8-1-2002

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LADB Article Id: 53005
ISSN: 1089-1560

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by LADB Staff
Category/Department: Central America
Published: 2002-08-01

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Falling investor confidence in the stock market and the financial scandals surrounding US companies like Enron and WorldCom will have negative repercussions for Central American economies, say analysts. The depreciation of the dollar, which has declined 15% in value over the last six months, adds another variable to the uncertain economic scene.

A report from the Economic Commission for Latin America and the Caribbean (ECLAC) said that the end of the US recession in the first quarter of 2002 lacked the characteristics of a true recovery. "It should be considered that the annualized growth rate of 5.8% in the US economy is due to increased government spending, principally on defense," said ECLAC. It also noted that, while consumer spending grew 3.5%, investments decreased, "which is an extremely counterproductive phenomenon for sustained economic growth." Analysts say that the continued threat of terrorist attacks in the US, uncertainty about economic recovery, bankruptcies and financial scandals have all contributed to the loss of investor confidence.

In Panama, the Central American country whose economy is most tightly linked to the US economy, recently released first-quarter data projected a 0.8% annual growth rate. However, a study from the Universidad de Panama attributes almost all of that economic growth to a 6% increase in government spending. Hardest hit by the stagnation of the global economy has been the export sector.

In the first quarter of 2002, Panama's exports fell by 6.7%, according to the Ministry of Economy and Finance. Central American countries whose economies are heavily dependent on exports have expressed concern about the effect of the global slowdown. In his presentation of the ECLAC report on June 10 in Washington, Jose Antonio Ocampo, executive secretary of ECLAC, said that the international financial system had structural problems and that developing countries had become more vulnerable to world economic crises.

The report, entitled "International Financial Reform: a Slow and Incomplete Process," was coordinated by the English economist Stephany Griffith-Jones. International financial reform, says the report, should concentrate on macroeconomic inequalities, the vulnerabilities of developing countries, and their limited economic opportunities. Fallout from the bankruptcies of large, global companies like Enron and WorldCom is still hard to assess, but may result in the restructuring of key industries in Central America.

Energy companies affiliated with Enron produce 20% to 30% of the energy of Guatemala, Nicaragua, and Panama. "What predictably will happen," said Isaac Cohen, a Guatemalan financial analyst, "is

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the restructuring of the electricity market. Regional financial institutions may become interested in entering the market."

Sliding currencies may salve export sector woes

Against this backdrop, these economies have now been confronted by a sliding dollar, which has begun to decline in value relative to the euro and the yen. The euro, which was at E1.15 per US$1, reached parity with the dollar on July 17. Likewise, the yen, which was trading for 134 yen per US$1, reached 117.6. These declines represent decreases of 15%. Panama and El Salvador use the dollar as their major currencies, while the Costa Rican, Honduran, and Nicaraguan currencies have all fallen in value, even relative to the sliding dollar in the last six months. Only the Guatemalan quetzal has increased in value.

Most analysts believe that the devaluation of the dollar and other regional currencies will have less impact on regional economies than will the US recession. Indeed, some believe that devaluation will have a positive impact on Central American exports. Rolando Gordon, assistant dean of the Universidad de Panama's department of economics, said that the devaluation of the dollar had not affected Panama's economy because most of Panama's trade was with the US. Gordon added that businesses that export products to Europe from dollarized economies could benefit from more competitive prices as a result of the fall in value. However, economic data through the end of May have shown an across-the-board drop in exports.

Carlos Acevedo, head of the macroeconomic analysis department for the Fundacion Salvadoreno de Desarrollo Economico y Social (FUSADES) said that a weakened dollar favored exports from the US and from other countries like El Salvador that use the dollar as currency. He said that this would help improve El Salvador's trade deficit, the largest in the region. Acevedo said that, although items imported from Europe would now be more expensive, trade between El Salvador and Europe was of relatively minor importance; El Salvador receives more than half its imports from the US, with the rest of its trade accounted for by other Central American countries.

Sigfrido Lee, an analyst with the Guatemalan Centro de Investigaciones Economicas y Nacionales (CIEN), said that the increase in the value of the quetzal was unusual, since economic statistics suggest that the national currency should be losing value. He said there have not been any studies that have successfully explained the increased value of the quetzal. Despite possible benefits for the export sector, the fall in value of the dollar and other currencies may have negative consequences, said Acevedo. Among these is the flight of foreign capital when national currencies lose value. "While it could improve the balance of trade, it could also have adverse effects on the balance of investment. However, in El Salvador, the investment markets are not very developed, so it should not be a particularly serious problem."

ECLAC criticizes asymmetries in international financial system

The ECLAC report signaled three principal asymmetries in the international financial system. The first is a policy of international lending that makes loans and demands repayment in the foreign rather than the national currency. The second is the short-term emphasis of financial markets in

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developing countries. Finally, the report notes the limited power of the small financial markets in these countries to combat the power of investor speculation.

The report argues that emerging economies, in particular those of Latin America, have been most heavily affected by worldwide economic crises over the last three decades. "This has demonstrated the profound macroeconomic and financial asymmetries that characterize the global macroeconomic and financial order," said the report.

Analysts say that while industrialized countries have more leeway to cushion business downturns (particularly the US, which manages the most important currency for international trade), developing economies have less ability to direct their economies. "The principal characteristic that economies in developing countries all share is a tendency to cycle between boom and bust," says the ECLAC report.

Ocampo said that a recent UN development conference proposed a number of reforms that presented "for the first time, a comprehensible and balanced agenda that should be used as a guide for reform." The reforms proposed included coordination of macroeconomic policies to reduce vulnerability to business cycles; improved emergency financing from the IMF for developing countries; and an improved multilateral mechanism for debt renegotiation.

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