operation. The value added of water production rose 7.6%.

Transport, storage and communications posted an upswing of 11.6%. The transport system benefited from the buoyancy of international trade, with the output of the railway segment and ports expanding 39% and 23.2%, respectively, mainly thanks to increased movements of container freight. Also robust, albeit lower, growth rates were recorded in Panama Canal activities (7.1%) and air transport (8.4%). Telecommunications were up 13.2%, led by the mobile telephony segment.

Table 2

PANAMA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
International reserves (millions of dollars)	1 405	1 310	1 101	1 011	974	792	469	631	1 039	...
Real effective exchange rate (index: 2000=100) [b]	101.7	105.3	105.6	107.3	109.0	109.4	109.9	112.4	113.1	112.7 [c]
Consumer prices (12-month percentage variation)	1.6	1.5	1.3	1.5	1.1	1.9	1.7	1.5	3.0	...
Average nominal exchange rate	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Nominal interest rates (annualized percentages)										
Deposit rate [d]	4.6	4.7	4.0	2.6	2.3	2.2	2.2	2.2	2.6	...
Lending rate [e]	8.8	8.8	8.7	9.2	8.4	8.0	8.0	8.5	8.5	...
Domestic credit (variation from same quarter of preceding year) [f]	-1.6	-3.0	0.0	-1.2	-0.3	3.1	3.0	5.2	6.6	7.2 [g]
Non-performing loans as a percentage of total credit [h]	3.1	2.9	2.7	2.5	2.6	1.9	1.9	1.7	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Data to May. [d] Six-month deposits in the local banking system. [e] One-year loans for commercial activities in the local banking system. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Data for April. [h] Refers to total credit extended by the multibanking system.

The encouraging performance of commerce (10.6%) was fuelled mainly by vigorous activity in the Colón Free Zone, which expanded 19%, since the national component of commerce increased by around 4%. Upturns in the economies of South American customers of the free zone were the main driver of this good performance. The hotel and restaurant sector grew by 8.2%, thanks to a 13% increase in tourist arrivals.

Financial intermediation dipped slightly (2.6%), reflecting a drop of 1% in the value added of banking activities and of 4% in insurance. In contrast, real estate, business and rental services climbed by 6.3%. Personal, community and social services expanded 3% and government services, 1.5%, both lower than the rate posted by the segments of other services (6.7%) and health (5.9%).

(b) Prices, wages and employment

The authorities prepared a new nationwide urban consumer price index, with a base year of October 2002, in order to reflect price variations more accurately. This indicator showed prices rising 1.5% in 2004. The sector to post the largest variation was transport (2.9%), owing to the rise in international petroleum prices. Food and beverages, health and education also saw price increases of over 1%. The other sectors registered decreases.

The wholesale price index was up by 4.4%, a large increase by Panamanian standards that was driven by a rise of 7.3% in import prices. Higher international market prices for petroleum and other raw materials were the main reasons for this uptrend.

Consumer inflation gathered pace in the first four months of 2005, with a rise of 3.3% over the year-earlier period. In contrast, the wholesale price index slackened its rate of increase to 1.7% in the first quarter.

Minimum wages are adjusted every two years, with 2004 falling between adjustment years. The rate of total unemployment dropped 1.3 points, from 13.1% in 2003 to 11.8%, thanks to the economic upswing. The drop in the unemployment rate was more pronounced in urban areas (2 percentage points). Total employment climbed 4.5%, raising the employment rate by 1.3 percentage points with respect to 2003.

(c) The external sector

Buoyant external demand provided a strong stimulus to the Panamanian economy and this was reflected in the activity of the Colón Free Zone. The current-account deficit widened from the equivalent of 3.6% of GDP in 2003 to 8.5%. The financial account returned a surplus of US$ 709 million, reflecting a large inflow of foreign direct investment (FDI).

The goods balance deteriorated again, with the deficit widening from US$ 1.112 billion in 2003 to US$ 1.585 billion in 2004. Goods exports, including those from the Colón Free Zone, increased in value by 16.6%, and imports by 21.2%. After a two-year decline, re-exports from the Colón Free Zone posted a strong upswing of 19.2%.

National exports expanded 10.6%. A number of export products recorded very high growth rates, including pineapples (199%) and melons (84%). Beef, lobster and other refrigerated fish also performed well (46%, 35% and 22%, respectively). The value of banana exports dropped by 4%, however, shrinking for a fifth consecutive year. Exports of shrimp were down by 5% and of sugar, by 18%. The export value of coffee declined by 11%, which was attributable to smaller volumes exported.

Goods imports expanded at an even stronger pace than exports, boosted by the upswing in economic activity. Imports to the Colón Free Zone rose 27.7%, after having shrunk for two years in a row. National imports climbed 14.9%, in view of larger imports of fuels, construction materials and capital goods.

The value of national exports was up by 37.4% in the first quarter of 2005, thanks to excellent sales of melon, watermelon, shrimp, sugar and coffee. Re-exports from the Colón Free Zone rose 10.1%. Movements of containers in port rose 23.1% and net tons through the Canal, 4%. Tourist arrivals were 23.1% higher than in the first quarter of 2004, and their expenditures rose 19.9%.

The services balance was the only current-account item to post an upturn in 2004, with a surplus that climbed from US$ 1.254 billion in 2003 to US$ 1.295 billion. The value of transport services rose 9%, partly because of higher prices in the Panama Canal's new rate structure and partly because of an increase in traffic volumes. Tourist income, which rose 11%, also contributed to the good performance of the services sector. Lastly, the banks saw their surplus decrease by about US$ 10 million.

The large sums paid in interest, together with outflows of profits, widened the deficit on the income balance to US$ 1.042 billion, while the surplus on the transfers balance narrowed slightly. Accordingly, the current-account deficit widened from US$ 437 million in 2003 to US$ 1.104 billion in 2004.

The strongest component of the financial account was FDI, which amounted to US$ 1.012 billion. This jump was the result of the reactivation of banking operations and an upturn in the activities of firms trading internationally through the Colón Free Zone. Another major contributing factor was the sale of Bellsouth Panama to the Spanish firm Telefónica Móviles for US$ 340 million.

The government's levels of net external indebtedness rose. Large movements, both inward and outward, of portfolio capital resulted in a portfolio investment deficit of US$ 170 million.