Box 1

CENTRAL AMERICA AND THE DOMINICAN REPUBLIC: MACROECONOMIC OUTLOOK

The countries comprising Central America and the Dominican Republic (CADR) (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic) have a shared institutional framework to deepen their trade and financial integration, whereby they aspire to become an economic union in the future and thus participate as a bloc in international trade. In 2021 this region represented Latin America's third largest economy by population (56.8 million) and fifth largest by output (GDP of $316 billion).

Economic activity and inflation

Growth in the CADR's (trend-cycle) monthly index of economic activity (IMAE by its Spanish initials)[1] has decelerated since May 2021. On data to September 2022, that slowdown has moderated, converging to a monthly average of 3.9% in 2022 Q3[2] (see Chart 1). However, the performance of the region's different productive sectors remains considerably heterogeneous. For instance, transportation, communication and accommodation and food service activities are displaying greater momentum than agriculture.

The average annual change in the consumer price index (CPI) in the region stood at 8.4% in January 2023, having seemingly reached its inflection point after peaking at 9.6% in August (see Chart 2). Provided there are no significant external shocks, this downward trend may take hold over the coming months, as the restrictive measures implemented by the monetary authorities (detailed below) take effect and global commodity prices stabilise. Overall, food and non-alcoholic beverages have recorded the greatest inflationary pressures in the region of late, mainly as a result of higher global commodity prices.

Public finances

CADR's public finances, at central government level, strengthened further at the beginning of 2022 Q4, boosted by year-on-year tax revenue growth of 16% (1.8% of regional GDP). This was consistent with the recovery in productive activity following the pandemic and higher inflation, which contributed to a $6 billion increase in tax revenue, explained mostly by income and consumption taxes. Government spending grew year-on-year by 10.9% (1.4% of GDP), mainly as a result of the increase in financial resources allocated to subsidies and other forms of public support in the region to contend with the overall increase in prices (mainly fuel, electricity and food prices).

To October 2022, the region had a budget deficit of 0.8% of its GDP (see Chart 3). The public debt-to-GDP ratio, at central government level, was 48.6%, having gradually fallen from its December 2020 peak of 53.4%.[3] This helped improve the region's overall risk profile, mainly from July 2022. However, despite this improvement, internal and external financing costs will remain high for all countries in the region over the coming quarters, limiting fiscal space in 2023 (see Chart 4).

External sector

In 2022 Q3, CADR's current account balance worsened, with the deficit growing from 0.5% of the region's GDP in the same period of 2021 to 3.2% ($8,262 million) (see Chart 5), mainly as a result of the widening trade deficit, which grew year-on-year by 45.7%. This was above all a consequence of the increase in goods imports (28.6%) caused by higher import prices and greater domestic demand associated with improved economic performance. The services surplus improved (49.3% year-on-year) as a result of the strong performance of tourism. However, net primary income payments grew by 9.4%, as direct investment enterprises reinvested their earnings. The secondary income surplus amounted to $36,359 million.

In 2022 remittances totalled $34,945 million, a rise of $3,753 million (12%) on the previous year (see Chart 6). This significant increase in remittance flows in 2022 is associated with favourable economic developments in the United States, reflected in high employment levels, particularly in the Hispanic segment. Remittances increased significantly for Guatemala, Honduras and Nicaragua, which saw growth above 20%. These external funds are of utmost importance to these economies, accounting for 28.5% of GDP in Honduras, 24.1% in El Salvador and 19.3% in Nicaragua. Remittances from Spain accounted for approximately 3.2% of the total sent to CADR ($1,140 million). The main recipients were the Dominican Republic, Honduras and Nicaragua.

1 For methodological details on how the regional IMAE is constructed, see https://www.secmca.org/wp-content/uploads/2021/03/Propuesta-de-cambio-en-el-m%c3%a9todo-de-agregaci%c3%b3n-de-variables-y-ponderadores-regionales.pdf (only available in Spanish).

2 Regional GDP totalled $87,908 million in 2022 Q3.

3 In December 2019, before the outbreak of the pandemic, the public debt-to-GDP ratio was 43.7%.

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CENTRAL AMERICA AND THE DOMINICAN REPUBLIC: MACROECONOMIC OUTLOOK (cont'd)

Monetary and financial conditions

Most central banks in CADR have raised their policy interest rates (see Chart 7). This new monetary policy stance seeks to counter the effect of external supply shocks on domestic energy and food prices, which prompted inflation to rise in 2022 and have darkened the outlook for 2023. As a result of this restrictive monetary policy, growth in monetary aggregates has slowed sharply in Costa Rica and the Dominican Republic, while in the other countries – except for Honduras, where it has picked up – the deceleration has been gradual.

However, the slowdown in monetary aggregates has not had significant repercussions for the financial systems of the region's countries, as they have sufficient liquidity and levels of capital exceeding the regulatory requirements, showing themselves to be resilient to a monetary contraction. Partly for this reason, the pace of growth of bank lending quickened in 2022, standing above 15% in some countries (see Chart 8).

Chart 1
Change in the monthly index of economic activity (IMAE) (trend-cycle)

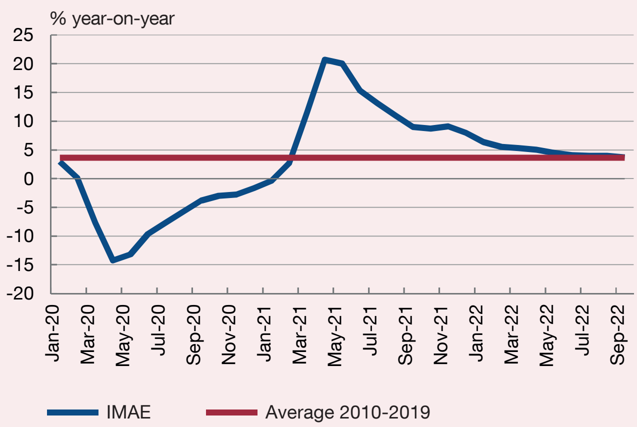


Chart 2
Inflation. Change in CPI

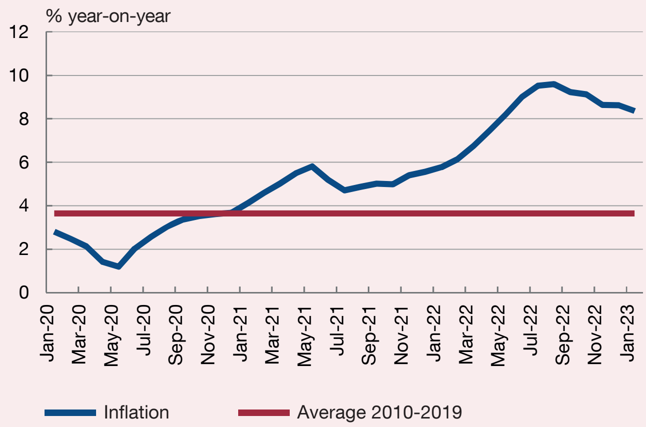


Chart 3
Central government debt and budget balance. % of GDP

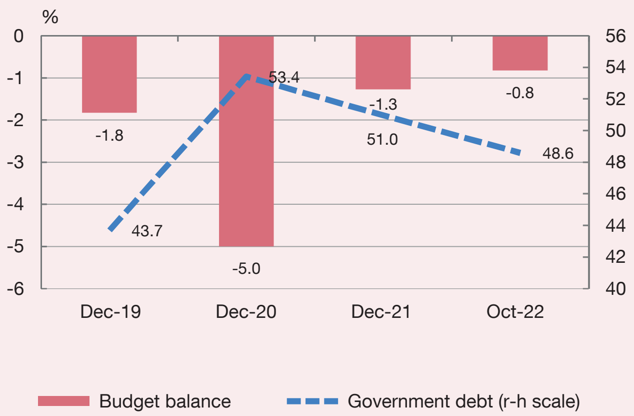
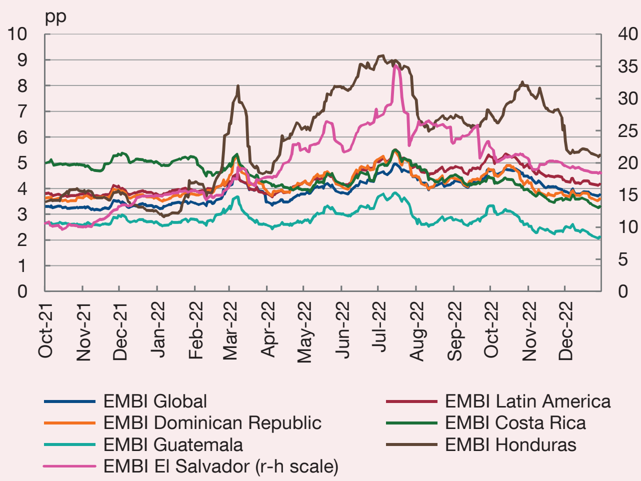


Chart 4
Sovereign spreads over US long-term yields (a)



SOURCE: CADR.

a The EMBI is the main indicator of country risk and is calculated by JPMorgan Chase. It is the difference between the yields on US dollar-denominated sovereign bonds issued by emerging countries and US Treasury Bonds.

Box 1

CENTRAL AMERICA AND THE DOMINICAN REPUBLIC: MACROECONOMIC OUTLOOK (cont'd)

Chart 5
Current account balance

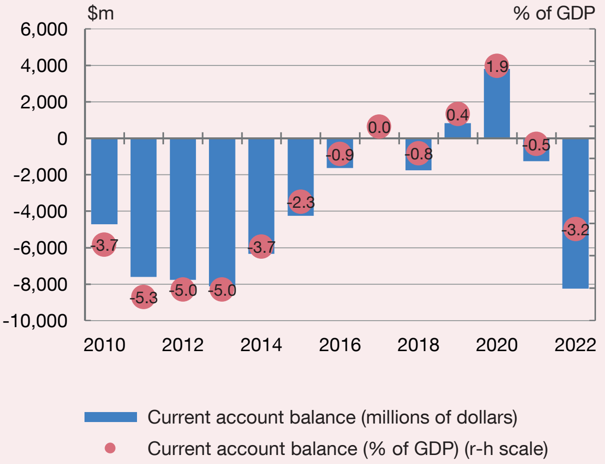


Chart 6
Remittances. $m and as a % of GDP (a)

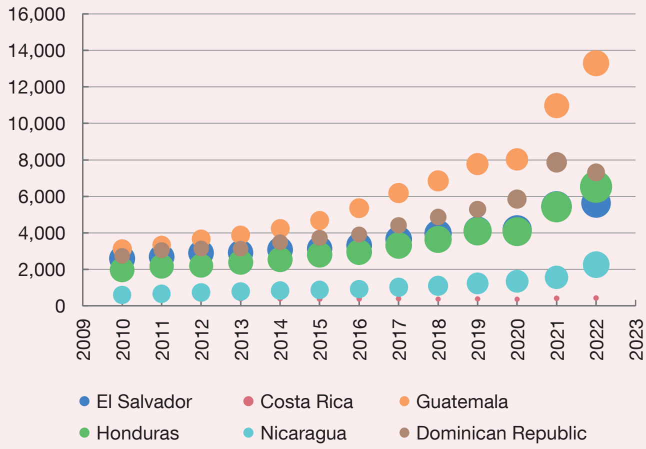


Chart 7
Policy interest rates

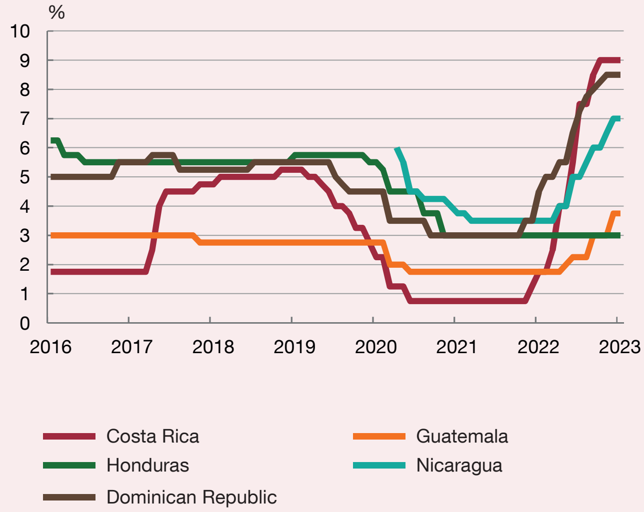
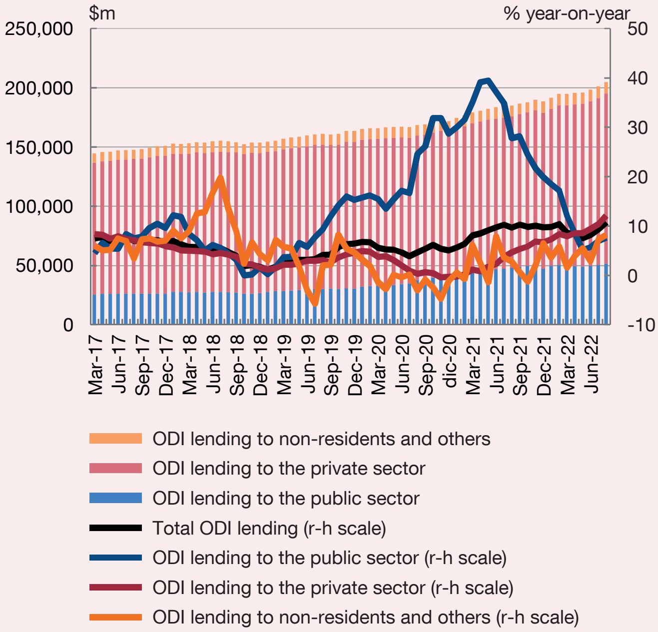


Chart 8
Total lending by ODIs (b)



SOURCE: Estadísticas del Sector Externo Armonizado.

a The size of the dot denotes the percentage of GDP.
b ODIs: Other deposit institutions, e.g. commercial banks and cooperatives.