Mexico and Central America

Costa Rica

In 2005, the Costa Rican economy continued to grow at a pace (4.2%) close to its trend growth rate. The expansion was driven by buoyant exports, which reflected, among other things, an upturn in exports of microprocessors manufactured by the Intel plant, tourist activity and international business services. By contrast, domestic demand felt the adverse effects of the terms-of-trade downturn on real available income, the high rate of inflation (14.2%) and larger net outflows of investment income, caused by the increase in repatriation of profits and dividends associated with foreign direct investment. This was in addition to the uncertainty generated by the delay in adopting the fiscal reform, the lack of parliamentary support for the initiatives of the executive branch and the deterioration of the political and social climate in a situation dominated by the elections of February 2006.

In this context, economic growth took place on the back of an expansion in exports, which was driven, in turn, by an upturn in sales of microprocessors produced by the Intel plant and a buoyant performance from tourism and international business services.

The central government was able to keep finances under control, thanks to the increase in income and containment of expenditure. The fiscal deficit will be similar to the previous year's (2.8%). In response to strong inflationary pressures and a widening external sector imbalance, monetary policy turned austere in the second semester, which translated into lower growth in credit than in 2004 and an upward trend in interest rates.

The balance-of-payments current-account deficit broadened to 5.2% of GDP, since the rising trade deficit and increased repatriation of profits and dividends from foreign direct investment exceeded the net surplus on the services account. Financial (especially private) resources from abroad, however, helped to swell net monetary reserves by US$ 290 million.

On the trade front, the executive branch sent the text of the Dominican Republic —Central America— United States Free Trade Agreement (CAFTA-DR) to the legislative assembly in October. Another key development was the entry into force of the free trade agreement with the member countries of the Caribbean Community (CARICOM) in 2005.

The objective of the central bank's monetary policy was to reduce inflation. To this end, it engaged in open market operations as the main instrument of monetary control, aiming to hold the legal reserve requirement down at 12%. The central bank also attempted to maintain a neutral exchange-rate policy while avoiding any real appreciation or depreciation of the colón. With this in mind, an austere fiscal policy stance was adopted, anticipating that the containment of domestic spending would be enough to bring down inflation.

In the first five months of the year, however, liquidity in the financial system expanded by 4%, owing to a small increase in credit (2.5%) and a rise in savings (6%). At the same time, the monetary base expanded because of rising external capital inflows attracted by high interest rates and the relative stability conferred on the foreign-exchange market by the policy of mini-devaluations. In May, cumulative inflation reached 6.37%, compared with 5.14% in the year-earlier period, which pushed the year-on-year inflation rate up from 11.45% to 14.46%. The central bank therefore decided in June to raise the reserve requirement from 12% to 15% and step up open-market operations.

In the realm of fiscal affairs, the central government's deficit (2.8% of GDP) was kept under control even though the administration's tax reform proposal has yet to be adopted by the legislative assembly, which has been discussing it for more than three years. The deficit was kept in check thanks to a large increase in current revenues, as a result of better tax collection and efforts to combat evasion. In addition, the management of State funds by means of the single-window principle has avoided the government's having to increase its borrowing even when certain agencies have had idle resources. The fastest-growing categories of revenue were income and sales taxes and customs duties.

In contrast to what has occurred in previous years, when a large part of the fiscal deficit was financed externally by issuing bonds on the international capital markets, in 2005 the government met its financing requirements by selling debt instruments on the local market.

Real growth in production came in at 4.2% in 2005. During the first five months of the year, however, economic activity slowed because of the adverse effects of the downturn in terms of trade on domestic spending variables, the austere fiscal policy and expectations of higher rates of interest. Also to blame were lower growth in Costa Rica's main trading partner countries and a number of incidental climatic factors, which hurt production of banana and sugarcane. During the rest of the year, however, especially in the third quarter, the rate of economic activity picked up in step with the expansion of exports, especially from the high-technology segment.

At the sectoral level, manufacturing performed particularly well (5.6%), chiefly thanks to exports of microprocessors manufactured by Intel, and to the upturn in the production of the textiles sector, some of whose firms have developed innovative strategies in response to competition from China, focusing on products with shorter lead times. At the same time, growth in goods production quickened owing to expansion in the agricultural sector (4.1%). Services (especially transport), telecommunications (cellular telephony and Internet service), hotels and financial services all continued to perform well.

The inflation rate came in at 14%, thereby exceeding the target of 12.7% established in the monetary programme. The determinants of this result were the steep rise in the international prices of petroleum and petroleum products, hikes in a number of utility rates, such as water and electricity, and higher prices for some agricultural goods.

Despite the growth of the economy, the open unemployment rate rose slightly and the purchasing power of wages fell. Notably, the adjustments made to the nominal minimum wage were barely enough to make up for the increase in prices.

Partial data on the external sector's performance indicate that the balance-of-payments current account posted a deficit of 5.2% of GDP, which was larger than in 2004. The improvement in the services account was not enough to make up for the increase in the deficit on the income account, owing to increased repatriation of profits and dividends, associated with foreign direct investment, as well as a deterioration in the balance of trade for goods. Inflows of external financial capital swelled international assets by US$ 290 million.

Exports of merchandise (f.o.b.) increased by 11.8%. The fastest-growing product categories included coffee (thanks to an upturn in international prices) and non-traditional agricultural goods (pineapple, melon, flowers, foliage and ornamental plants). The most prominent industrial exports were sales of microprocessors and exports to the Central American Common Market. The expansion of imports took place chiefly in the categories of raw materials and intermediate goods, which was largely a reflection of the higher oil bill and imports by firms located in the export-processing zones.

COSTA RICA: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	6.5	4.2	4.2
Consumer prices	9.9	13.1	14.2 [b]
Average real wage [c]	0.4	-2.6	-1.2
Money (M1)	21.5	12.5	11.9 [d]
Real effective exchange rate [e]	6.2	2.8	1.6 [d]
Terms of trade	-1.5	-3.8	-5.7
	Annual average percentages		
Urban unemployment rate	6.7	6.7	6.9
Central government overall balance / GDP	-2.9	-2.8	-2.8
Nominal deposit rate	10.9	10.0	10.4 [f]
Nominal lending rate	23.4	21.2	22.0 [f]
	Millions of dollars		
Exports of goods and services	8 190	8 610	9 756
Imports of goods and services	8 483	9 140	10 367
Current account	-929	-831	-1 031
Capital and financial account	1 268	912	1 321
Overall balance	339	80	290

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2005.
[c] Average wages reported by workers covered by social security.
[d] Year-on-year average variation, January to October.
[e] A negative rate indicates an appreciation of the currency in real terms.
[f] Average from January to November, annualized.

El Salvador

In 2005, GDP in El Salvador rose by 2.5%, which resulted in the largest increase in per capita GDP (0.7%) in six years. External demand, particularly for agricultural products, and the upturn in public investment were the most buoyant elements, while the increasing inflow of family remittances (16.6% of GDP) helped to boost private consumption. The economy continued to suffer the effects of the hike in international oil prices and the rise in international interest rates, which in turn pushed up debt servicing. Inflation trended upwards, and the current account deficit represented 3.9% of GDP. The floods caused by hurricane Stan and the eruption of the Ilamatepec volcano in October caused considerable damage and losses of US$ 355 million.[1] A higher growth rate (3.5%) is expected in 2006 on the strength of reconstruction works, a buoyant world market and better performances from agriculture and tourism. The government's fiscal deficit will nonetheless be slightly wider than in 2005, when it had narrowed from 1.1% of GDP to 0.6%.

Fiscal austerity was maintained in 2005, with a view to reducing the public deficit. Tax reforms resulted in higher income than in 2004 (US$ 172.4 million), following amendments to the tax code and the laws governing pensions, banking and income tax. The tax burden therefore rose to 13.2% of GDP, which was almost one percentage point higher than in 2004, while non-tax revenues represented 3% of GDP. The fact that the budget was approved on time and with no amendments generated a 35.6% increase in investment from the non-financial public sector (NFPS), which had dropped off by 38.3% in 2004 following delays in the adoption of that year's budget.

Current expenditure expanded for the third year in a row, mainly due to higher debt interest and pension disbursements of about 2% of GDP. With a view to reducing the impact of the rise in oil prices, up to September subsidies were allocated to the following sectors: transport (US$ 5.86 million), energy (US$ 17.53 million) and liquefied gas (US$ 32.44 million). These outlays, plus reconstruction costs, generated an NFPS deficit of 3% of GDP in 2005.

Up to September, public external debt stood at US$ 4.922 billion, as a result of the placement of bonds worth US$ 401.8 million and loans obtained from the World Bank (US$ 100 million) and the Inter-American Development Bank (US$ 40 million). Overall, public external debt remained around 40% of GDP.

In 2005, nominal interest rates gradually rose due to the increase in international rates. In real terms, rates on 180-day deposits remained at -1% in 2005, while the interest rate on loans of up to one year climbed from 1.8% in 2004 to 2.4%. However, the improved economic performance generated an expansion of banking credit to the private sector (7%) and the public sector (8.5%). At the end of the year, the net international reserves of the central reserve bank were only slightly lower than in 2004.

Also during 2005, a consumer protection law was adopted and the government presented a package of laws to be reformed in preparation for the entry into force of CAFTA-DR, which will offer greater incentives and facilities for exports and foreign direct investment (especially in non-traditional and ethnic products).

1 Economic Commission for Latin America and the Caribbean (ECLAC), "Efectos en El Salvador de las lluvias torrenciales, tormenta tropical Stan y erupción del volcán Ilamatepec (Santa Ana) octubre del 2005 y Perfiles de proyecto" (LC/MEX/R.892), Mexico City, ECLAC subregional headquarters in Mexico, November 2005.

GDP grew by 2.5% in response to the favourable terms of trade for certain agricultural goods and the expansion of private consumption, which benefited from the inflow of family remittances. Performance also improved in the following sectors: electricity, finance, services, transport and communications, construction and tourism.

The agricultural sector posted its highest growth in six years (4.3%), due to the increase in the production of basic grains and higher coffee and sugar prices. Following a 14% decline in 2004, the construction sector grew by 0.8% thanks to greater public and private investment in the Port of La Unión and the Port of Acajutla. Manufacturing value added expanded by more than twice the growth recorded the previous year (1.8%), despite the closure of certain maquila enterprises. In September, the government presented a manufacturing policy proposal due to be implemented from January 2006 with a view to strengthening the competitiveness of the manufacturing sector.

The damage and losses caused by hurricane Stan and the eruption of the Ilamatepec volcano affected mainly housing and road infrastructure and, to a lesser extent, agriculture, the environment, health, water and sanitation and tourism. Greater public investment throughout 2005 and the reconstruction works initiated at the end of the year should boost economic activity in 2006.

Year-on-year inflation up to October was 5.9% as prices rose following the temporary food supply shortages caused by the October floods and high oil prices. This figure was above the 3%-4% inflation target set for 2005, giving rise to the second straight year of reductions in families' purchasing power in the absence of wage increases. Despite economic growth, the open unemployment rate also climbed as the number of jobs dropped in the maquila sector.

The export sector performed better in 2005 (6.1%) than in 2004. This was the result of increased demand and higher prices for agricultural products including coffee and sugar, and an increase in non-traditional exports (9%). However, increased import buoyancy generated a balance-of-payments current account deficit of 3.9% of GDP, which was similar to the level observed in 2004.

EL SALVADOR: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	1.8	1.5	2.5
Consumer prices	2.5	5.4	4.6 [b]
Real minimum wage	2.1	-1.4	-4.4
Money (M1)	-2.0	8.5	8.7 [c]
Real effective exchange rate [d]	1.5	-0.1	1.0 [e]
Terms of trade	-3.9	-1.0	-1.0
	Annual average percentages		
Urban unemployment rate	6.2	6.5	7.2
Central government overall balance / GDP	-2.7	-1.1	-2.9
Nominal deposit rate	3.4	3.3	3.4 [f]
Nominal lending rate	6.6	6.3	6.9 [f]
	Millions of dollars		
Exports of goods and services	4 006	4 301	4 650
Imports of goods and services	6 462	7 029	7 684
Current account	-764	-612	-661
Capital and financial account	1 080	572	593
Overall balance	316	-40	-67

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Preliminary estimates.
[b] Twelve-month variation to November 2005.
[c] Year-on-year average variation, January to September.
[d] A negative rate indicates an appreciation of the currency in real terms.
[e] Year-on-year average variation, January to October.
[f] Average from January to November, annualized.

Net flows of foreign direct investment rose by 2.4% in relation to the previous year, bringing their total to at US$ 477 million thanks to extraordinary income from the purchase of bank assets. In addition, the growing promotion of tourism generated revenues of US$ 629 million.

The economy benefited from a significant external boost in the form of an increase in family remittances (11%), which was in turn due to lower unemployment rates and an increase in the number of Latin Americans employed in the United States, plus a rise in the average level of remittances following the recent natural disasters. Over US$ 2.000 billion in remittances fuelled private consumption and —according to figures up to September 2005— the remittances covered almost 90% of the merchandise trade gap and, in disaggregated terms, they amounted to 80% of merchandise exports and 44% of goods imported.

Guatemala

The Guatemalan economy recorded 3.2% growth in 2005, the highest figure since 2001, and per capita GDP growth stood at 0.7%. Private consumption expanded by 4.1% thanks to favourable export prices and an increase in family remittances. The latter, together with capital inflows, triggered an appreciation of the local currency. For the second consecutive year, inflation remained at about 9%.

The authorities' projections for 2006 point to growth of just over 4%, driven by an increase in public investment and loans to the private sector. Other positive factors are the entry into force of CAFTA-DR and preferential access to European Union markets. In addition, the authorities predict inflation of between 4% and 6%, a fiscal deficit of 2.5% of GDP and a current account deficit of 3.9% of GDP.

Fiscal policy was slightly more expansionary than in 2004, when significant cuts were made in spending owing in part to the suspension of two taxes. As a result, the government deficit increased from 1% of GDP in 2004 to 1,4% in 2005.[1] The tax burden declined from 10.1% of GDP in 2004 to 9.9% in 2005. The tax reform introduced by the government in mid-2004 included the creation of an extraordinary tax imposed temporarily to support the peace agreements and modify income tax. September saw the restoration of the fuel distribution tax, which had been suspended by the Constitutional Court and replaced temporarily by an extraordinary fuel tax in December 2004.

Up to September, government spending was geared towards the priorities established in the peace agreements and the "*Vamos Guatemala*" reactivation programme. For its part, real social spending expanded by 8% compared with the same period of the previous year. More physical investment projects took place as well as capital transfers to autonomous and decentralized institutions.

The monetary authorities took measures geared to the adoption of a scheme of explicit inflation targets and the use of a single benchmark interest rate applicable to all short-term monetary stabilization operations.

The Bank of Guatemala has applied an active policy in order to moderate inflationary pressures, resorting actively to open-market operations and raising interest rates. The rate for seven-day deposit certificates (monetary policy benchmark rate) increased by 25 basis points in February, May, September and November, to stand at 4% at the end of the year. However, in order to curb the appreciation of the quetzal, the Bank of Guatemala purchased foreign currency to the tune of US$ 347 million in the first half of 2005, which has reportedly boosted the money supply and exerted some degree of inflationary pressure.

GDP growth of 3.2% in 2005 was fuelled by domestic demand that proved more buoyant than external demand. Public consumption grew by 4.6%, reversing the 10% decline recorded in 2004, and gross fixed capital investment (up 2.6%) was spurred by private investment. All productive sectors, except mining and construction, showed positive results. Agriculture grew by about 3%, thanks to an improvement in the production of basic grains, vegetables and greens, while coffee production remained unchanged and banana and cardamom production diminished; manufacturing was up by 2.9%, a performance associated with the recovery in exports.

In early October, Guatemala was hit by hurricane Stan, which caused the death of 669 persons, the disappearance of 884 others and material damage and losses estimated at US$ 983 million. The strongest impact was felt in the relatively less developed departments, which are inhabited by families with very low incomes.[2]

The twelve-month variation in consumer prices to November stood at 9,3% (compared with 9,2% in 2004), exceeding by a wide margin the annual target of 4% to 6% set by the Bank of Guatemala. Imported inflation accounted for approximately one third of this figure. No data were available for unemployment in 2005, but the open unemployment figure for 2004 was

1 The fiscal deficit projected in the 2005 budget was 1.8%.

2 See Economic Commission for Latin America and the Caribbean (ECLAC), *Efectos en Guatemala de las lluvias torrenciales y la tormenta tropical Stan, octubre de 200*5 (LC/MEX/R.895), Mexico City, ECLAC Subregional Headquarters in Mexico, November 2005.

3.1%. Up to November, there had been no adjustment in minimum wages.

The deficit on goods and services widened for the ninth consecutive year to stand at US$ 4.137 billion (13% of GDP), despite the rise in the value of merchandise exports, based mainly on the rally in prices. In the first half of the year, non-traditional exports expanded for the fourth consecutive year (17%); clothing, natural rubber, vegetables and above all chemicals performed well. The value of merchandise imports grew by 9%, owing in part to the high oil prices.

According to the Guatemalan Tourism Institute, the number of tourists to the country declined by 100,000 as a result of hurricane Stan. Tourist arrivals are expected to amount to 1.2 million persons in 2005, which implies a US$ 50 million fall in earnings from tourism. Net payments of profits and interest stood at US$ 360 million, the balance of current transfers amounted to US$ 3.25 billion, while family remittances were in the vicinity of US$ 3 billion. The balance-of-payments current account deficit (US$ 1.25 billion, or 4.1% of GDP) was more than offset by income from the capital and financial account and an overall balance of US$ 325 million was recorded.

GUATEMALA: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	2.1	2.7	3.2
Consumer prices	5.9	9.2	9.2 [b]
Average real wage	0.4	-2.4	...
Money (M1)	13.4	10.3	13.3 [c]
Real effective exchange rate [d]	-0.3	-2.9	-7.3 [e]
Terms of trade	-2.9	-0.9	-2.8
	Annual average percentages		
Urban unemployment rate	3.4	3.1	...
Central government overall balance / GDP	-2.3	-1.0	-1.8
Nominal deposit rate	5.2	4.5	4.6 [f]
Nominal lending rate	15.0	13.8	13.1 [f]
	Millions of dollars		
Exports of goods and services	4 119	4 608	5 085
Imports of goods and services	7 302	8 483	9 223
Current account	-1 039	-1 188	-1 250
Capital and financial account	1 589	1 797	1 529
Overall balance	550	609	279

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Preliminary estimates.

[b] Twelve-month variation to November 2005.

[c] Year-on-year average variation, January to September.

[d] A negative rate indicates an appreciation of the currency in real terms.

[e] Year-on-year average variation, January to October.

[f] Average from January to November, annualized.

Honduras

In 2005, buoyant external conditions and domestic demand enabled the Honduran economy to grow by 4.2%, which was slightly lower than the growth recorded in 2004. Per capita GDP rose by 1.7%, compared with the 2.5% registered in 2004. Despite improvements in other macroeconomic indicators such as inflation and the fiscal position, the labour market situation remained precarious. Perpetuating the pattern observed in the previous biennium, growth is expected to continue to increase by more than 4% in 2006. The new government, due to take office in January, will continue to implement the programme agreed with the International Monetary Fund (IMF), which includes a further reduction of the fiscal deficit. Inflation is predicted to be lower than in 2005 thanks to less upward pressure from the international oil market. Lastly, the entry into force of CAFTA-DR in January 2006 is expected to result in more significant inflows of foreign direct investment.

The most significant achievements of 2005 in terms of fiscal policy included reaching completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in April, complying with the programme agreed with IMF and ratifying the above-mentioned treaty. These events boosted positive expectations for the economy, despite the rise in international petroleum prices.

The Heavily Indebted Poor Countries (HIPC) Initiative, together with the recent initiative of the Group of Eight, will result in debt relief of almost US$ 2.800 billion over 15 years (60% of current external public debt). From 2006, resources saved on debt servicing will be used for social programmes implemented under the poverty reduction strategy, which will in turn help greater progress to be made towards achieving the Millennium Development Goals.

The government managed to resist pressure to increase spending in the run up to the elections, which has not always been the case in the past. The central government's fiscal deficit therefore narrowed from the equivalent of 3.4% of GDP to 2.9%, as predicted.[1] Total revenues, which swelled by 6% in real terms, were buoyed by healthy economic activity and increased tax receipts.

There was little growth in expenditure (4%), thanks to controlled wage increases and expenditure containment measures adopted in the final quarter. Outlays for the poverty reduction strategy, on the other hand, rose by over 30%. Progress was also made in the modernization of the legal framework for public finances.

Since May, monetary policy has been implemented under a new framework designed to communicate the central bank's position more clearly to agents. The changes relate both to operational targets and to central bank instruments. Intermediate targets were abandoned in favour of an operating target in the form of a short-term money-market interest rate. A distinction was also made between short-term and long-term liquidity management and monetary policy instruments were extended. In addition, the amount of liquidity needed by the financial system has been calculated empirically, in order to minimize the divergence between current rates and the operational target.

The significant increase (50%) in family remittances swelled the central bank's net international reserves more than planned, which in turn pushed up money creation by around 13% in real terms. The monetization of foreign

[1] According to data from the central bank, on the basis of accrued interest on the public external debt.

exchange obliged the central bank to partially sterilize currencies by increasing the net issuance of lempira-denominated absorption certificates.

Interest rates continued to fall amidst abundant liquidity, and real borrowing rates are on the verge of entering negative figures. Credit to the private sector rose by 16%, mainly in the form of loans to businesses, consumers and industry. Financial indicators continued to improve thanks to the favourable economic climate.

The exchange rate underwent a nominal depreciation of 2.5%, which positioned it at the lower limit of the exchange-rate band established by the central bank. In real terms, this actually constituted a slight appreciation, which helped to slow down the rate of inflation. The fact that even more significant appreciations were recorded by currencies of other Central American countries increased the competitiveness of Honduras.

The current expansionary cycle of the Honduran economy has been characterized by acceleration in external and domestic demand. However, both variables were less buoyant than in the previous year, partly due to lower growth in the world economy and the adverse effects of high petroleum prices. Largely thanks to the exceptional rise in remittances, consumption became the most robust element of domestic demand, given that investment suffered a slight setback that would have been worse were it not for growth of around 20% in public investment.

Growth was fairly uniform throughout all sectors. Although two sectors experienced slowdowns in 2004, all sectors posted positive growth rates of between 2% and 6% in 2005. The sole exception was the construction sector, which expanded by almost 15%. Growth in agriculture was dampened by weather problems, whereas manufacturing notched up more growth thanks to buoyancy in the maquila industry. Tourism and telecommunications also turned in positive performances.

In the final quarter, the upward trend of consumer prices was reined in, and inflation is therefore expected to stand at 8.0%. Although this is beyond the range of 6.5% to 7.5% stipulated in the monetary programme, it is nonetheless below the 9.2% recorded in 2004. This rate of inflation is mainly the result of the rise in petroleum prices. The largest increases were recorded in food and non-alcoholic beverages, accommodation, electricity and gas and other fuels.

Although figures on the labour market are as yet unavailable, the situation remains precarious as the underemployment rate exceeds 30%, while the real average minimum wage edged up by a mere 0.8%.

HONDURAS: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	3.5	5.0	4.2
Consumer prices	6.8	9.2	7.7 [b]
Real minimum wage	8.6	0.8	0.8
Money (M1)	15.4	15.2	17.5 [c]
Real effective exchange rate [d]	1.8	1.5	0.2 [e]
Terms of trade	-4.3	-0.9	-2.8
	Annual average percentages		
Urban unemployment rate	7.6	8.0	6.8 [f]
Central government overall balance / GDP	-5.6	-3.1	-3.0
Nominal deposit rate	11.5	11.1	10.9 [g]
Nominal lending rate	20.8	19.9	19.0 [g]
	Millions of dollars		
Exports of goods and services	2 693	3 066	3 257
Imports of goods and services	3 839	4 557	5 037
Current account	-292	-391	-468
Capital and financial account	65	759	496
Overall balance	-227	368	28

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2005.
[c] Year-on-year average variation, January to August.
[d] A negative rate indicates an appreciation of the currency in real terms.
[e] Year-on-year average variation, January to October.
[f] Data correspond to May.
[g] Average from January to September, annualized.

In terms of the external sector, the current account deficit widened slightly from the equivalent of 5.2% of GDP 5.7%. Both exports (6%) and imports (12%) grew less than in the previous year, although the latter continued to expand at higher rates than the former.

Traditional exports stagnated as the respective performances of coffee and banana cancelled each other out. The price of coffee improved while the volume exported dropped, whereas banana prices fell while export volumes increased. Non-traditional exports grew by 6%, especially shrimp, lobster and melon. Maquila value added climbed by 10%.

Merchandise imports rose as consumer goods (mainly fuelled by remittances), raw materials and intermediate goods increased in the light of the oil bill. However imports of capital goods were lower than in 2004, which was a reflection of faltering investment.

The financial account posted a positive balance of US$ 500 million. Foreign direct investment remained at its usual level of around US$ 200 million, most of which was channelled into free zones. The accumulation of reserve assets stood at US$ 180 million.

Mexico

The growth rate of the Mexican economy fell from 4.2% in 2004 to 3% in 2005, and per capita GDP increased 1.6%. Inflation and interest rates remained stable with a downward trend, which contributed to reducing the level of country risk. Exports slowed despite the surge in oil income caused by high international prices. Despite the dynamic growth of the United States economy, the demand for Mexican manufactures from that country slowed down because of the increasing share of Asian products absorbed. In particular, China established itself as the second largest exporter to the United States after Canada. As the expansion rate of exports also declined, the current account deficit was similar to that of 2004 (1.2% of GDP). Consumption slowed down, although consumer credit continued its significant expansion. Capital formation rose for the second year, after three years of consecutive declines, combining higher investment in machinery and equipment with slower growth in construction, although housing loans continue to grow. Economic growth in 2004 and 2005 stimulated employment, while real remuneration remained unchanged.

Economic policy was based on fiscal and monetary austerity, while extraordinary oil income gave additional degrees of freedom for accomplishing the fiscal deficit target (0.2% of GDP) and paying off public debt. The floating exchange-rate resulted in a real appreciation in the peso (3%) because of high flows of remittances from emigrants, hydrocarbon exports and foreign direct investment.

Public-sector income rose by a real 5.2% in the period from January to October, boosted by the increase in oil income (7.1%) which amounted to 36.2% of the total. Non-oil income rose by 4.1% over the same period. Fiscal changes in 2004 contributed to a rise in VAT collection in real terms of 6.3% and in income tax of 5.8%.

The higher than expected receipts allowed a hike in real public-sector budget spending by 2.9% from January to October, in view of the impetus from higher current outlays (6.6%), although physical investment diminished (-1.1%). The additional allocations to the states from excess oil income were increased in accordance with the relevant fiscal mechanism established in the new legislation for making the use of these funds more transparent.

The public sector's financial requirements, which cover all activities, whether implemented by public or private entities, are estimated as amounting to 2.2% of GDP and 2.3% excluding exceptional income from profits of the Banco de México or privatizations.

The federal government acquired international reserves from the Banco de México to cover maturities of debt bonds in 2006 and 2007 for a total of US$ 4.767 billion. By October, external debt of almost US$ 17 billion was repaid, which helped to reduce the balance by 1.3 percentage points of GDP. As domestic debt increased, total net public debt amounted to 23.1% of GDP by October, which was similar to the figure at the end of 2004.

In order to achieve the monetary-policy goal for inflation of close to 3%, the main instrument used was the "corto" (a target level for commercial banks' deposits in the central bank); this was raised to 69 million pesos per day at the end of 2004 and to 79 million pesos per day in March 2005, remaining at that level until the end of the year. The authorities maintained this restrictive stance for most of the year, in line with the monetary policy of the United States; as the financial situation became more stable and inflation declined, however, domestic monetary policy was decoupled from that of the United States in October 2005. The anchor rate, which had risen from 6.1% at the beginning of the year to 9.75% at the end of June, diminished to 9% at the end of October.

The expansion of the monetary base (by a real 7.6% in October in relation to the same month of the previous year) slowed slightly, and the preference for liquid instruments declined while it increased for other instruments. M1 expanded by 7.3%, especially current account deposits, and there was a significant rise in M2 (12.4%) and in financial savings (13.7%). The reduction in the public sector's financial needs and the flexibility of the international financial markets helped to maintain the availability of financial resources for the private sector.

Financing for the non-banking private sector rose by 3% in real terms between June 2004 and June 2005, while household credit grew by 14.1%, with particularly rapid growth in consumer loans (42%), and mortgage loans grew by 6.5%. Total financing to enterprises was down by 4.2% in real terms over the same period, although there was rapid growth in credit from commercial banks for construction, in contrast to the pronounced slowdown in credit to the manufacturing sector and the decline in the agricultural sector.

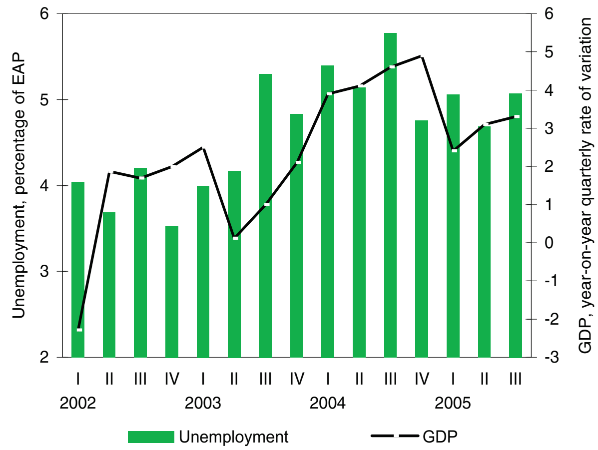
The foreign-exchange market showed a slight trend to appreciation of the peso, especially in the last quarter, when there was a greater inflow of foreign currency from remittances, foreign direct investment and oil exports. The nominal exchange rate declined from 11.26 pesos per United States dollar at the beginning of the year to about 10.50 pesos at the end of November. For the first 11 months the average parity was 10.92 pesos per United States dollar, so that the real annual appreciation is estimated at 3%.

The Banco de México continued to accumulate international reserves, although to a lesser extent than in previous years, as the mechanism to slow accumulation was operating, and US$ 3.388 billion were sold up to October. At the end of November, the net variation in reserves was almost US$ 4 billion in relation to the end of 2004, and there was a balance of US$ 65.474 billion.

The economy expanded by 3% between January and September, and this figure is not expected to change in the fourth quarter. External demand slowed down owing to the displacement of Mexican products on the United States market in the face of competition from other countries. Domestic demand evolved favourably in response to the growth in employment, remittances and the expansion of credit. It is estimated that private consumption increased by about 4% over the year, while government consumption stagnated. The rise in gross fixed capital formation is estimated at 6% (7.5% in the previous year), which was a result of the slower growth in construction, as the purchase of machinery and equipment expanded significantly.

As a result of the slowdown in manufacturing exports (80% of total exports), production in that sector grew only slightly (0.9%) in the first nine months of the year. There was a decline in activity in textiles (-1.9%), wood (-2.8%), base metals (-0.4%) and metal products and machinery and equipment (-1.2%), while paper and chemicals increased by 1.5% and 0.7%, respectively. Motor vehicle production expanded by 1% between January and October thanks to the impetus of domestic sales (4.4%) as exports continued to decline, although to a lesser extent. Basic services maintained their positive trend thanks to the boost from private consumption and public spending.

MEXICO: GROSS DOMESTIC PRODUCT AND UNEMPLOYMENT



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In 2005, inflation remained within the limits established by the monetary authorities and was at about 3% at the end of the year. Some inflationary pressures were observed in areas affected by hurricanes Stan and Wilma, but they were neutralized by the timely replacement of supply and did not affect the general level of prices. The lower variation in prices was partly due to the appreciation of the peso in relation to the United States dollar. The non-core component of inflation slowed gradually (2.85% as of October), owing to lower rises in agricultural prices, controlled goods and services and education. The core component diminished owing to the lower variation in prices of processed foods.

Despite the slower growth of the economy, the open unemployment rate declined from 5.4% of the urban economically active population between January and October 2004 to 4.9% in the same period of 2005, because of both the recovery of formal employment since 2004 and the absorption of workers in the informal sector. According to the new national survey of occupation and employment, the underemployed population amounted to

MEXICO: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	1.4	4.2	3.0
Consumer prices	4.0	5.2	2.9 [b]
Average real wage [c]	1.3	0.2	-0.3
Money (M1)	14.2	13.9	10.7 [d]
Real effective exchange rate [e]	12.5	4.7	-2.4 [f]
Terms of trade	1.0	2.9	2.9
	Average annual percentage		
Urban unemployment rate	4.6	5.3	4.8
Public sector overall balance / GDP	-0.6	-0.3	-0.2
Nominal deposit interest rate	5.1	5.4	7.7 [g]
Nominal lending interest rate	6.9	7.2	9.9 [h]
	Millions of dollars		
Exports of goods and services	177 299	201 911	225 830
Imports of goods and services	187 680	215 372	241 781
Current account	-8 615	-7 271	-9 300
Capital and financial account	18 053	11 329	14 800
Overall balance	9 438	4 058	5 500

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to November 2005.
[c] Manufacturing.
[d] Year-on-year average variation, January to September.
[e] A negative rate indicates an appreciation of the currency in real terms.
[f] Year-on-year average variation, January to October.
[g] Average from January to November, annualized.
[h] Average from January to October, annualized.

7% of the economically active population and informal employment accounted for 11.9 million persons (28.2% of the employed population).

The number of workers affiliated to the Mexican Social Security Institute (IMSS) exceeded 13 million in October (4.2% more than in October 2004) and the annual average was higher than the previous peak recorded in 2000 (12.6 million); in this context the increase in employment in the maquila industry is striking (5.5% from January to September), reaching 1.164 billion workers, a figure which is still 10% less than the level recorded in 2000.

Labour productivity in the manufacturing industry rose by 2% up until July (6.7% for the same period of the previous year), while real average remuneration diminished by 0.4%; accordingly, the trade sector showed a productivity increase of 4.3% and a rise in remuneration of 0.3% in the same period.

Foreign trade slowed down. Between January and October, exports expanded by 12.0% (2.3 percentage points less than in 2004), the same rate as for imports, which produced a trade deficit of US$ 4.849 billion (a year-on-year increase of 15.4%). The fastest-growing exports were in the oil sector (35.8%), despite the reduction in volume, while non-oil exports rose by 8.8% (3.7 percentage points less than in 2004). Between January and October, the average price of the Mexican mixture was US$ 42.5 per barrel (US$ 30.9 per barrel in 2004). The slower growth of exports affected imports, especially of intermediate goods, which grew by 9.3% in the period mentioned (15% in 2004).

The share of Mexican exports in the total world imports of the United States diminished from 10.7% to 10.2% from September 2004 to September 2005, while China's share rose from 12.8% to 14.2% over the same period. The balance-of-payments current-account deficit is expected to be US$ 9.3 billion at the end of the year, equivalent to 1.2% of GDP. Family remittances until September showed an accumulated value of US$ 14.719 billion (18.8% more than in 2004) and are expected to reach US$ 20 billion by the end of the year; foreign investment would probably amount to US$ 16 billion.

With the prospect of a slight slowdown in the United States economy and in view of the scarce growth in competitiveness, the estimate for Mexico's GDP growth in 2006 was 3.5%, mainly supported by domestic demand, which would continue to be boosted by the expansion of credit to the private sector and a low inflation rate (around 3%). Presidential elections will be held in July 2006. This is expected to be a very competitive process, but without leading to any major changes on the economic front.

Nicaragua

Real GDP grew by 4% in 2005, which is equivalent to a loss of almost one percentage point in relation to 2004 and a per capita GDP increase of 1.4%. Although the expansion of the economy and global trade boosted the country’s exports, the hike in international oil prices and of some industrial commodities resulted in a deterioration in the terms of trade and a rise in inflation, which went from 8.9% in 2004 to 11.3% in 2005 and contributed to a large extent to the widening of the trade deficit.

In addition, the macroeconomic situation became weaker in view of the uncertainty caused by the lack of parliamentary support for the executive’s initiatives and the growing political tensions in a situation marked by the presidential elections planned for 2006. As a result of the problems that arose during consideration and approval of the public budget for 2005 and the limited progress achieved in structural reform, the triennial agreement signed with the International Monetary Fund was in fact suspended, which led to a considerable reduction in outlays for budgetary support and the balance of payments.

Despite the commitment shown for achieving the quantitative goals and the recent efforts to implement the structural reform agenda before the end of the year, it seems increasingly unlikely that the government will be in a position to rescue the triennial agreement. Nevertheless, the debt relief planned in connection with the Heavily Indebted Poor Countries Initiative will not be affected. At the end of September 2005, Nicaragua had negotiated a reduction in external debt of US$ 3.782 billion, of a total of US$ 6.328 billion in scheduled relief.

It is important to emphasize that in this political and economic context, Nicaragua ratified CAFTA-DR.

The effects of the fiscal policy were a key factor in the macroeconomic performance. The central government fiscal deficit before grants was lower, which contributed to achieving monetary-policy goals in relation to price and exchange-rate stability.

Central government current income grew by 22.4% and the tax burden was raised to 16.7% of GDP. Grants, which were equivalent to 3.6% of GDP, were down by 12% compared to the previous year. Consequently, the share of total income in GDP (20.8%) diminished by half of one percentage point.

Current income increased by 13.3%, leading to an expansion of current saving, which rose from 3.4% of GDP in 2004 to 4% in 2005. This was a result of the significant decline in outlays for interest payments on domestic and external debt (-17%). Accordingly, although total expenditure expanded by 14.6%, it remained virtually unchanged as a proportion of GDP (22.8%), despite a wage hike, the granting of subsidies to the transport sector, allocations to universities and municipalities and higher capital expenditure. Consequently, the fiscal deficit (excluding grants) declined from 6.1% of GDP in 2004 to 5.6% in 2005. The government transferred resources to the Central Bank in an amount equivalent to 1.6% of GDP, which improved its financial position.

In monetary affairs, the Central Bank maintained the exchange-rate policy of daily mini-devaluations consistent with a pre-announced annual devaluation rate to serve as an anchor for inflationary expectations. Nevertheless, in view of the lack of a clear direction in economic policy and the high inflationary pressures, it decided not to modify the devaluation rate of 5% and maintained the reserve requirement at 16.25%. At the same time, the Central Bank used open-market operations to reduce its domestic debt by paying off securities to the private sector on net terms. This paved the way for an increase in financial intermediation at lower interest rates. The structure of the credit portfolio reveals brisk growth in housing, consumer and business loans.

Real production growth was moderate in 2005, down from 5.1% to 4%. The rise in GDP was due to both the expansion of exports (6.3%) and the rise in domestic demand (5%). If inventory-rebuilding is excluded, however, the increase in domestic demand is much lower (4.1%), owing to the contraction in public investment in real terms (-1.4%). In contrast, private investment and consumer spending grew at higher rates than in 2004.

As for supply, GDP growth mainly reflected the positive performance of export-oriented agricultural activities and the higher value added in manufacturing, especially among free-zone firms and in construction. Service activities also contributed to the economic recovery. The fastest-growing service sectors were financial services, commerce, transport and telecommunications.

Inflation, at 11.3%, was 2.4 percentage points higher than in 2004. The faster price increases were due to short-term factors —including higher fuel and transport costs, rate adjustments for certain basic services and a temporary hike in the prices of some agricultural products due to supply factors— rather than a deterioration in monetary conditions or an increase in domestic spending.

Preliminary official data show that, despite the economic growth, the level of unemployment rose slightly. In contrast, it is estimated that the real average wage increased, in particular because of the higher remuneration in central government. In April a 15% adjustment was approved for the minimum wage in all sectors.

The expansion of economic activity was accompanied by a larger imbalance in the external sector. The current account deficit (US$ 865 million) rose from 16.5% of GDP in 2004 to 18.1% in 2005. This was due to the widening of the trade deficit, since the income account deficit was substantially less in view of lower interest payments and the substantial increase in current transfers (16.2%), especially family remittances. The reduction in official capital flows was compensated by the inflows of private capital, but the higher net capital revenue was not sufficient to finance the current-account deficit, and there was thus a loss of net international reserves.

Exports grew by 12.7%, while imports were up by 19.7%. The higher level of exports reflected both the recovery in sales of traditional products and the expansion of sales of non-traditional products, including food products, leather, wood, plastics and chemicals and the strong growth of net exports in the free zones (especially maquila firms in the textile industry) and in tourism earnings.

NICARAGUA: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	2.3	5.1	4.0
Consumer prices	6.6	8.9	10.5 [b]
Average real wage	1.9	-2.2	-1.6
Money (M1)	...	24.2	25.6 [c]
Real effective exchange rate [d]	4.0	1.7	-0.4 [c]
Terms of trade	-3.4	-1.9	-2.8
	Annual average percentages		
Urban unemployment rate	10.2	9.3	...
Central government overall balance / GDP	-2.8	-2.2	-2.0
Nominal deposit rate	5.6	4.7	4.0 [e]
Nominal lending rate	15.5	13.5	12.3 [e]
	Millions of dollars		
Exports of goods and services	1 307	1 653	1 873
Imports of goods and services	2 385	2 851	3 374
Current account	-749	-732	-865
Capital and financial account	280	-793	826
Overall balance	-470	-1 524	-39

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to October 2005.
[c] Year-on-year average variation, January to October.
[d] A negative rate indicates an appreciation of the currency in real terms.
[e] Average from January to October, annualized.

All categories of imports showed substantial growth. There was a large increase in imports of commodities and intermediate goods, mainly because of the higher cost of oil and petroleum products (44.4%) and external purchases of capital goods, owing to the expansion of investment. Purchases of consumer goods expanded considerably, boosted by an increase in imports of non-durable goods.

Although the official figures for family remittances in 2005 are not yet available, they have continued to play an important role in the Nicaraguan economy. In 2004, they accounted for 11.4% of GDP and 36.7% of the trade and income balance.

Panama

Although growth was more moderate in 2005, Panama's economy has nevertheless expanded considerably over the past two years (around 6% in 2005 and 7.6% in 2004) thanks to favourable external conditions and buoyant domestic demand. This had a positive effect in terms of bringing down the unemployment rate to 9.6%, and significantly narrowing the fiscal deficit (3.6%). The balance-of-payments current- account deficit, on the other hand, widened to 9.8% of GDP and inflation exceeded usual levels (4%). Growth in 2006 is expected to be around 6.5%, provided that work is begun as planned on extending the Panama Canal and upgrading sanitation in the Bay of Panama. Unless these projects are implemented, growth will be lower as world trade is expected to slow down and interest rates look set to rise. Inflationary pressure should decrease and the fiscal balance is expected to improve, with a deficit of around 2.6%. A narrowing of the current account deficit is also predicted.

The government's main four projects for 2005 were: fiscal reform, social security reform, the conclusion of free trade negotiations with the United States and a referendum on the widening of the Panama Canal. Given that the projects have proved controversial, progress has only been made in the first two.

The fiscal reforms approved in February included 11 measures related to expenditure and 12 related to income. One of the most controversial measures, which met with opposition from the business sector and whose effects will be felt in 2006, is the "alternative calculation" of income tax, which involves paying a percentage of gross income. The proposed reform of the social security system met with even greater opposition, and led to the paralysis of sectors such as construction, which halted its activities for a month. The government therefore called for a dialogue with civil society groups, and this generated a proposal that included individual savings plans. The resulting bill was presented at the end of the year.

The deficit of the non-financial public sector (NFPS) narrowed from 5% of GDP to 3.6%. Revenues rose by around 11% in real terms as a result of increased tax receipts from buoyant economic activity, greater control in terms of collection and a rise in non-tax income from dividends. Expenditure was up by 5% due to debt interest and transfers. Public investment weakened and the payroll declined. The fiscal adjustment facilitated the reduction of the floating debt, thereby cutting delays in payments to suppliers.

In 2005, the authorities implemented measures aimed at improving the public debt profile. Fiscal reform and the efforts to reform the social security system combined with favourable international market conditions to bring Panama's country risk to a record low. This enabled the substitution of some costly debt and the short-term maturity debt, thereby mitigating the budgetary effects of debt servicing. Up to September, public debt stood at US$ 10.03 billion (an increase of US$ 52 million), three quarters of which corresponds to external debt.

The banking sector benefited from a favourable economic situation at the national and regional levels —especially in terms of South American customers— and two new banks were set up. Between December 2004 and September 2005, assets increased by 4%, thereby offsetting the drop recorded between 2002 and 2003. Improvements were also recorded in other indicators including liquidity, profits and the arrears rate.

The loan portfolio increased by around 9% up to September: a rise driven by mortgages (15%), personal consumer loans (9%) and trade (13%). Deposit rates edged up slightly, while lending rates dipped, which reduced the level of intermediation.

Trade policy was directed at concluding a free trade agreement with the United States and another with

Singapore. The talks with Singapore were concluded successfully, while those with the United States stalled, although a final round of negotiations is scheduled for the beginning of 2006. Negotiations with Chile were reopened, and an agreement was signed with Mexico on the reciprocal promotion and protection of investment.

Growth was 6%, which was lower than in 2004 but higher than the potential growth of the economy. Sectors providing services to the rest of the world benefited from the buoyancy of the United States and Asian economies, and the steady growth of Latin America. Domestic demand expanded thanks to household consumption (boosted by the increase in employment and credit) and abundant private investment in sectors such as ports and tourism.

The agriculture and fishing sectors performed well (6%), mainly on the strength of increases in fishing, livestock and export crops such as coffee and pineapple. Manufacturing expanded slightly on the back of activities related to food processing and the manufacturing of metal products. Commerce also turned in a fine performance (6%), both at the strictly domestic level and in the Colón Free Zone. The most buoyant sector is still transport, storage and communications (12%), thanks to the positive results for port activities, railways, the Panama Canal and mobile telephones.

Year-on-year inflation up to October recorded growth of 3.9%, the highest rate observed since 1982. This exceptional rise was due to international petroleum prices, with transport displaying growth of over 10%. Significant increases were also registered in housing, water, electricity and gas and food and beverages. Inflation measured by the wholesale price index was higher (6.6%), which suggests that inflation will remain above usual levels in 2006.

The labour market continued to improve by virtue of the considerable buoyancy of the economy. The urban unemployment rate retreated significantly from 14.1% to 12%. There were no adjustments to the minimum wage in 2005, hence average real wages varied very little.

The balance-of-payments current account deficit widened again from the equivalent of 7.7% of GDP in 2004 to 9.7% in 2005, due to the increase in exports (12%) and imports (15%). Merchandise exports benefited from buoyant world trade, particularly exports of coffee, melon, watermelon, pineapple and shrimp larvae. Banana exports, on the other hand, declined. Merchandise imports climbed considerably, especially in terms of petroleum derivatives and capital goods.

The positive balance of services result rose by more than US$ 100 million to stand at around US$ 1.400 billion. This was due to increases in tolls and the volume transported by the Panama Canal, plus the good performance of port and tourist activities. The income balance, on the other hand, posted a deficit of US$ 100 million corresponding to profits and dividends.

The financial account (including errors and omissions) recorded a positive balance of US$ 1.800 billion. Although foreign direct investment (US$ 700 million) was lower than in 2004, it nonetheless remained one of the main sources of financing for the hefty current account deficit.

PANAMA: MAIN ECONOMIC INDICATORS

	2003	2004	2005 [a]
	Annual growth rates		
Gross domestic product	4.2	7.6	6.0
Consumer prices	1.5	1.5	4.0 [b]
Real minimum wage	0.7	0.9	-2.9
Money (M1)	7.3	14.2	7.7 [c]
Real effective exchange rate [d]	2.6	5.0	2.7 [e]
Terms of trade	-4.4	-1.9	-1.9
	Annual average percentages		
Unemployment rate [f]	13.1	11.8	9.6
Non-financial public-sector overall balance / GDP	-4.8	-5.0	-3.6
Nominal deposit rate	4.0	2.2	2.7 [g]
Nominal lending rate	8.9	8.2	8.4 [g]
	Millions of dollars		
Exports of goods and services	7 606	8 611	9 634
Imports of goods and services	7 464	8 901	10 213
Current account	- 437	-1 104	-1 515
Capital and financial account	284	709	1 834
Overall balance	- 153	- 395	319

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary estimates.
[b] Twelve-month variation to October 2005.
[c] Year-on-year average variation, January to August.
[d] A negative rate indicates an appreciation of the currency in real terms.
[e] Year-on-year average variation, January to October.
[f] Includes hidden employment.
[g] Average from January to August, annualized.