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Central America: Economic Developments and Outlook

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Punta Cana

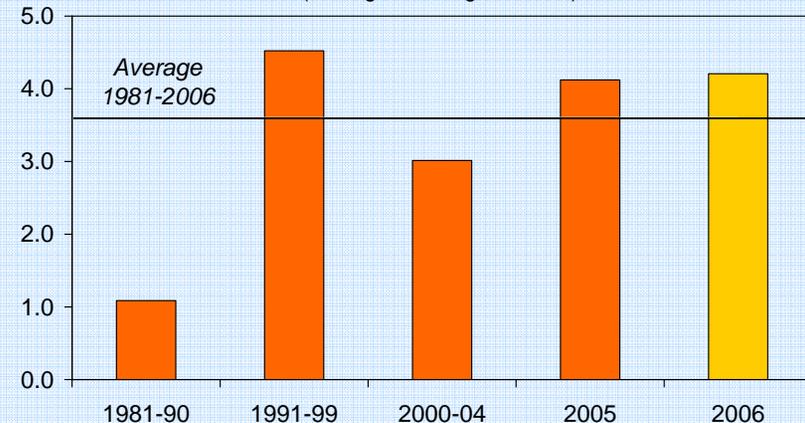
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Global environment supports growth

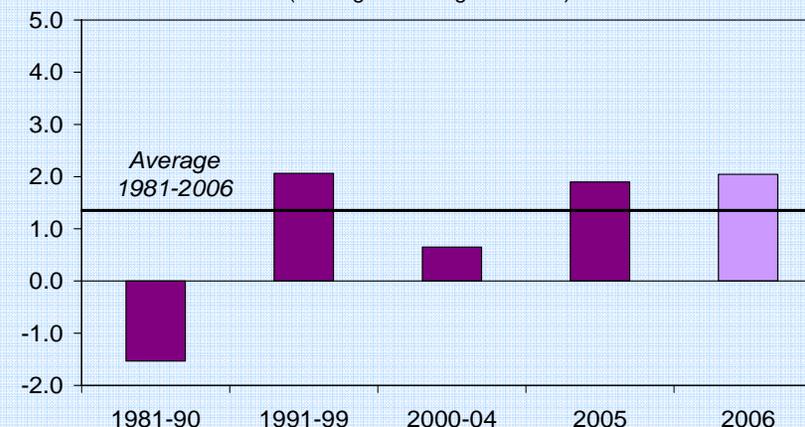
- Strong external demand conditions have contributed to robust growth in 2005 and 2006.
- Despite this positive performance, growth remains too low to significantly reduce poverty.

Central America: Real GDP, 1981–2006
(Average annual growth rate)



Sources: IMF, World Economic Outlook; and Fund staff estimates.

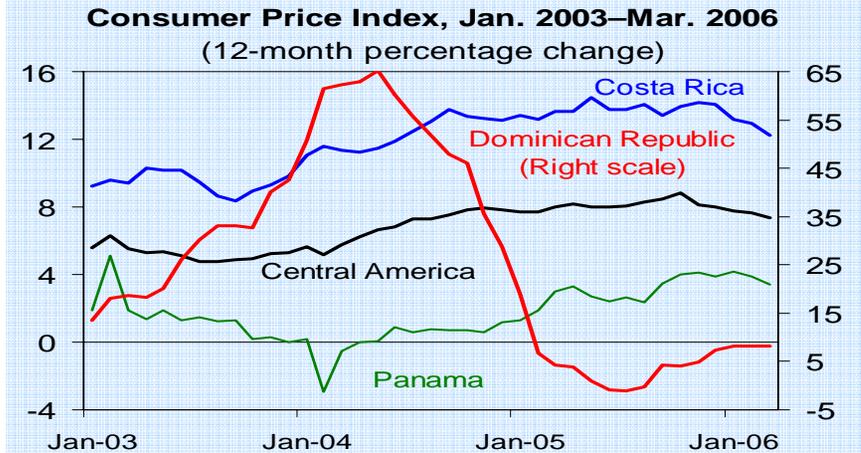
Central America: Real GDP per Capita, 1981–2006
(Average annual growth rate)



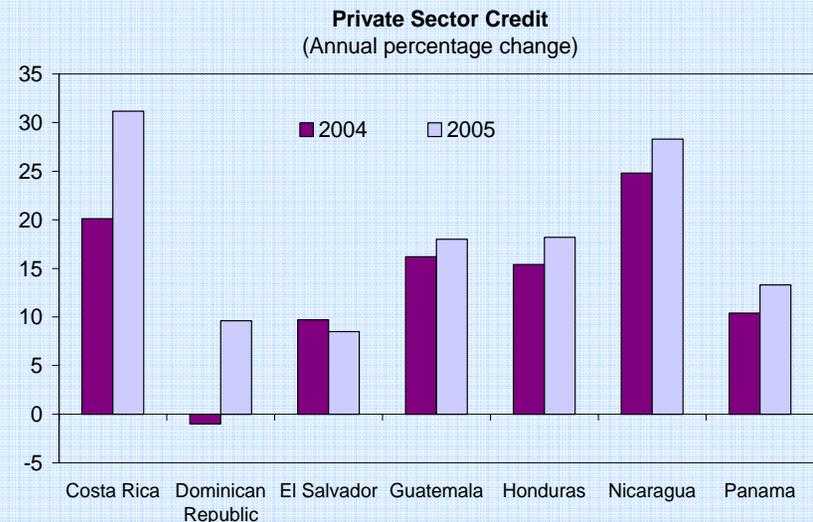
Source: IMF, World Economic Outlook; and Fund staff estimates.

Inflation is falling but remains high

- The hike in oil prices had an adverse impact on inflation in 2005.
- Thanks in part to monetary policy action, inflation has started to subside in 2006.
- Strong credit growth and oil price volatility continue to pose risks.



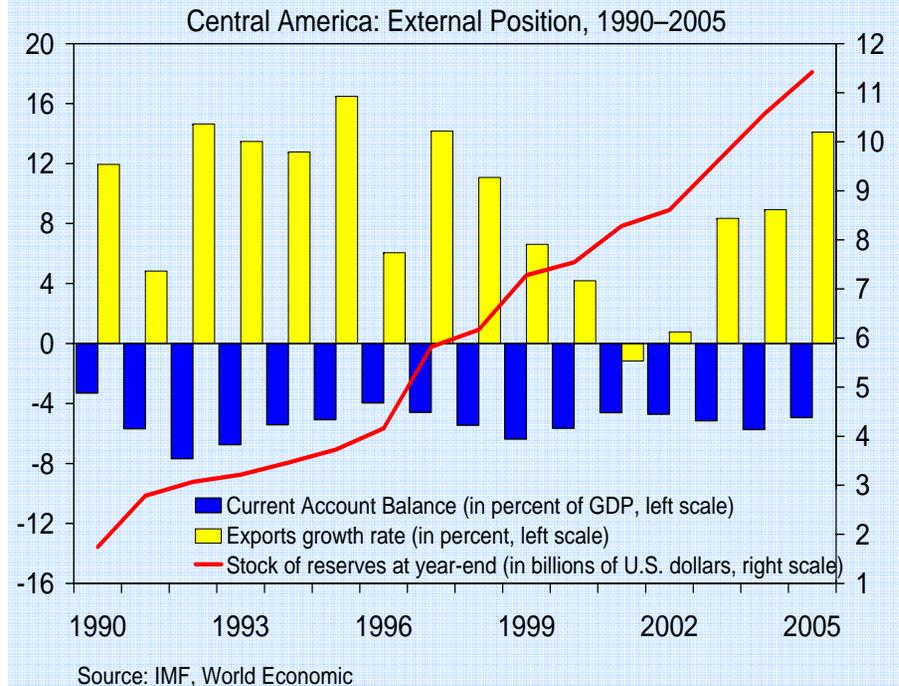
Sources: IMF, Information Notice System; and national authorities.



Source: National authorities.

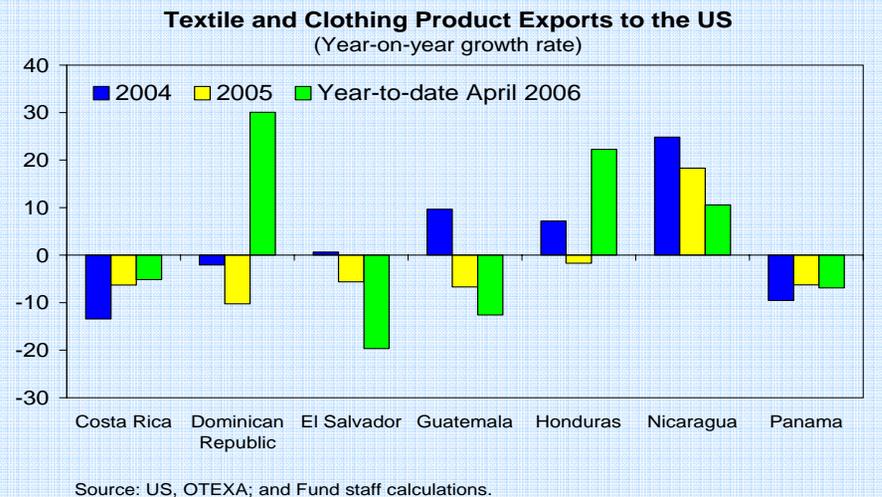
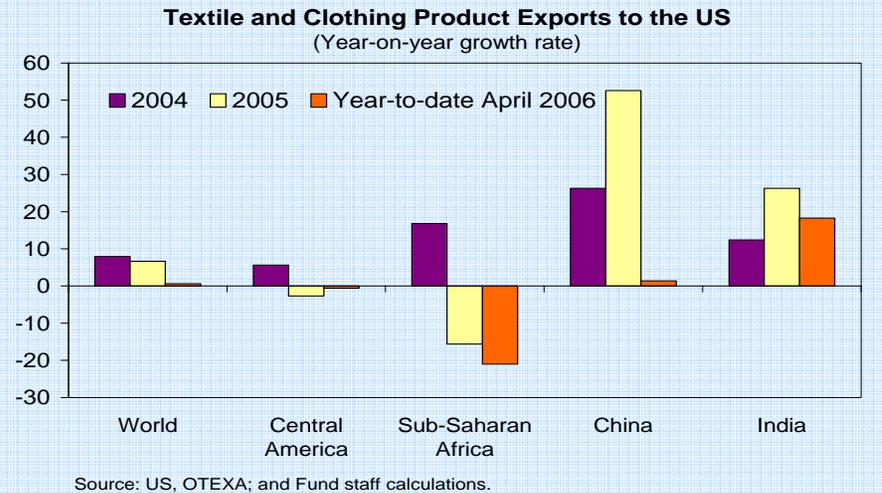
Stronger external positions

- Driven by positive global demand, exports have continued to perform well (except textiles)
- Although the impact of the oil shock on imports has been high, there has not been any deterioration of current account positions.
- Helped by strong capital inflows, foreign exchange reserves have grown steadily in many countries.



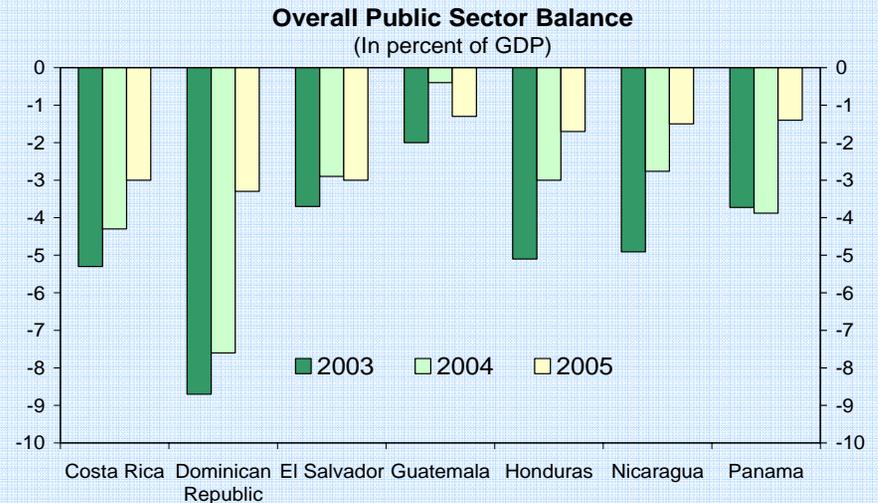
Textile exports to the U.S.

- While initially textile and clothing exports to the U.S. held up, the CA region has suffered losses since the second half of 2005.
- However, experience has differed considerably across countries of the region.

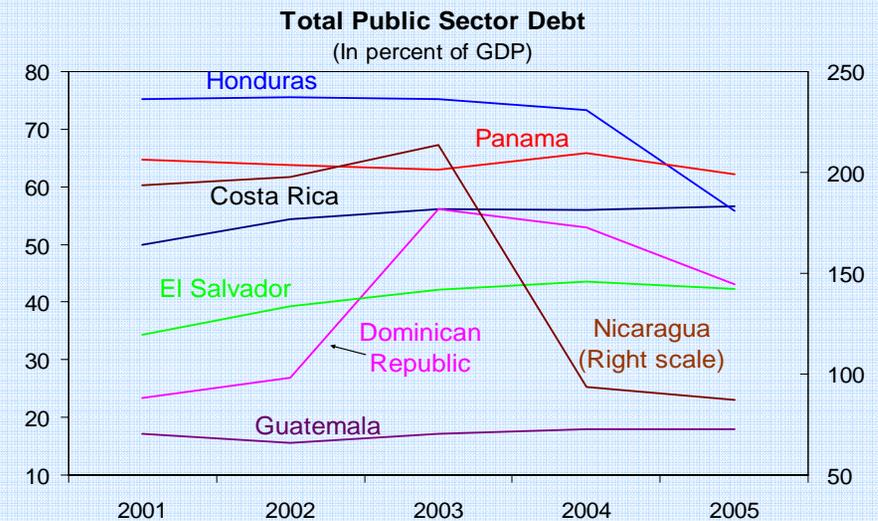


Public finances remain fragile

- Some progress has been made toward fiscal consolidation.
- But, it has generally not yet been sufficient to achieve significant reduction in debt levels
- Exceptions: Honduras and Nicaragua, which have benefited from the Multilateral Debt Relief Initiative.



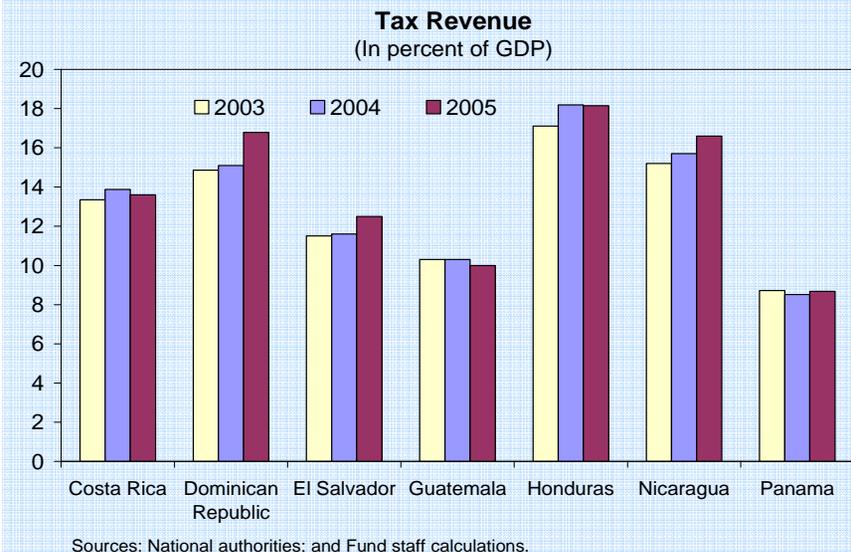
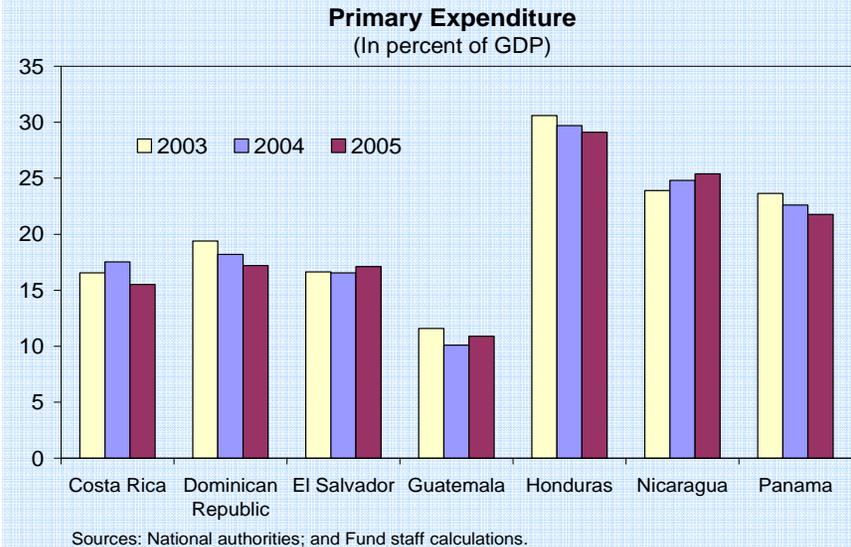
Sources: National authorities; and Fund staff calculations.



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Public finances remain fragile

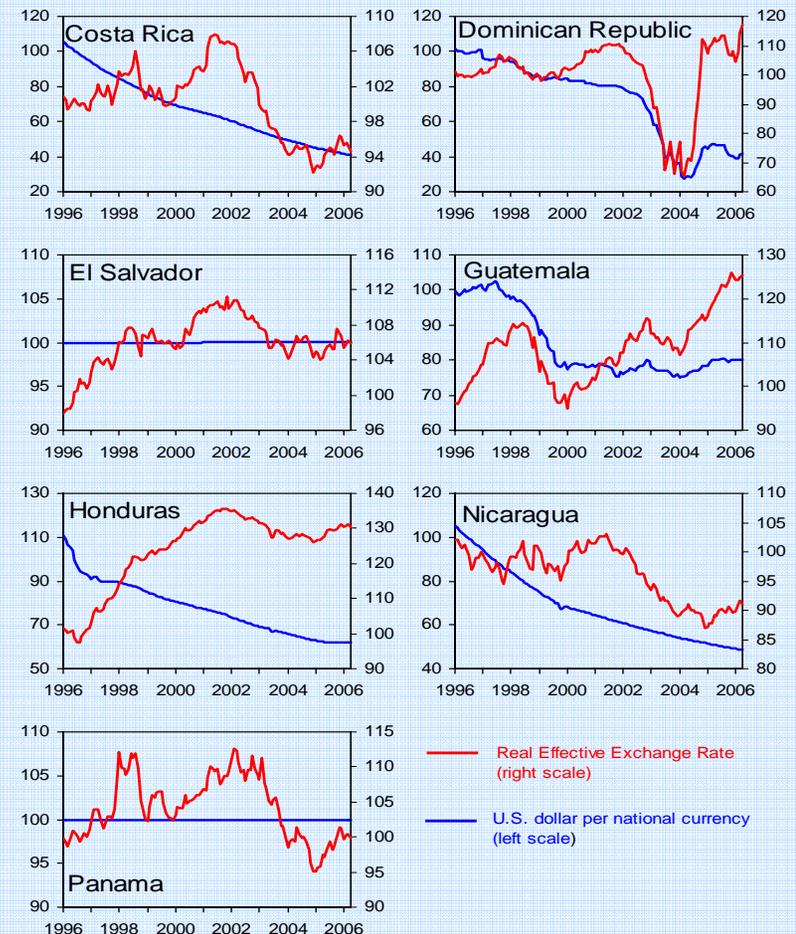
- Some progress has also been achieved in raising tax revenue in countries with the lowest revenue to GDP ratios
- But more remains to be done to finance needed priority spending in these countries.



Evolving monetary and exchange rate regimes

- Exchange rates have been relatively stable in recent years.
- In 2005/06, in several countries, the authorities have resisted appreciating pressures for fear of losing competitiveness.
- Some countries are gradually moving toward more flexible exchange rate systems or practices.

Central America: Exchange Rates, 1996–2006 1/
(Index 1996=100)



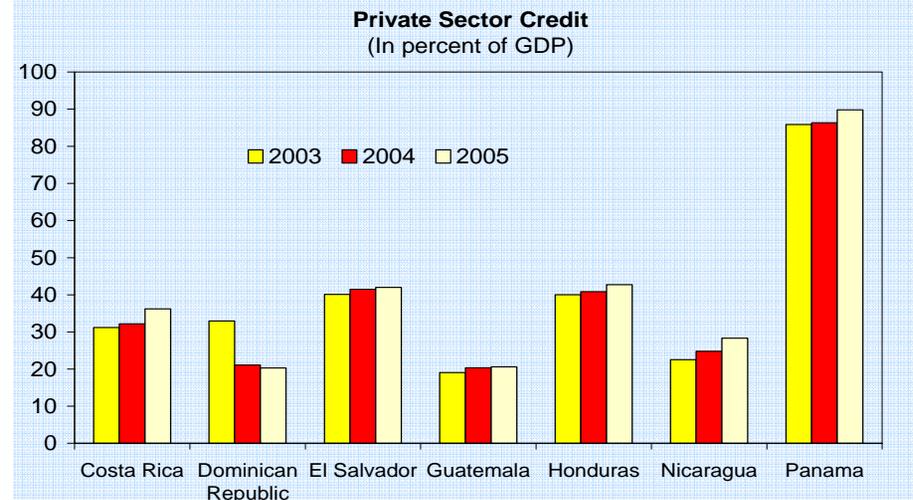
Source: IMF, Information Notice System.
1/ Increase (decrease) means appreciation (depreciation).

Greater trade liberalization

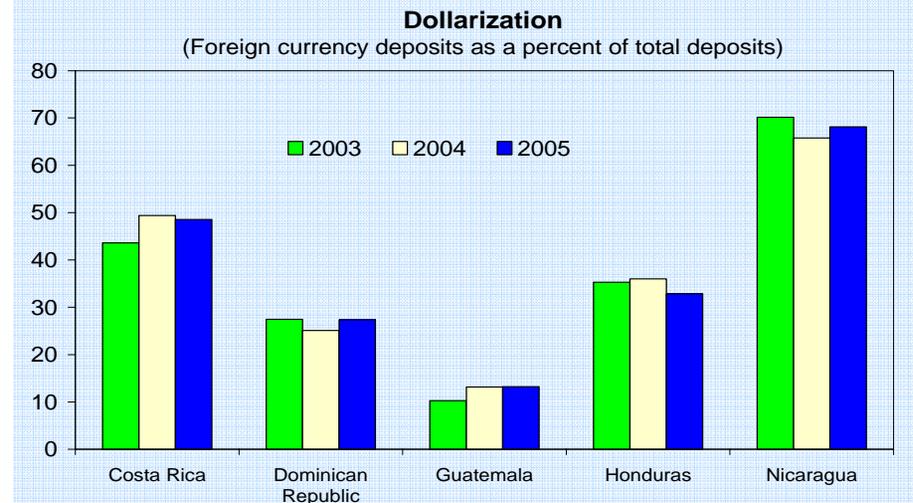
- All countries but Costa Rica have ratified the Central American-Dominican Republic Free Trade Agreement (CAFTA-DR).
- The agreement has become effective in El Salvador, Nicaragua, and Honduras. Guatemala is expected to follow soon.
- Prospects for the initiation of discussions with the EU about on a CA-EU free trade agreement in the fall.

Growing financial sectors

- In most countries, financial sector intermediation is increasing.
- Financial dollarization is high.
- Regional banking groups play an important and growing role.
- Effective financial sector supervision remains a challenge.



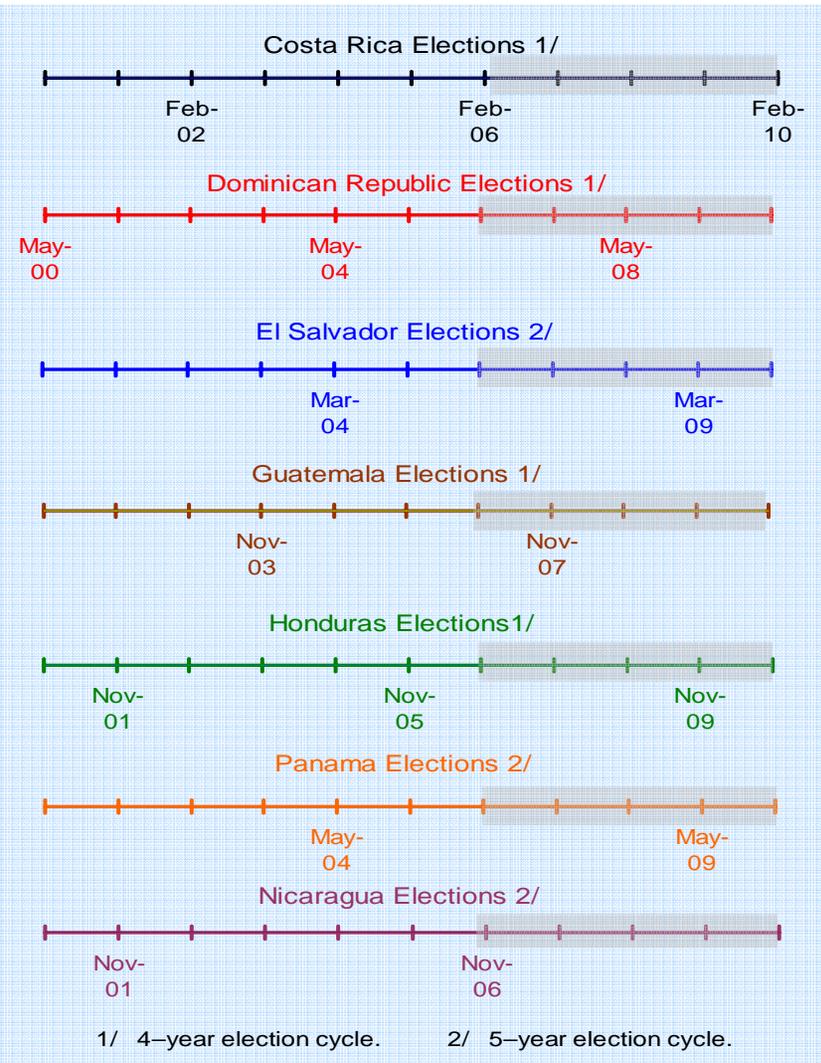
Source: National authorities.



Source: National authorities; and Fund staff calculations.

Heavy electoral calendar

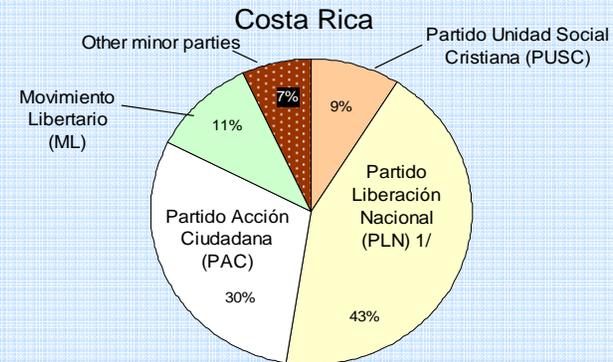
- Elections recently took place in Costa Rica, El Salvador, and the Dominican Republic.
- Nicaragua is fast approaching its presidential election.
- Preparations for the Guatemalan presidential election appear to have started.



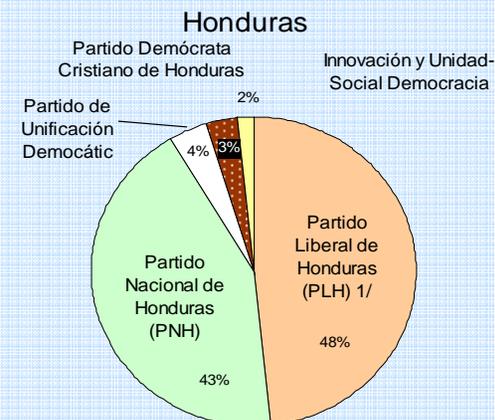
Complex political landscape

- In many countries of the region, governments lack majority support in congress.

Distribution of Congressional Seats by Party Affiliation



1/ Political party of President Oscar Arias.



1/ Political party of President José Manuel Zelaya.

Source: World factbook.

The Fund and Central America

- Article IV consultations and Fund-supported programs
 - Bilateral technical assistance
 - Regional technical assistance (tax coordination, cross-border supervision)
 - Regional outreach for parliamentarians and journalists, book tour
- Proposed for 2006/07:
 - An investors' conference at the end of the year
 - Additional regional TA on statistics and capital markets
 - Outreach activities in the form of a follow up book tour
 - Bilateral outreach activities for parliamentarians