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ECONOMIC OUTLOOK

The Central American Market

Coffee producers face a grim year ahead as prices continue 30-40% below December, 1999 levels. Bumper crops throughout Latin America have pushed production levels ahead of demand. The Association of Coffee Producing Countries (ACPC) scrambled to put together a plan to slow the export of harvested coffee. This initiative is led by Brazil and Colombia who together control 40% of world coffee exports. Both governments have pledged to subsidize farmers who hold coffee off the market to maintain quota levels. But the plan does not include non-members Mexico, Guatemala and Vietnam, who together control 30% of world exports. Mexico's marketing system is legislated to prohibit the kind of government intervention contemplated in the ACPC plan. For Central America, low coffee prices have arrived just when foreign currency earnings are badly needed to fund the recovery from Hurricane Mitch and to cope with higher oil import costs.

El Salvador

Reeling from an embarrassing defeat in recent congressional elections, former president Alfredo Christiani resigned as leader of the ARENA party's executive committee. A new party leader will be selected later this month, possibly in a primary election, which would be the first the party has run since 1989. Christiani is a convenient scapegoat for acting President Francisco Flores, who after 9 months in office has produced only mediocre results.

The March congressional elections bolstered the position of the former rebels, the FMLN, who now hold the most seats even though they are short of a majority. As the cold war drifts into memory, ARENA cannot live by its anti-communist platform alone. It must produce growth, reduce crime and improve social services. Or so the voters told them in March.

The government's decision to peg the currency to the dollar without full dolarization is bound to prove just as ineffectual as similar tried and failed schemes elsewhere in the region. Inflation has dropped to near zero levels but interest rates must remain high to keep money traders happy. Monetary restraint is crippling domestic investment and construction. Foreign direct investment (FDI) will not fill the gap as long as government remains corrupt and the country is rife with crime. A change in currency policy - towards float or dollarization - becomes increasingly necessary at the same rate that it becomes politically impossible to put into practice. Things will come to a head in the next 12 to 24 months.

Guatemala

Bold new steps by the Portillo government include slashing import tariffs on sugar and cement, raising the minimum wage and enforcing stricter banking rules. The business community, organized by the powerful lobby group CACIF, is upset at what they regard as reversals of campaign promises. Officially, the government's reforms are the first essential stage in preparing the country for more liberal trade agreements. But the real motive behind removing sugar protectionism was punishment for the national sugar producers who recently raised prices by 15%. Meanwhile, enforcement of deposit regulations and auditing laws will accelerate a badly needed consolidation of the banking industry.

After a year of capital flight, high interest rates have stopped the Quetzal from sliding but threaten to paralyze new investment. Declining coffee prices and higher oil prices will further challenge the government's efforts to simultaneously stabilize the currency and bring down interest rates.

Panama

Economic growth of 3.2% in 1999 was driven by electricity output (+21%), construction (+12%) and financial services (+5.4%). There was also a 40% increase in cellular phone usage. The construction sector got a big boost from a \$193 million hydroelectric plant in western Chiriqui province. Housing construction also surged ahead, financed by increases in domestic credit of 21% in 1998 and 17% in 1999. This loan boom is bound to end over the next 12 months as the government tightens its fiscal belt and continues the upward march of interest rates in line with the US Fed.

As interest rates rise, the government is anxious to pay down some of its external debt (Brady Bonds). It tabled a proposal to spend its \$1.3 billion privatization windfall on debt reduction. This policy is strongly opposed by most Panamanians who feel that the funds should go to the public, either directly or through social spending. The government's efforts to attract new foreign investment to the Colón free trade zone have proceeded more slowly than expected. FDI will be a good economic barometer over the next year as Panama moves forward without US management of the canal.

Costa Rica

The first quarter of 2000 has proven difficult for Costa Rica, on the heels of a few relatively positive years. Three separate killings of foreigners this year have stained the country's proud reputation as a peaceful and green tourist magnet. Finicky North American tourists (who avoided flights to London during the Bosnian conflict) are sure to find Costa Rica a less appealing destination. Any dents in tourist growth will hurt the balance of payments and rural development efforts. Meanwhile, the government's initiatives to modernize its decrepit telecom and electrical sectors hit a snag when more than 100,000 protestors hit the streets in defense of jobs and the sovereignty of key industries. Costa Rica can claim leadership in several arenas. For example, it has the highest computer penetration in Latin America. But it's still the only country in Central America with state monopolies in both telecom and electricity. In spite of these difficulties, Costa Rica is still booming, following 6.2% and 8% growth in 1998 and 1999 respectively. Attracting Intel's manufacturing investment a few years back is now paying off: exports jumped 20% in 1999, thanks entirely to high tech production by Intel and several of its 1st tier suppliers. Moodys recently revised Costa Rica's credit rating from stable to positive, citing the country's political transparency and stability along with export growth as clear signs of advance.

Honduras

The aftereffects of Hurricane Mitch are still evident. Honduras will face a grain shortage of 350,000 tonnes in 2000 and another 400,000 tonnes in 2001. Export fruit and coffee production continues to lag pre-Mitch levels. To add insult to injury, a territorial dispute motivated Nicaragua to slap a 35% tariff on Honduran exports, initiating a full-fledged trade war. Honduran exports to Nicaragua are expected to drop by more than half in 2000. The trade balance is further weakened by higher oil prices. Many

speculate that inept and corrupt officials inefficiently - if not illegally - squandered much of the millions pledged by donor countries. The result is an increased dependence on foreign debt and relief leading to an enormous current account deficit. The government has been forced to maintain interest rates 17 percentage points above inflation to defend a weak currency. Some reprieve may be realized with the privatization of the nation's airports and a majority stake in the national telecom monopoly, Hondutel. Together, these divestments will pump around \$450 million into the government's coffers. Remittances from Honduran relatives in the US continue as the most vital safety-line for a country riddled by bad luck and bad government.

Nicaragua

The economy continues to grow at impressive rates, reaching 7.5% in 1999 with projections of 5% or better over the next year or two. The Alemán government will privatize both its telecom and electricity sectors this year. Coffee and other cash crop production volume is up. Cash remittances from relatives abroad grew by more than 40% last year, providing badly needed dollars. But much of the nation's economic future rides on its ability to negotiate debt relief. Public foreign debt now stands at \$5 billion, a staggering 220% of GDP.

Nicaragua cannot afford to maintain current levels of interest payments without jeopardizing the social infrastructure. But debt relief has attracted international scrutiny of the Alemán government's political maneuvering. In March, Nordic countries suspended \$3 million in aid because the government fired the nation's independent comptroller, Augusto Jarquín, a fierce critic of Alemán. Jarquín and others had brought to light several cases of fraudulent spending of donor relief funds. Even more alarming is the fact that the silencing of Jarquín was sanctioned by the opposition Sandanistas, who collaborated with the government to tinker with the constitution. Many speculate that a broad political pact will replace next year's elections with a constituent assembly in order to reform the constitution and undo changes instituted by the Chamorro administration in 1995.

CENTRAL AMERICA ECONOMIC FORECAST

INDICATOR	El Salvador		Guatemala		Panama		Costa Rica		Honduras		Nicaragua	
	1999e	2000f	1999e	2000f	1999e	2000f	1999e	2000f	1999e	2000f	1999e	2000f
GDP (USD Bn)	\$12.00	\$12.80	18.3	18.6	\$9.70	\$10.20	\$10.70	\$11.20	\$5.60	\$6.00	\$2.20	\$2.30
Real GDP Growth	2.00%	3.00%	3.00%	4.00%	3.20%	4.00%	8.00%	5.50%	-3.00%	1.50%	7.60%	5.40%
Inflation	0.00%	2.00%	5.00%	8.00%	1.40%	1.30%	10.00%	10.00%	11.00%	12.00%	7.00%	9.00%
Interest Rates	14.00%	15.00%	18.00%	17.50%	11.00%	10.40%	24.00%	20.00%	29.00%	29.00%	20.00%	19.00%
Fiscal Balance (% of GDP)	NA	NA	-2.80%	-2.00%	NA	NA	-4.00%	-3.80%	NA	N/A	NA	N/A
Exports (USD Bn)	\$2.50	\$2.65	\$2.40	\$2.45	\$6.80	\$7.10	\$6.60	\$7.40	\$1.20	\$1.45	\$0.56	\$0.60
Imports (USD Bn)	\$4.00	\$4.10	\$4.30	\$4.60	\$7.85	\$8.20	\$6.30	\$7.30	\$2.50	\$2.60	\$1.56	\$1.65
Trade Balance (USD Bn)	(\$1.50)	(\$1.45)	(\$1.90)	(\$2.15)	(\$1.05)	(\$1.10)	\$0.30	\$0.10	(\$1.30)	(\$1.15)	(\$1.00)	(\$1.05)
Current Acct (USD Bn)	(\$0.20)	(\$0.30)	(\$1.10)	(\$1.00)	(\$0.90)	(\$0.80)	(\$0.35)	(\$0.28)	(\$0.54)	(\$0.50)	(\$0.75)	(\$0.80)
Current Acct (% of GDP)	-1.67%	-2.34%	-6.01%	-5.38%	-9.28%	-7.84%	-3.27%	-2.50%	-9.64%	-8.33%	-34.09%	-34.78%
Foreign Reserves (USD Bn)	\$2.00	\$1.85	\$1.20	\$1.25	\$1.45	\$1.50	\$1.40	\$1.45	\$1.00	\$1.60	\$0.50	\$0.65
Foreign Debt (USD Bn)	\$3.00	\$3.20	\$2.65	\$2.85	NA	NA	\$3.10	\$3.50	\$3.70	\$3.30	\$5.00	\$4.50
Foreign Debt (% of GDP)	25.00%	25.00%	14.48%	15.32%	NA	NA	28.97%	31.25%	66.07%	55.00%	227.27%	195.65%
FX rate (end of period)	8.7	8.7	8	8.75	1	1	305.00	330.00	14.70	15.40	12.30	13.30

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