USAID
Economic Analysis
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EADS Economic Trends Report

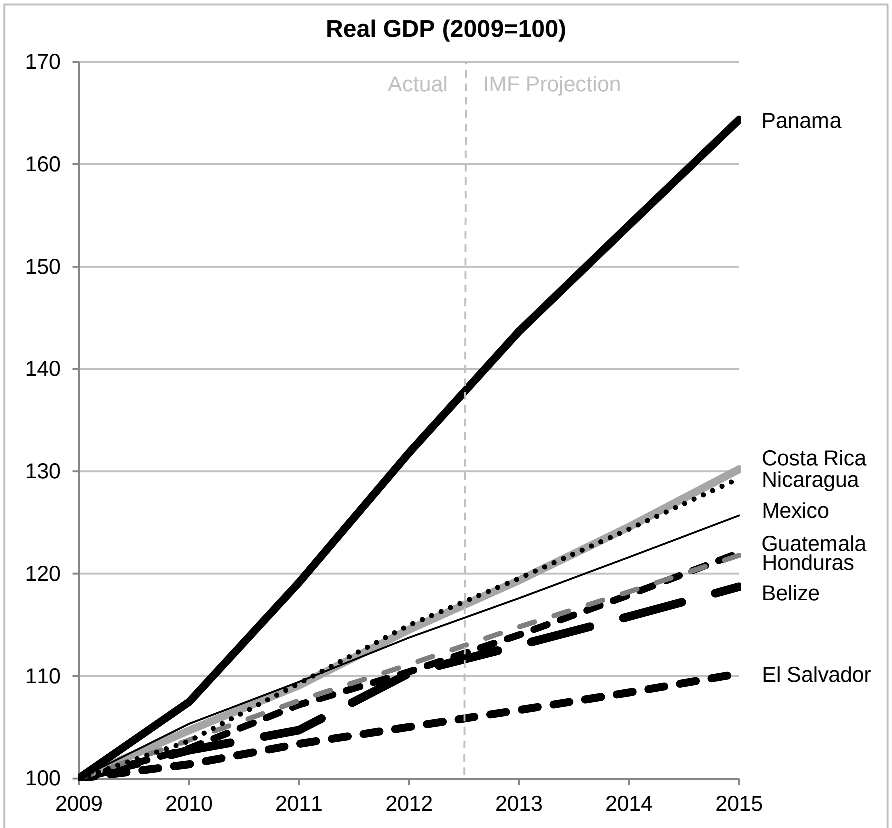
Central America and Mexico

May 2013

Economic Overview

Growth rates in most of Central America and Mexico were overall little changed in 2012 from 2011, and a modest deceleration is projected for 2013. Countries currently expanding the slowest—El Salvador, Guatemala, Honduras, and Mexico—will grow about the same pace in 2012 and 2013. Other fast growing economies in the region—Costa Rica, Nicaragua, and Panama—will see a modest decline in their growth rates for 2013, while fast-growing Belize will slow down sharply as oil production continues to ease.

Panama continues to lead the pack with double-digit economic growth, the highest investment-to-GDP ratio in the region, and rapid export expansion. Infrastructure spending on the Canal and a new metro subway system has sparked a sustained burst of economic vitality.



SOURCE: IMF, *World Economic Outlook*, April 2013.

Mexico's economy has bounced back well from the 2008–2009 slowdown despite subpar economic growth in the United States and Europe. One favorable trend for Mexico has been that U.S. manufacturing has fared better than the overall U.S. economy, and Mexico has increased its market share as a supplier to U.S. industry. In its assessment of the Mexican economy last November, the IMF cited productivity gains, control of unit labor costs, and sustained foreign direct investment into Mexico.

Costa Rica responded to the 2008–2009 global slowdown with fiscal stimulus, currency depreciation, and a stand-by arrangement with the IMF. The results were a minimized economic slowdown and resurgence in growth. However, an upswing in capital inflows points to a risk of overheating in the economy and the rising public debt could become unsustainable.

For the past two years, economic growth in Nicaragua has outpaced expectations and exceeded five percent each year. The expansion has been driven mostly by construction spending and other forms of domestic investment. Increased capital inflows have offset higher prices for oil imports while the growth rate in exports has been modest.

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

Honduran economic growth has stayed above three percent a year after the economy contracted in 2009, but the IMF projects that the pace will ease slightly through 2015. In 2012, fiscal policy in Honduras as expansionary as tax revenues dropped and spending increased. Tax administration remains weak and attempts by the government to improve tax collection are hindered by a judicial veto of part of the tax reform plan. Export growth was strong in 2011, but slipped to more modest growth rates. The free trade zone industrial sector contracted in 2012, curbing the overall growth of the economy.

Economic growth in Belize picked up in 2012 despite a drop in oil production, as the agriculture and services sectors rebounded from weather-related shocks in 2011. Oil production is projected to continue to decline, but this should be offset by sounder fundamentals (banking supervision reforms took effect in January 2013) and resilience in non-oil export sectors. Real GDP growth is projected to average 2.5 percent during 2013–2015.

Guatemala's economy accelerated modestly in 2011, but has since eased back and is projected to hit annual growth rates just over three percent through 2015. Key sectors such as tourism (projected to rise by 2.5 percent in 2013) and coffee (shipments for October 2012 through April 2013 were 0.3 percent higher than for the same period a year earlier) are proving to be resilient.

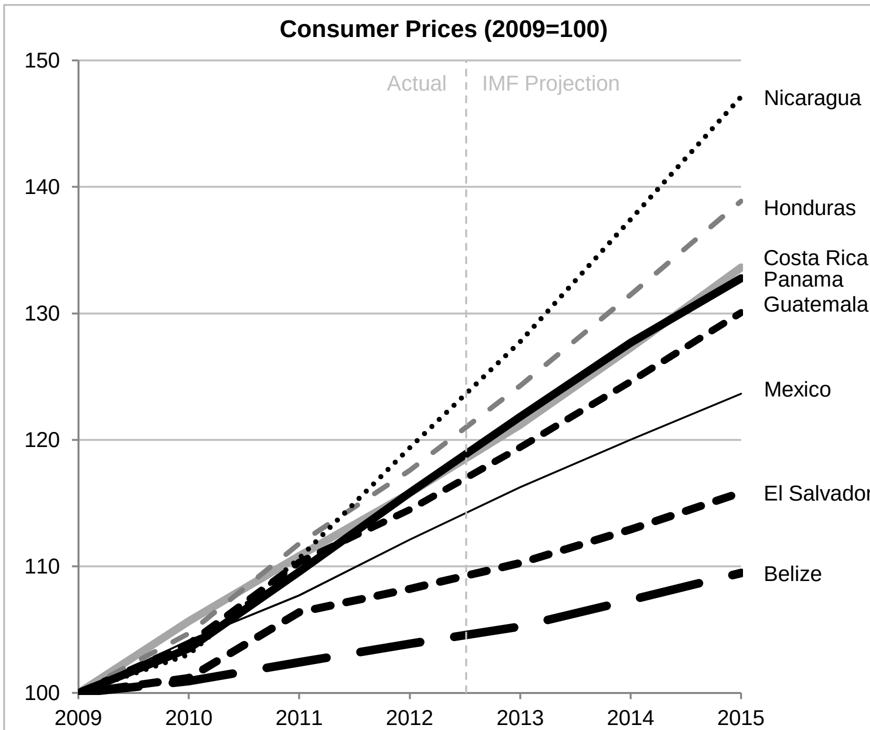
Recovery from the 2008–2009 global slowdown has been slowest in the region for El Salvador, with the IMF projecting that annual real economic growth will average less than two percent for the 2011–2015 period. Weather-related shocks have hindered Salvadoran economic growth, but relatively low levels of investment and uncompetitive industries are also to blame.

Real GDP Growth, 2013 (IMF Projections)	South America	Central America	Mexico	Caribbean
	4.6%	4.0%	3.4%	1.8%

Inflation

Most of the economies in the region have only modest inflation rates, with Belize and El Salvador seeing annual price increases at or just above a projected 2 percent annual rate for the 2012–2015 period. The problem is most acute in Nicaragua, where the inflation rate has more than doubled in the last two years and is projected to remain above seven percent through 2015. Higher world prices for oil, electricity rate increases, and an increased minimum wage are all putting pressure on prices in Nicaragua.

In Honduras, although inflation is relatively high for the region at over five percent and the core inflation rate is slightly higher, it has eased since 2011 and is projected to be stable through 2015.



SOURCE: IMF, *World Economic Outlook*, April 2013.

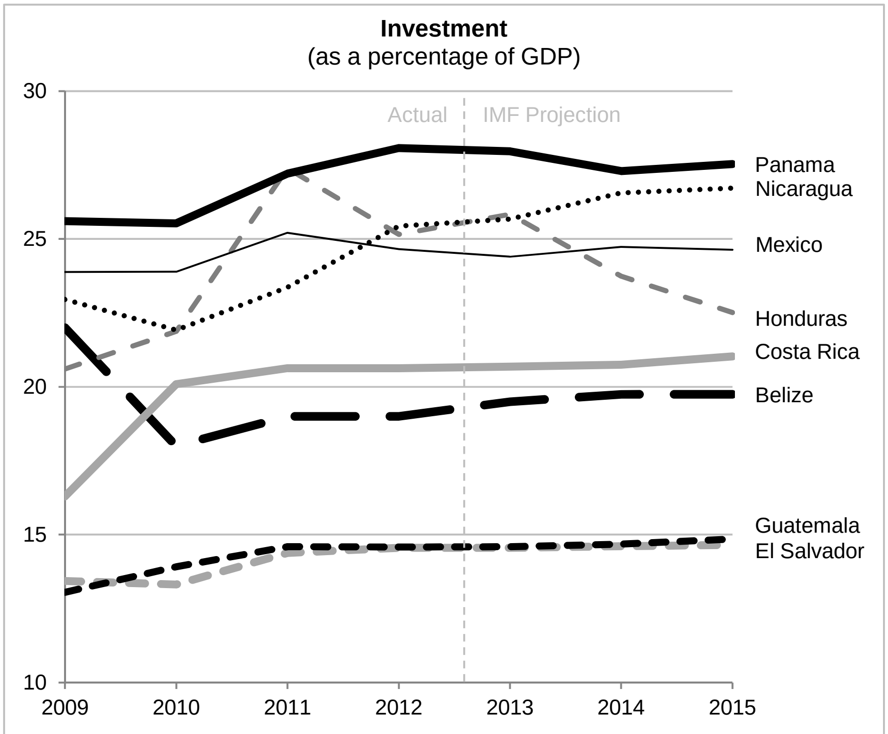
The rest of the region is projected to have inflation rates in the two to five percent range for 2013–2015. Mexico's inflation rate is staying mostly in check, despite a spike in food prices due to higher international corn prices, a domestic bird flu outbreak, and drought conditions. In Costa Rica, inflation was successfully trimmed by a few percentage points in 2009 and is projected to be stable at around five percent through 2015.

Panama's rapid economic growth rates have caused some inflationary pressures, with the projected rate of four to five percent for 2013–2015 up from 2.4 percent in 2009. Pressures seemed particularly strong in the first half of 2012, but the inflation rate has eased in recent months. The core inflation rate was just under 6.0 percent in 2011, but dropped sharply to 4.1 percent by November 2012.

CPI Inflation, 2013 (IMF Projections)	Mexico 3.7%	Caribbean 4.0%	Central America 4.3%	South America 6.2%

Investment

Panama's canal expansion, airport, and subway development, and the associated private sector investment in new hotels and offices give it the leading investment ratio in the region. Nicaragua has also been increasing its construction and investment spending recently, while Mexico's manufacturing sector continues to attract relatively high levels of investment.



SOURCE: IMF, *World Economic Outlook*, April 2013.

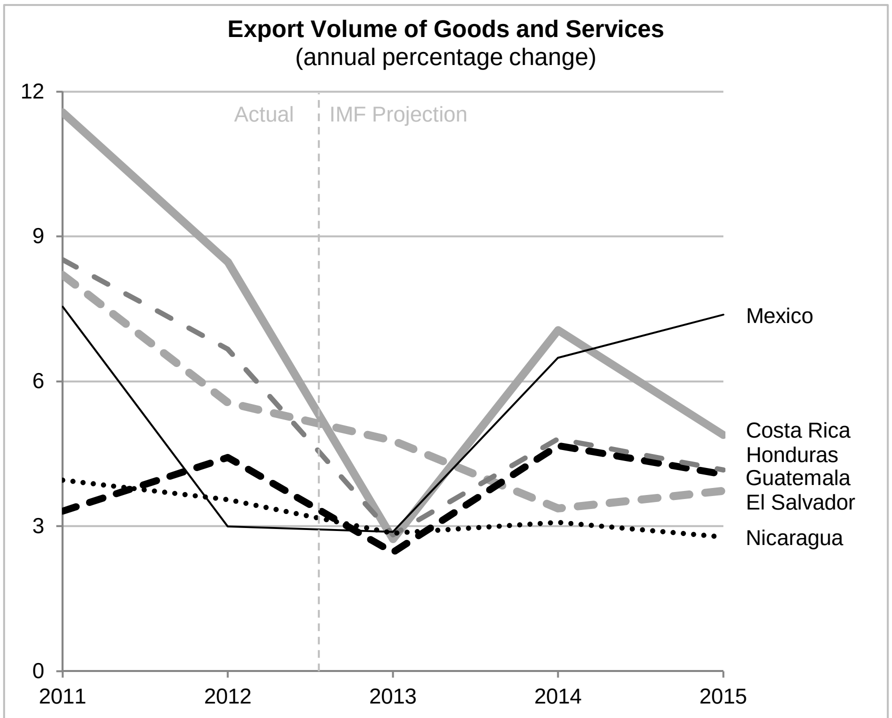
Countries in the rest of the region have investment ratios that are mostly stable but relatively low compared with other Latin America and Caribbean economies. In El Salvador, investment remains low despite government efforts to facilitate higher levels through public-private partnerships. Guatemala also needs to boost investment to get on a faster economic growth trajectory. A recent IMF staff report recommends that the structural reforms to improve the business environment and a better revenue system to support public investment are needed.

The IMF is projecting that the investment ratio in Honduras, which rose sharply to 27 percent in 2011, will fall back to 23 percent by 2015. Although Honduras did improve its overall *Doing Business* score in the most recent ranking, it continues to have a combined score for investor protection and contract enforcement that is the lowest in the region, with an average rank of 174 (out of 185) in the world.

Investment, 2013 (as a percentage of GDP) (IMF Projections)	Caribbean 27.0%	Mexico 24.4%	South America 22.9%	Central America 21.3%

Trade

Central American and Mexican exports began to lose some momentum during 2012 and are projected to expand more slowly in 2013 before rebounding in 2014. On the bright side, export volumes for all the economies are expanding each year during the projection period through 2015. The sole exception is Belize, where growth of exports of goods and services are expected to be essentially flat for 2012–2015.



SOURCE: IMF, *World Economic Outlook*, April 2013.

Mexican exports have been increasing to Europe and other markets, but remain concentrated in the United States, particularly in the context of the U.S. manufacturing supply chain. Favorable trends for Mexico currently include: a location advantage (for the U.S. market) enhanced by generally higher oil prices and changes in U.S. inventory practices; competitive unit labor costs in Mexico relative to China; and increased protection for proprietary technologies in Mexico which encourage continued foreign direct investment in its manufacturing sector. The Mexican government is weighing policy changes in the oil sector which will affect the size of this key export industry in coming years.

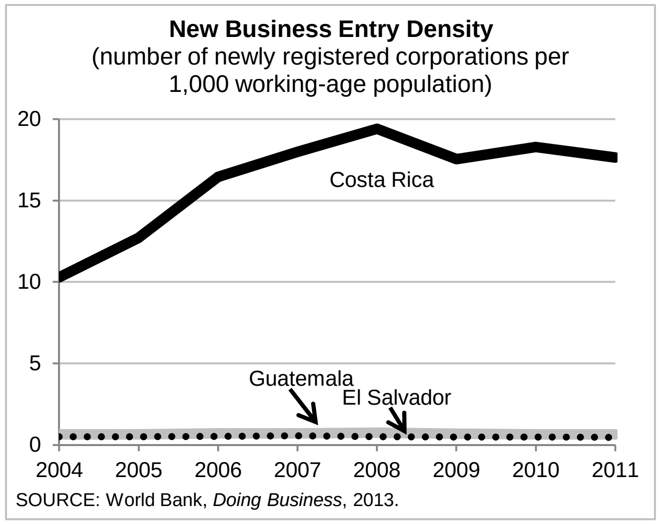
Guatemalan export strength played a leading role in reviving the economy after the 2008–2009 slowdown. Exports are projected to expand steadily, if modestly, through the projection period in 2015. The Guatemalan economy remains heavily dependent on exports to the United States and on tourism, both of which present some downside risks to the economic outlook.

Costa Rican export buoyancy also played a leading role in sustaining the economy after 2008, even while the country's share of manufacturing exports in world trade has fallen. The services sector is more than making up for the slack. As the IMF noted in a recent staff appraisal, Costa Rica has improved its competitive position recently by rising up four spots (to 57th place) in the *Global Competitiveness Index*, but inadequate infrastructure and government bureaucracy continue to limit export and investment growth.

Export Volume of Goods and Services, 2013 (annual percentage change) (IMF Projections)	South America 6.7%	Caribbean 6.5%	Central America 3.5%	Mexico 2.9%

Entrepreneurship and the Cost of Doing Business

New data from the World Bank's *Doing Business* team measures "new business entry density," or the number of newly registered corporations per 1,000 working-age population. Although not available for all countries yet, data for Costa Rica, El Salvador, and Guatemala for 2004–2001 display a wide disparity in new business performance.



Costa Rica's new business density rate is significantly larger than in both El Salvador and Guatemala, and the gap has widened since 2004. Other *Doing Business* data on the transparency of business regulation show that Costa Rica and El Salvador get the top score on that measure (five points) while Guatemala gets a lowly two points. Those scores help explain the new business density gap between Costa Rica and Guatemala, but do not explain why El Salvador's new business rate is so modest.

Looking at other *Doing Business* indicators, the contrasting performance of Costa Rica and El Salvador remains puzzling. El Salvador does better than Costa Rica on reducing the number of procedures needed to open a business (8 versus 12) and the number of days needed open a business (17 versus 60). But one measure offers an explanation. The typical financial cost of starting a new business, when expressed as a percentage of per capita income in the country, is at nearly half of the income level in both El Salvador (47 percent) and Guatemala (48 percent). By sharp contrast, the cost of starting a new business is only 11 percent in Costa Rica.

There are undoubtedly multiple factors which explain the vibrancy of the entrepreneurial sector in Costa Rica and its low-key nature in El Salvador and Guatemala, but the two latter countries would likely benefit from a focus on cutting the average cost involved in starting a new business.

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 ESDB 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 2013) and country-specific reports from the International Monetary Fund (http://www.imf.org/), the *Global Economic Prospects* and the *Doing Business* reports from the World Bank (http://www.worldbank.org/), and the UN's *World Economic Situation and Prospects* (http://www.un.org/en/development/desa/policy/wesp/index.shtml).