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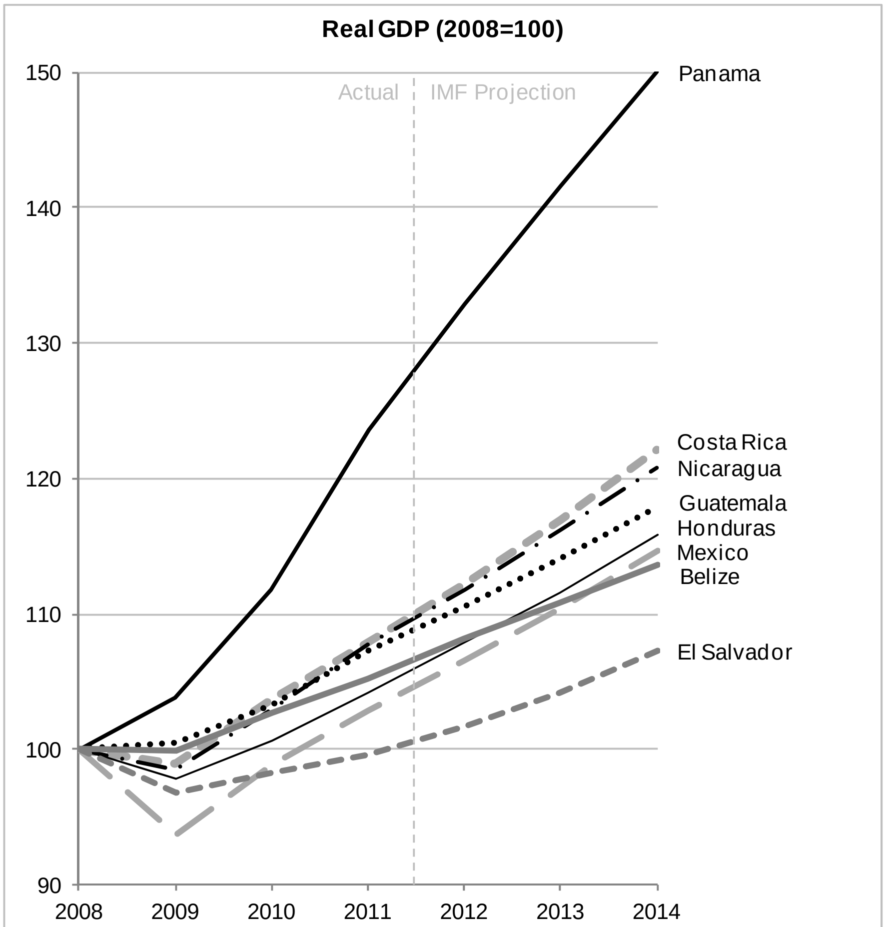
EADS Economic Trends Report

Central America and Mexico

May 2012

Economic Overview



SOURCE: IMF, *World Economic Outlook*, April 2012.

Like most of Latin America, the Central American and Mexican economies are growing only modestly. The downturn in many countries in 2009 gave way to the sharp upswing in 2010, but that volatile pattern has been replaced by a phase of steady and modest growth rates.

Mexico's economy, the region's hardest hit in 2009, bounced back as exports to the U.S. were strong, banks proved to be sound, and company balance sheets were all above average. In the first few months of 2012, domestic demand remained strong and the economy has benefitted from export growth to the United States. The unemployment rate remains favorable at around 4 percent. Political uncertainties will affect the economic outlook, with the presidential election in Mexico on July 1st this year.

The economy in Belize is expected to expand in the 2.5–3.0 percent annual range this year and next, with higher exports of oil, increased manufacturing output, and rising domestic demand for consumer products contributing to growth. Despite ample liquidity, the banking system remains at risk. Nonperforming loans are hovering around 20 percent of total loans. Until the government can improve the bank regulatory framework, the high level of nonperforming loans will curb credit growth and economic expansion. Recent nationalizations of the telecoms and electricity companies, at least partly motivated by the risk of rolling power blackouts, prompted S&P to downgrade Belize's sovereign credit rating and have cast a long shadow on the investment climate.

In Guatemala, real GDP expansion of almost 4 percent in 2011 will be followed by annual growth of around 3 percent this year and the next, as projected by the IMF. Strong exports and private consumption are moving the economy forward while the government has been able to trim its budget deficit and keep the debt-to-GDP ratio stable.

Countries covered in this report include Belize, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, and Panama. Due to data limits, not all countries are represented in every graph or analytical section.

Real GDP is expected to be grow in the 3.5–4.0 percent range in Honduras this year and next, driven largely by domestic demand. The telecoms, construction, and retail trade sectors all had strong rebounds in 2011 and the momentum has carried forward into this year. A global downturn in demand for Honduran manufacturing exports and an unfavorable outcome for the agricultural sector are the biggest risks to the economic outlook.

Nicaragua's economy is expected to grow at around 4 percent a year this year and next, boosted by private consumption and investment. Tax reform in 2009 has been followed by increased revenues and a narrower fiscal deficit. Monetary policy has been accommodative while nonperforming loans remain very low and bank liquidity is ample. Although the Nicaraguan economy has a high degree of dollarization, the Central Bank implemented policy by reducing its debt while net international reserves were rising.

The Costa Rican expected economic growth rate this year and next, in the 4.0–4.5 percent range, puts it above the average for Central America. The rebound from the 2009 contraction was led by stronger exports and increased foreign direct investment. Even as export growth slows in 2012, investment remains strong. Political uncertainties hang over the economic outlook. The president's party lost control of the legislature, and with it the ability to control policy initiatives. In addition, the Costa Rican supreme court has overturned tax reform and the government will need to find new ways to recoup the revenues it had planned on getting.

El Salvador has the slowest growing economy in the region. Domestic demand is sluggish and the country attracts relatively little foreign direct investment. Changes in financial regulations, designed to promote more widespread access to credit, will take place this year and could eventually help the economy expand more rapidly.

Panama remains the fastest growing economy in the region. Large public investments, including the expansion of the Canal, are the main drivers of growth. The labor market is tight, particularly in the construction and transportation sectors. Investment is being supported by an expansionary fiscal stance, but Panama has also attracted increased foreign direct investment. Real GDP growth is estimated by the IMF at over 10 percent in 2011 and is projected to remain around 7 percent this year and next. Good fiscal management, taking advantage of the rapid economic growth in recent years, has led to a rapid decline in the ratio of public debt to the size of the economy and an upgrade of Panama's sovereign credit rating by Moody's and Fitch.

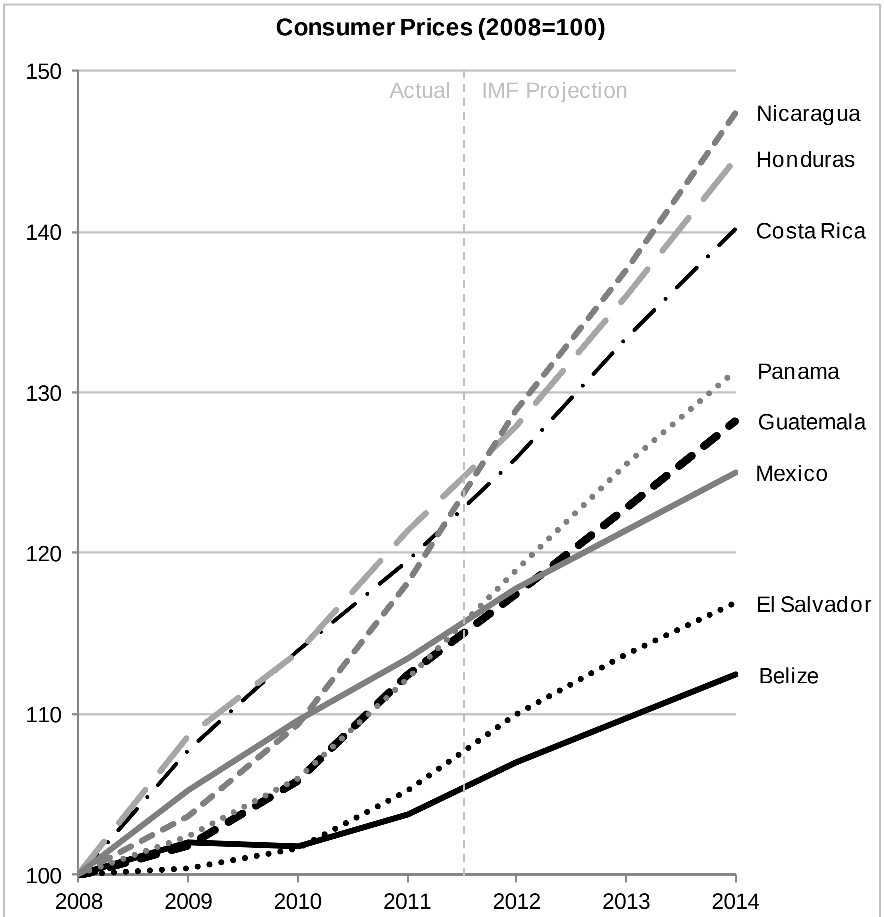
Overall, the Central American and Mexican region is well placed to benefit from continued foreign investment flows, firm commodity prices, and prudent macroeconomic management.

Real GDP Growth, 2012 (IMF Projections)	South America	Central America	Mexico	Caribbean
	3.9%	3.8%	3.6%	2.5%

Inflation

Although inflation rates in the region remain moderate, higher food prices exerted upward pressure on the CPI in 2011. Only Costa Rica and Mexico had lower inflation in 2011 compared with 2010. In both countries, currency appreciation contributed to keeping a lid on import prices. In Mexico, an additional factor was that some production sectors were still operating below capacity, alleviating any upward pressure on prices.

The highest inflation rate in the region belongs to Nicaragua, where the IMF projects inflation to rise to 9 percent rates in 2012. If world commodity prices fail to continue to rise sharply, Nicaragua should be able to reduce its inflation rate in 2013 below 7 percent. (Inflation rates in this section refer to period average comparisons.)



SOURCE: IMF, *World Economic Outlook*, April 2012.

Inflation in Panama has moved above the average for its recent past, hitting the 6 percent mark this year. Strong investment spending is causing some overheating and a large increase in the minimum wage during 2010 is rippling through the economy. Higher world prices for food and fuel also add to inflation, while a higher VAT rate adopted in 2011 imparted a one-time boost to the CPI.

Belize had a modest deflation in 2010, but higher food and fuel prices reversed that into an inflation rate of just under 2 percent for 2011. IMF projections have annual inflation remaining around or below 3 percent for the next several years. So long as the economy is only growing modestly, Belize will be able to avoid inflationary pressures even if food and fuel prices climb higher. Since 2008, Belize has been the least inflationary economy in the region.

CPI Inflation, 2012 (IMF Projections)	South America 7.7%	Central America 5.4%	Caribbean 4.1%	Mexico 3.9%

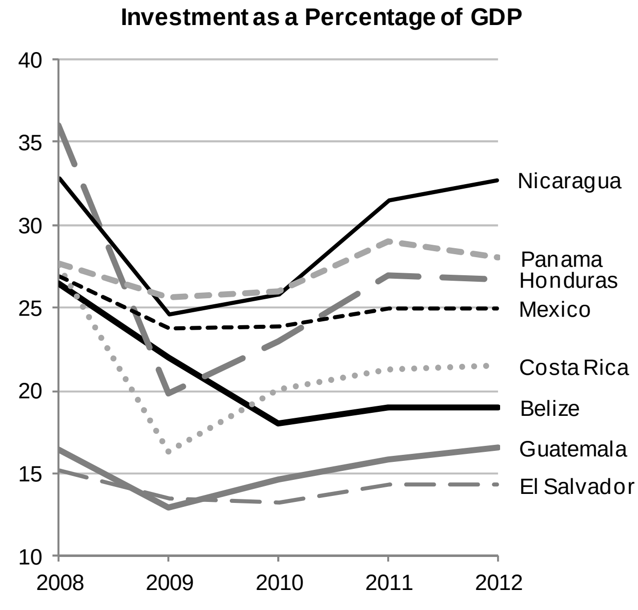
Investment

Although the typical level of investment as a percentage of GDP varies significantly between the eight economies in Central America and Mexico, the trend since 2008 has been broadly similar. Most economies responded to the economic downturn in 2009 by cutting investment levels and then quickly rebounded to pre-crisis levels.

Among countries with high investment ratios in the region, Nicaragua's rebound in 2011 restored its position as the highest ratio. With credit growth in Nicaragua somewhat subdued, recent gains in investment represent strong FDI inflows.

Canal expansion and an ambitious public investment program in Panama have kept its investment ratio among the highest in the region, but those factors are projected to hit their peak this year.

Among countries with low investment ratios in the region, Belize saw the largest decline since 2008 and a negligible rebound. The financial system is burdened by a high percentage of nonperforming loans and the investment climate is weak.

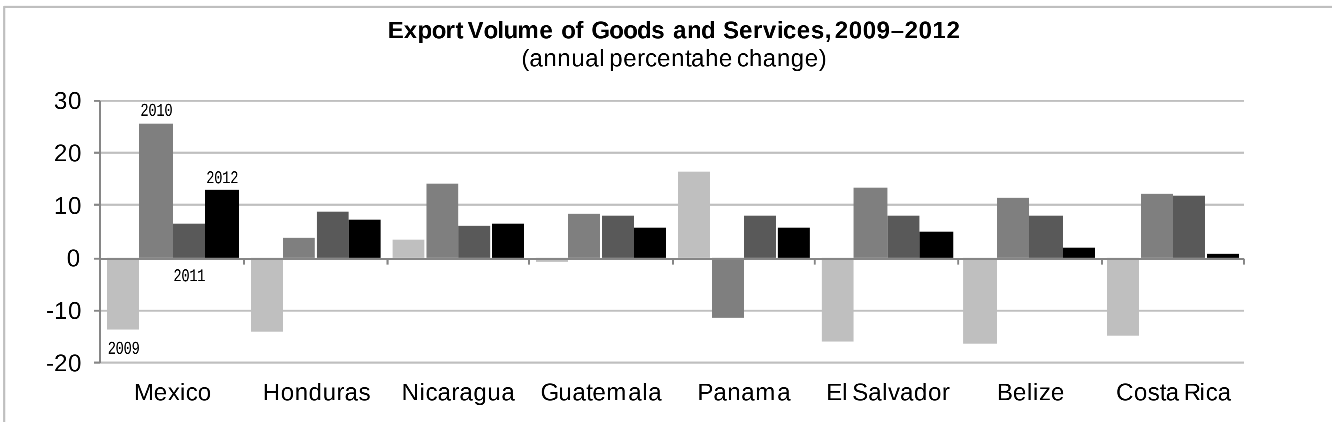


SOURCE: IMF, *World Economic Outlook*, April 2012.

Total Investment, 2012 (as a percentage of GDP) (IMF Projections)	Caribbean 27.8%	Mexico 25.0%	Central America 22.7%	South America 22.6%

Trade

Central American and Mexican trade began to lose momentum in 2011 and the slowdown continues for most of the region. The economies of the region's major trading partners, including China and the United States, are shifting into a slower growth phase. As the growth rates of exports ebb, the economies also expand more slowly. For example, industrial production in Mexico for February 2012 was at a 4.2 percent year-on-year rate, down from the 6.3 percent rate in February 2011. The growth rate of export volumes in Mexico had slowed from 26 percent in 2010 to 6 percent last year, reflecting less robust U.S. demand. Fortunately for the Mexican economy, the IMF is projecting faster export volume growth in 2012.

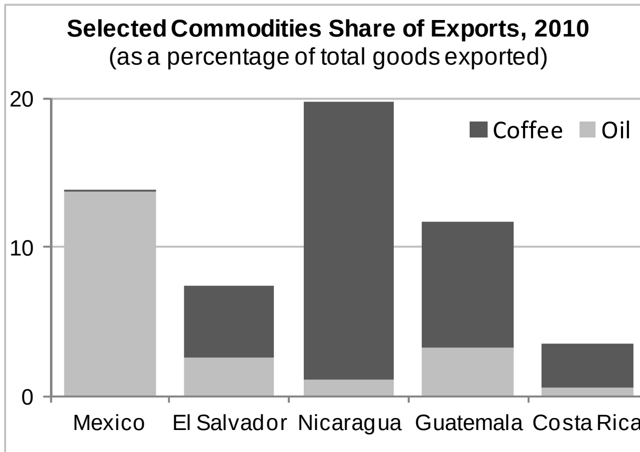


SOURCE: IMF, *World Economic Outlook*, April 2012.
NOTE: 2012 values are projections.

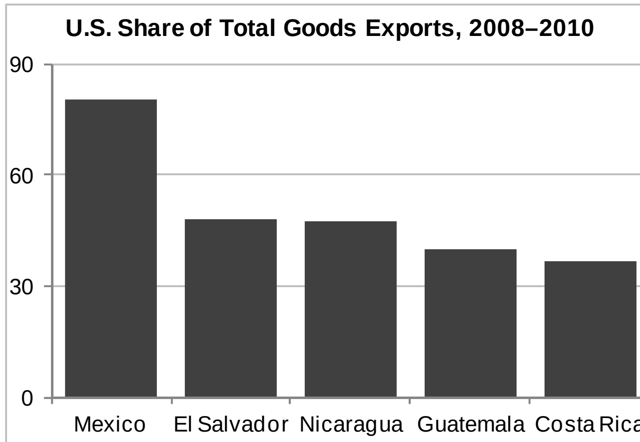
The IMF projects only a small gain in export volume for Belize in 2012, but the country's external position remains strong. Exports of oil, citrus, and bananas were up in the past two years while demand for imports remained subdued. As a percentage of GDP, the current account deficit was nearly cut in half from 2009 to 2010.

In the most recent World Economic Outlook, the IMF analyzed the relationship between domestic economic activity and world commodity price swings, in those countries with a large share of exports in commodities. Exporting any commodities implies a vulnerability to prices swings, but the IMF analysis found that the impact on domestic indicators was greater for exporters of oil and copper than for exporters of coffee and cotton. Unlike its Central American neighbors, Mexico is a major oil exporter. The Central American economies, by contrast, more typically rely on coffee exports.

Another area of vulnerability to the economic outlook for all countries in the region is the strength of the U.S. economy, a key destination for exports. By this measure, Mexico is much more vulnerable to a slowdown in the U.S. economy. Based on data for 2008–2010, Mexican exports of goods are much more heavily concentrated in U.S. markets than are the exports of any of the Central American economies.



SOURCE: UN, *Comtrade*, April 2012.



SOURCE: IMF, *Direction of Trade Statistics*, April 2012.

Export Volume of Goods and Services, 2012 (annual percentage change) (IMF Projections)	Mexico 12.8%	Caribbean 5.8%	Central America 4.7%	South America 4.2%

Additional Information
For questions or more information, please contact the author, Michael Shea at mshea@devtechsys.com.
For country-specific data and additional information about the countries covered in this report, please visit the EADS Country Portal at http://esdb.eads.usaidallnet.gov/query/do?_program=/eads/esdb/countryPortal.
Sources used in compiling this report include the semi-annual *World Economic Outlook* (April 2012) and country-specific reports from the International Monetary Fund (http://www.imf.org/), the *Global Economic Prospects* from the World Bank (http://www.worldbank.org/), specific country documents from the IMF (http://www.imf.org/), and the UN's *World Economic Situation and Prospects* (http://www.un.org/en/development/desa/policy/wesp/index.shtml).