BUSINESS MONITOR international

Q1 2014

www.businessmonitor.com

CENTRAL AMERICA

BUSINESS FORECAST REPORT

INCLUDES 10-YEAR FORECAST TO 2022

Political Risk To Have Economic Implications

ISSN 2044-0642

Published by Business Monitor International Ltd.

Copy Deadline: 29 November 2013

COSTA RICA, EL SALVADOR, GUATEMALA, HONDURAS, NICARAGUA, PANAMA – MACROECONOMIC INDICATORS

	2012e	2013f	2014f	2015f	2016f	2017f	2018f	2019f	2020f	2021f	2022f
Costa Rica											
Nominal GDP, US$bn [19]	45.1	49.7	53.1	55.8	59.9	64.7	69.6	74.9	80.8	87.2	94.0
Real GDP growth, % chg y-o-y	5.1	3.0	3.5	4.0	4.1	4.2	4.1	4.0	4.1	4.0	3.9
Budget balance, % of GDP [3,19]	-3.9	-4.9	-5.3	-4.9	-4.5	-4.4	-4.4	-4.3	-4.3	-4.2	-4.1
Current account balance, % of GDP [19]	-5.3	-6.5	-7.0	-7.7	-8.0	-7.8	-7.7	-7.5	-7.0	-6.5	-6.2
El Salvador											
Nominal GDP, US$bn [25]	23.8	24.4	25.7	27.5	29.2	31.1	33.2	35.6	38.4	41.3	44.4
Real GDP growth, % change y-o-y [4,25]	1.6	1.8	2.0	2.2	2.3	2.3	2.7	2.9	3.3	3.4	3.1
Budget balance, % of GDP [25]	-3.4	-3.5	-3.1	-2.7	-2.6	-2.4	-2.3	-2.1	-2.0	-1.8	-1.7
Current account balance, % of GDP [25]	-5.3	-5.2	-3.9	-2.7	-1.6	-0.8	-0.7	-0.4	-0.7	-0.5	-1.0
Guatemala											
Nominal GDP, US$bn [27]	50.8	55.2	55.8	61.2	68.5	73.5	79.3	86.1	92.7	100.2	108.5
Real GDP growth, % change y-o-y [7,27]	3.0	3.4	3.5	3.5	3.5	3.5	3.6	3.8	3.9	4.1	4.3
Budget balance, % of GDP [30]	-2.4	-2.3	-2.0	-2.3	-2.5	-2.8	-3.1	-3.4	-3.8	-4.1	-4.4
Current account balance, % of GDP [27]	-2.9	-2.9	-2.0	-1.7	-1.3	-1.2	-0.8	-0.6	-0.2	0.0	0.4
Honduras											
Nominal GDP, US$bn [31]	18.6	19.2	19.8	21.1	22.5	24.3	26.3	28.4	30.7	32.8	35.0
Real GDP growth, % change y-o-y [11,31]	3.3	3.1	3.3	2.8	2.8	3.4	3.2	2.6	2.8	2.6	2.4
Budget balance, % of GDP [33]	-6.0	-5.1	-5.1	-4.6	-4.2	-4.1	-3.9	-3.8	-3.6	-3.5	-3.3
Current account balance, % of GDP [31]	-9.4	-8.9	-8.1	-7.1	-6.7	-6.4	-6.2	-6.3	-6.3	-6.4	-6.4
Nicaragua											
Nominal GDP, US$bn [34]	10.5	10.6	11.1	11.6	12.0	12.7	13.4	14.0	14.7	15.3	15.8
Real GDP growth, % change y-o-y [12,34]	5.2	3.9	4.2	4.0	3.8	4.1	3.8	3.9	3.5	3.4	3.4
Budget balance, % of GDP [17,34]	-0.2	-0.1	0.0	0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.4
Current account balance, % of GDP [34]	-12.9	-13.1	-13.4	-13.3	-13.6	-13.2	-12.7	-12.4	-11.4	-11.4	-11.5
Panama											
Nominal GDP, US$bn [22]	36.0	41.1	45.9	51.0	56.5	62.0	67.1	73.0	79.6	85.8	92.7
Real GDP growth, % change y-o-y [35]	10.7	7.8	7.1	6.4	6.9	6.2	5.1	5.7	6.0	5.0	5.4
Budget balance, % of GDP [35]	-2.1	-2.7	-3.0	-2.7	-2.3	-2.3	-1.7	-1.0	-0.3	0.4	1.1
Current account balance, % of GDP [29]	-9.1	-9.7	-10.4	-10.3	-9.1	-8.3	-8.8	-8.8	-8.8	-10.0	-10.9

Notes: e BMI estimates. f BMI forecasts. 1 Base Year 1991 = 100; 2 July 2006 = 100; 3 Non-Financial Public Sector (excl. Central Bank); 4 Base Year = 1990; 5 Jan 93 = 100; 6 Economy dollarised since 2001, when colon was replaced at rate of SVC8.75/US$; 7 Base Year = 2001; 8 Base Year = 2000; 9 Base Year = 2002; 10 Average; 11 Base Year 2000 = 100; 12 1994 = 100; 13 Gross Fixed Investment; 14 Gross Fixed Investment, 1994 = 100; 15 1999 = 100; 16 30-Day Average Lending Rate; 17 Excluding Donations; 18 Panama's economy is completely dollarised. Sources: 19 Banco Central de Costa Rica/BMI; 20 World Bank/UN/BMI; 21 INEC Costa Rica/BMI; 22 IMF; 23 Banco Central de Costa Rica; 24 BMI; 25 Banco Central de la Reserva de El Salvador/BMI; 26 IFS; 27 Banguat/BMI; 28 INE; 29 IMF/BMI; 30 Ministry of Finance/BMI; 31 BCH/BMI; 32 ILO/BMI; 33 Secretar de Finanzas/IMF/BMI; 34 BCN/BMI; 35 BMI calculation; 36 INEC Panama/BMI; 37 INEC.

Contents

BMI Ratings – Brief Methodology

Composite Rating

The composite rating is an unweighted geometric mean of the short-term political and short-term economy ratings, allowing a ranking of all countries in **BMI**'s emerging markets universe.

Political Ratings

The political ratings are an indicator of political stability, seen as a pre-requisite for a stable economy and business environment. The long-term political rating considers more structural elements such as: Is there a functioning democracy? Are there free and fair elections? Is there separation between party and state? Have recent governments pursued similar, enlightened policies amid a stable political environment? The short-term political rating considers more transient influences such as: Have there been recent large-scale demonstrations or strikes? To what extent have these threatened the political status quo? Is unemployment currently a potential source of political instability? What is the current position in the political cycle – to what extent is this contributing to political risk? Is the government having trouble passing legislation?

Economy Ratings

The economy ratings assess the degree to which the country approximates the ideal of non-inflationary growth with contained fiscal and external deficits and manageable debt ratios. The ratings use as raw material historical data and forecasts fed in from **BMI**'s country databases: as historical data are revised and forecasts change, so the ratings change. Factors in the long-term rating include GDP growth, unemployment, inflation, real interest rates, exchange rates, the fiscal balance, the current account balance and external debt. A number of other structural factors are also thrown into the equation, including dependence on the primary sector, reliance on commodity imports, reliance on a single export sector and central bank independence. The factors included in the short-term rating are a subset of those in the long-term rating.

Business Environment Rating

The business environment rating is a broad indicator of the investment climate, for both domestic and foreign players. While areas such as competitiveness, finance, openness and environment comprise the bulk of the rating, there is also an important feed from the political and economy ratings. The factors considered include: the state of the national infrastructure, the education system, cronyism/ corruption, red tape, the legal framework, property rights, market access and the corporate tax regime.

BMI Ratings

Costa Rica

BMI's ratings rank states in terms of political risk, the economy and the quality of the business environment. There are four ratings: a composite rating, a political rating, an economic rating and a business environment rating. These are reviewed every month and the results posted on **BMI**'s online service (www.businessmonitor.com). The political and economic ratings have short- and long-term components. The long-term ratings are designed to reflect more structural considerations and will not change greatly in the short term. The short-term ratings will change frequently in response to more transient influences. All ratings are expressed as a number between one and 100. A high rating is an indicator of lower risk.

BMI Risk Ratings – Costa Rica

	Latest Rating	Previous Rating	Trend	Region Avg	Global Mkts Avg
S-T Political	69.4	72.5	=	61.4	65.0
L-T Political	71.8	71.8	=	61.4	63.1
S-T Economy	52.7	57.7	=	55.0	53.4
L-T Economy	62.0	62.6	=	56.7	53.3
Business Environment	52.1	52.1	=	45.7	48.5
Composite	61.5	61.5	=	46.2	52.3

POLITICAL RISK
Social Stability Weighs On Risk Rating

■ We recently downgraded our Short-Term Political Risk Rating for Costa Rica from 72.5 to 69.4. This downgrade came primarily on the back of deteriorating social stability. We have seen increasing incidences of public unrest, and with polls reflecting deep public dissatisfaction with the current government, we believe that public unrest is unlikely to die down over the medium term. That said, the country remains the second highest ranked in Central America, behind Panama, and continues to score well above the Latin American average of 59.8.

■ Costa Rica's Short-Term Political Risk Rating is 69.4.

ECONOMIC RISK
Macro Downgrades Temper Costa Rica's 'Ability To Pay'

■ In our latest Sovereign Risk Rating analysis, we noted that Costa Rica's total score had fallen from 56 to 54, largely on the back of a downgrade to its 'Ability To Pay' score. Indeed, we have revised down our 2013 real GDP growth forecast from 3.5% to 3.0%, and our 2014 forecast from 3.7% to 3.5% in recent months. Moreover, accelerating spending has led us to forecast a wider fiscal shortfall of 4.8% of GDP for 2013, from 3.8% previously. These revisions inform our view that Costa Rica's sovereign credentials have continued to deteriorate in recent months.

■ We give Costa Rica an Economic Risk Rating of 52.7 down from 57.7 the previous month.

BUSINESS ENVIRONMENT
A Big Step Forward For Terminal Project

■ In October, Costa Rica's largest infrastructure project came one step closer to completion. BAM International and Van Oord were awarded contracts to construct the Moín Container Terminal. Although a few challenges to the project remain, the awarding of the construction contracts signals that APM Terminals, which signed a US$992mn 33-year concession contract with the Costa Rican government in 2011, believes that the outlook is promising. As such the project is now factored into our Infrastructure team's construction industry real growth forecasts, which average 5% over the terminal's construction period.

■ Costa Rica scores 52.1 in our Business Environment Ratings.

El Salvador

BMI's ratings rank states in terms of political risk, the economy and the quality of the business environment. There are four ratings: a composite rating, a political rating, an economic rating and a business environment rating. These are reviewed every month and the results posted on **BMI**'s online service (www.businessmonitor.com). The political and economic ratings have short- and long-term components. The long-term ratings are designed to reflect more structural considerations and will not change greatly in the short term. The short-term ratings will change frequently in response to more transient influences. All ratings are expressed as a number between one and 100. A high rating is an indicator of lower risk.

BMI Risk Ratings – El Salvador

	Latest Rating	Previous Rating	Trend	Region Avg	Global Mkts Avg
S-T Political	49.6	49.6	=	61.4	65.0
L-T Political	58.9	58.9	=	61.4	63.1
S-T Economy	48.5	48.5	-	55.0	53.4
L-T Economy	48.5	48.5	=	56.7	53.3
Business Environment	42.0	42.0	=	45.7	48.5
Composite	48.2	48.2	-	46.2	52.3

POLITICAL RISK
Gang Truce Becoming Shaky

■ The mayors of eight of El Salvador's 11 peace zones have said that the truce with gangs has become unsustainable owing to a lack of federal funds promised for violence prevention initiatives. The country's peace zones are areas where members of the Mara Salvatrucha and Barrio 18 gangs have agreed to renounce all criminal activity. A former defence ministry adviser, Raúl Mijango, said that only the gang members were working towards the truce and taking promised actions – the government has not yet taken definitive actions to support the truce.

■ We give El Salvador a score of 49.6 in our Short-Term Political Risk Ratings.

ECONOMIC RISK
Social Spending To Drive Government Outflows

■ El Salvador's National Assembly has passed a budget for the 2014 fiscal year, indicating that expenditure will be mainly geared towards social areas to promote a population that is 'healthy, educated and productive', according to a press release issued by the legislative body at the beginning of November. The budget amounts to US$4.7bn, an increase of US$174mn compared to the previous budget. The government hopes to promote programmes which will boost economic productivity through skills training, enabling the country to develop a more sound 'social basis' for economic development.

■ We give El Salvador a score of 48.5 in our Short-Term Economic Risk Ratings.

BUSINESS ENVIRONMENT
Supreme Court Strikes Down Revenue Tax

■ El Salvador's Supreme Court has ruled that the required payment of 1.0% on revenue as a minimum payment for income tax is illegal. The ruling came after a legal team established by the National Association of Private Enterprise (ANEP), together with union representatives and other affected enterprises, submitted a claim of unconstitutionality. 'That 1.0% on sales turns out to be much more than the 30% on income and they were acting incorrectly at the time of making the calculations,' said Jorge Daboub, president of the ANEP.

■ Our Business Environment score for El Salvador is 42.0.

Guatemala

BMI's ratings rank states in terms of political risk, the economy and the quality of the business environment. There are four ratings: a composite rating, a political rating, an economic rating and a business environment rating. These are reviewed every month and the results posted on **BMI**'s online service (www.businessmonitor.com). The political and economic ratings have short- and long-term components. The long-term ratings are designed to reflect more structural considerations and will not change greatly in the short term. The short-term ratings will change frequently in response to more transient influences. All ratings are expressed as a number between one and 100. A high rating is an indicator of lower risk.

BMI Risk Ratings – Guatemala

	Latest Rating	Previous Rating	Trend	Region Avg	Global Mkts Avg
S-T Political	47.5	47.5	=	61.4	65.0
L-T Political	45.8	45.8	=	61.4	63.1
S-T Economy	59.0	59.0	+	55.0	53.4
L-T Economy	56.1	56.1	=	56.7	53.3
Business Environment	40.9	40.9	=	45.7	48.5
Composite	48.4	48.4	+	46.2	52.3

POLITICAL RISK
Special Forces Recruited By Zetas

- According to a newly declassified report by the United States Drug Enforcement Agency, Los Zetas, the brutal Mexico-based drug gang, has recruited among the ranks of the Kaibiles, an elite Guatemalan special forces unit, for operations in both Mexico and Guatemala. The report notes that members of the Kaibiles have even provided the gang with firearms and grenades from the Guatemalan military's arsenal. The Zeta's influence is growing in Guatemala, which is becoming an increasingly important leg of the transit route for illegal narcotics on their way to the United States.
- We give Guatemala a score of 47.5 in our Short-Term Political Risk Ratings.

ECONOMIC RISK
October Remittances Hit Record

- Remittances to Guatemala reached a record US$480.0mn in October, spiking more than 14% compared to the previous month's total of US$420.7mn. According to Guatemala's central bank, Banguat, total remittances through the first 10 months of 2013 have totalled US$4.3bn. The Banguat authorities expect the total to surpass US$5.0bn by the end of the year, and reach US$5.2bn by 2014. Remittances are a major source of hard currency and revenue for the country, amounting to more than 10.0% of GDP and providing a boost to household income.
- We give Guatemala a score of 59.0 in our Short-Term Economic Risk Ratings.

BUSINESS ENVIRONMENT
New Hydro Project Approved

- Guatemala's Ministry of Energy and Mines has approved a hydroelectric station in Alta Verapaz which is expected to generate 100MW of electricity. The station will use the river Icbolay to produce the energy, and is expected to become operational in four years, and will last for about 50 years. The facility will generate enough power to meet 1% of the country's total demand, according to Edwin Rodas, the deputy minister of energy. Hydroelectric power has become a major theme in the government's development strategy, despite opposition from local communities.
- Our Business Environment score for Guatemala is 40.9.

Honduras

BMI's ratings rank states in terms of political risk, the economy and the quality of the business environment. There are four ratings: a composite rating, a political rating, an economic rating and a business environment rating. These are reviewed every month and the results posted on **BMI**'s online service (www.businessmonitor.com). The political and economic ratings have short- and long-term components. The long-term ratings are designed to reflect more structural considerations and will not change greatly in the short term. The short-term ratings will change frequently in response to more transient influences. All ratings are expressed as a number between one and 100. A high rating is an indicator of lower risk.

BMI Risk Ratings – Honduras

	Latest Rating	Previous Rating	Trend	Region Avg	Global Mkts Avg
S-T Political	43.8	43.8	=	61.4	65.0
L-T Political	53.3	53.3	=	61.4	63.1
S-T Economy	50.0	50.0	=	55.0	53.4
L-T Economy	41.9	41.9	=	56.7	53.3
Business Environment	36.3	36.3	=	45.7	48.5
Composite	0.0	43.6	=	46.2	52.3

POLITICAL RISK
International Observers Arrive For Elections

- A network of human rights organisations have sent 180 observers to monitor Honduras's presidential elections scheduled for November 24. Candidates focused their efforts on convincing the electorate of their plans to improve security, as organised crime and drug-related violence are on the rise in the country, with the UN reporting 7,172 homicides over the course of 2012, the highest per-capita rate in the world. International observers have also expressed concern about the level of politically-motivated violence, as well as the persecution of journalists.
- We give Honduras a score of 43.8 in our Short-Term Political Risk Ratings.

ECONOMIC RISK
Pacific Alliance Observer Status Granted

- Imported capital goods fell by 4.6% in the first eight months of 2013 compared to the same period in 2012. This was underpinned by a steep decline in capital imports for the agricultural sector, which saw a decline of 24.3%, according to data provided by the Banco Central de Honduras. While this has positive near-term implications for the trade account, it may dim the outlook for long-term productivity of the agricultural sector, and by extension, the country's ability to expand exports over the coming years.
- We give Honduras a score of 50.0 in our Short-Term Economic Risk Ratings.

BUSINESS ENVIRONMENT
Maquilas To Benefit From New FTA

- Daniel Facussé, president of the Honduran Maquila Association has told reporters that the maquila industry, which includes manufacturing firms producing primarily for exports, stands to see major benefits from the country's new Free Trade Agreement (FTA) with Canada. He noted that maquila exports are expected to reach an all-time high of US$3.3bn in 2013, representing a growth rate of 4.5% since 2012. He added that textile companies in particular are expected to see significant benefits from the FTA with Canada.
- Our Business Environment score for Honduras is 36.4.

Nicaragua

BMI's ratings rank states in terms of political risk, the economy and the quality of the business environment. There are four ratings: a composite rating, a political rating, an economic rating and a business environment rating. These are reviewed every month and the results posted on **BMI**'s online service (www.businessmonitor.com). The political and economic ratings have short- and long-term components. The long-term ratings are designed to reflect more structural considerations and will not change greatly in the short term. The short-term ratings will change frequently in response to more transient influences. All ratings are expressed as a number between one and 100. A high rating is an indicator of lower risk.

BMI Risk Ratings – Nicaragua

	Latest Rating	Previous Rating	Trend	Region Avg	Global Mkts Avg
S-T Political	55.2	55.2	=	61.4	65.0
L-T Political	44.7	44.7	=	61.4	63.1
S-T Economy	39.2	38.3	-	55.0	53.4
L-T Economy	37.7	37.7	-	56.7	53.3
Business Environment	40.3	40.3	=	45.7	48.5
Composite	42.8	42.8	-	46.2	52.3

POLITICAL RISK
Ortega Proposes To Eliminate Term Limits

■ On October 31, Nicaraguan President Daniel Ortega and the ruling Frente Sandinista de Liberación Nacional (FSLN) proposed 39 far-reaching amendments to the country's constitution. Among the most notable amendments was a proposal to eliminate wording that raises questions about the legality of presidents serving consecutive terms. While Nicaragua's constitutional court has previously ruled that Ortega's current second term is legal under the constitution, amending the wording could pave the way for Ortega to unambiguously serve an unlimited number of consecutive terms in office.

■ We give Nicaragua a score of 55.2 in our Short-Term Political Risk Ratings.

ECONOMIC RISK
Noble Energy Strikes Out On First Round Of Exploration

■ Noble Energy announced plans in November to plug and abandon its Paraiso-1 well, after its first foray into Nicaragua's offshore acreage failed to uncover commercially viable resources. While there were hydrocarbon shows and tertiary-age carbonate reservoirs found, the company reports there was no accumulation of oil or other hydrocarbons. Nonetheless, the country remains highly underexplored, suggesting there is still potential for future commercially viable finds. With Nicaraguan consumption of oil having soared from 25,400 barrels per day (b/d) in 2002 to 33,000 b/d in 2012, the discovery of oil and gas resources would be a boon for the country, helping to ease its rising import burden. This is especially true as support from Venezuela, a long-time benefactor, begins to come under increasing pressure.

■ Nicaragua scores 39.2 in our Short-Term Economic Risk Ratings.

BUSINESS ENVIRONMENT
New Internet Laws Will Stifle Market

■ Nicaragua's government is considering a number of regulatory changes that would give the state greater control of the Internet. The reforms look to change a number of articles of the constitution including presidential limits and the power to pass administrative decrees. We note that in Nicaragua's underdeveloped broadband market, the reforms will have little immediate impact for many consumers. With broadband penetration at just 3%, very few people have regular Internet access. That said, increasing Internet controls will not encourage operators to invest in their networks and can slow the rate of take up among subscribers, hindering future growth.

■ Nicaragua receives a score of 40.3 in our Business Environment Ratings.

Panama

BMI's ratings rank states in terms of political risk, the economy and the quality of the business environment. There are four ratings: a composite rating, a political rating, an economic rating and a business environment rating. These are reviewed every month and the results posted on **BMI**'s online service (www.businessmonitor.com). The political and economic ratings have short- and long-term components. The long-term ratings are designed to reflect more structural considerations and will not change greatly in the short term. The short-term ratings will change frequently in response to more transient influences. All ratings are expressed as a number between one and 100. A high rating is an indicator of lower risk.

BMI Risk Ratings – Panama

	Latest Rating	Previous Rating	Trend	Region Avg	Global Mkts Avg
S-T Political	71.9	71.9	=	61.4	65.0
L-T Political	67.9	67.9	=	61.4	63.1
S-T Economy	64.8	63.3	+	55.0	53.4
L-T Economy	67.0	65.3	=	56.7	53.3
Business Environment	51.6	51.6	=	45.7	48.5
Composite	61.9	61.9	=	46.2	52.3

POLITICAL RISK
Biden Praises Handling Of August Cargo Incident

■ US Vice President Joe Biden visited Panama in mid-November, and praised the country's seizure of a cargo ship in mid-August that was found to be carrying weapons illegally from Cuba to North Korea. We had previously suggested that the government's solid handling of the international incident that unfolded in its waters could see some goodwill for the ruling Cambio Democrático (CD) spill over onto its 2014 presidential candidate, José Domingo Arias. With recent polling data for Panama's 2014 presidential race indicating that Arias has begun to establish a substantial lead over his two main rivals, we believe that the CD's diplomatic successes may have, in fact, played a role in bolstering its domestic support.

■ We give Panama a score of 71.9 in our Short-Term Political Risk Ratings.

ECONOMIC RISK
Strong Growth In Infrastructure Market

■ The ongoing renovation of the Panama Canal, which began in 2007, has fuelled the country's construction industry, adding about 25-30% to industry value each year and bolstering economic activity. Despite a slowdown in the next few years, we forecast strong growth in industry value from 2018 onwards when the third phase of the Panama Metro (another US$1bn-plus project) will begin construction. Our Infrastructure team notes that Panama's outperformance amongst other Central American markets is to a large extent due to the relatively low levels of political and security risk in the market, an environment which has enabled project financing and project execution to proceed unhindered.

■ Panama scores 64.8 in our Short-Term Economic Risk Ratings.

BUSINESS ENVIRONMENT
Undiversified Power Market Could Create Problems

■ While our Power team anticipates that demand for electricity will rise in accordance with the country's strong economic growth, we warn that the undiversified nature of the country's power mix could hamper such growth. Panama is heavily reliant on hydropower for electricity generation (roughly 58% of the total in 2013, according to our forecasts), with imported oil-fired generation accounting for the majority of the rest. The problematic nature of this reliance was evidenced in May 2013 when Panama declared a state of emergency across a third of the country after drought-hit hydropower plants stopped producing electricity. In fact, the power rationing suspended some operations at the Panama Canal – highlighting the crucial relationship between economic activity and power supply.

■ Panama receives a score of 51.6 in our Business Environment Ratings.

Latin America – Ratings League Tables

	S-T Political	Rank	Trend
Chile	75.8	1	=
Uruguay	74.8	2	=
Panama	**71.9**	**3**	**=**
Brazil	69.6	3	=
Costa Rica	**69.4**	**5**	**=**
Colombia	68.5	6	=
Peru	67.5	7	=
Mexico	65.6	8	=
Paraguay	57.7	9	=
Nicaragua	**55.2**	**9**	**+**
Ecuador	53.3	11	=
Bolivia	50.6	12	=
Argentina	50.2	13	=
El Salvador	**49.6**	**14**	**=**
Guatemala	**47.5**	**15**	**=**
Venezuela	46.7	16	=
Honduras	**43.8**	**17**	**=**

Regional ave 61.4/Global ave 65.0/Emerging Markets ave 62.5

	L-T Political	Rank	Trend
Chile	84.2	1	=
Uruguay	72.2	2	=
Costa Rica	**71.8**	**3**	**=**
Panama	**67.9**	**4**	**=**
Mexico	67.1	5	=
Brazil	66.5	6	=
Argentina	63.4	7	=
Colombia	62.8	8	=
Peru	61.5	9	=
El Salvador	**58.9**	**10**	**=**
Paraguay	58.9	10	=
Honduras	**53.3**	**12**	**=**
Ecuador	50.2	13	=
Venezuela	48.8	14	=
Guatemala	**45.8**	**15**	**=**
Nicaragua	**44.7**	**16**	**=**
Bolivia	44.2	17	=

Regional ave 61.4/Global ave 63.1/Emerging Markets ave 59.6

	S-T Economy	Rank	Trend
Peru	73.1	1	=
Chile	73.1	2	=
Mexico	70.8	2	-
Bolivia	66.5	4	=
Colombia	66.5	5	=
Panama	**64.8**	**6**	**-**
Uruguay	62.1	7	=
Brazil	60.6	8	=
Guatemala	**59.0**	**9**	**=**
Paraguay	57.5	10	=
Ecuador	57.3	11	=
Costa Rica	**52.7**	**12**	**-**
Honduras	**50.0**	**13**	**=**
El Salvador	**48.5**	**14**	**=**
Argentina	41.5	15	=
Nicaragua	**39.2**	**16**	**=**
Venezuela	32.7	17	+

Regional ave 55.0/Global ave 53.4/Emerging Markets ave 521.5

	L-T Economy	Rank	Trend
Brazil	72.5	1	-
Chile	71.9	2	=
Peru	70.4	3	=
Colombia	67.9	4	=
Mexico	67.6	5	=
Panama	**67.0**	**6**	**=**
Uruguay	65.8	7	=
Argentina	64.6	8	=
Bolivia	64.1	9	=
Costa Rica	**62.0**	**10**	**=**
Guatemala	**56.1**	**11**	**=**
Paraguay	54.0	12	=
Ecuador	52.6	13	-
El Salvador	**48.5**	**14**	**=**
Venezuela	45.4	15	=
Honduras	**41.9**	**16**	**=**
Nicaragua	**37.7**	**17**	**=**

Regional ave 56.7/Global ave 53.3/Emerging Markets ave 50.9

	Business Environment	Rank	Trend
Chile	64.0	1	=
Uruguay	59.8	2	=
Mexico	53.8	3	=
Brazil	53.7	4	=
Peru	53.5	5	=
Colombia	52.6	6	=
Costa Rica	**52.1**	**7**	**=**
Panama	**51.6**	**8**	**=**
Argentina	48.3	9	=
Paraguay	43.2	10	=
El Salvador	**42.0**	**11**	**=**
Guatemala	**40.9**	**12**	**=**
Nicaragua	**40.3**	**13**	**=**
Ecuador	38.4	14	=
Bolivia	37.5	15	=
Honduras	**36.3**	**16**	**=**
Venezuela	32.6	17	=

Regional ave 45.7/Global ave 48.5/Emerging Markets ave 45.1

	Composite	Rank	Trend
Chile	72.2	1	=
Uruguay	66.0	2	=
Mexico	63.3	3	=
Peru	63.2	4	-
Panama	**61.9**	**5**	**=**
Costa Rica	**61.5**	**6**	**=**
Colombia	61.5	7	=
Argentina	52.7	8	=
Paraguay	**52.3**	**9**	**+**
Bolivia	50.1	10	=
Guatemala	48.4	11	=
El Salvador	**48.2**	**12**	**=**
Ecuador	47.8	13	-
Nicaragua	**42.8**	**14**	**=**
Venezuela	40.1	15	+
Honduras	**-**	**16**	**-**
Brazil	-	17	-

Regional ave 46.2/Global ave 52.3/Emerging Markets ave 49.0

Executive Summary

Core Views

- Central America as a region will remain heavily dependent on the performance of developed-state economies, particularly the US, which remains a major source for remittance flows and demand for exports.

- Drug-related violence and rising levels of insecurity will remain the major concerns for most of the region's electorate, although such concerns will be particularly elevated among the 'northern triangle' states of Guatemala, El Salvador and Honduras.

- The region's economic trajectory remains highly divergent. Panama is set to experience one of the fastest real GDP growth rates in the world over the next few years, whereas El Salvador and Guatemala will struggle.

Major Forecast Changes

- We believe that growth in Nicaraguan government revenues will continue to outpace growth in expenditures in 2014, leading to an improvement in the country's fiscal position following a spate of tax reforms implemented since 2010. As such, we forecast that Nicaragua's nominal budget balance will shift to a small surplus of 0.04% of GDP in 2014, from a forecasted deficit of 0.3% of GDP in 2013.

- Following a weak H113, we revised our balance of payments forecasts for Panama to account for wider trade and current account shortfalls.

Key Risk To Outlook

- **Upside Risk:** The performance of the US economy, and particularly US demand for regional exports, remains the biggest upside risk to our growth forecasts. We currently forecast US real GDP growth 1.8% in 2013 and 2.8% in 2014, but if growth is significantly stronger, we would be likely to see Central American economies perform better than we currently anticipate.

Political Outlook – Regional

SWOT Analysis

Strengths

- By and large, democratic process is well entrenched, with elections taking place regularly. Most of the region's governments are at least nominally committed to the rule of law, freedom of press and market-friendly policies.

Weaknesses

- Many regional governments are dogged by a weak institutional framework, with the perception among electorates of corruption being endemic to the political process.
- The region remains a key drug trafficking route, and the power of drug cartels has become much more apparent in recent years, with most governments relatively powerless to stop them.

Opportunities

- Most countries in the region are on fairly good terms with regional neighbours, and the Central America Free Trade Agreement acts to ensure some degree of economic and political cooperation.

Threats

- The rising tide of violent crime is a serious problem and a major concern for regional policymakers. The 'northern triangle' of Guatemala, El Salvador and Honduras has one of the highest non-political crime rates in the world, with high levels of poverty exacerbating the problem.

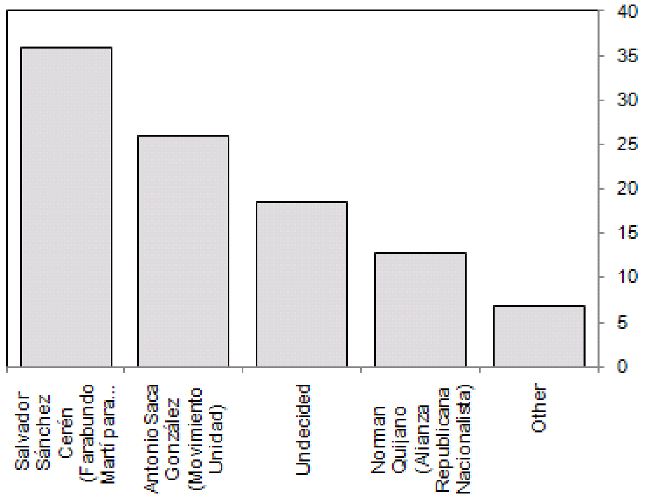
Political Outlook

Central America: 2014 Election Outlook

BMI VIEW

Three countries in Central America – El Salvador, Costa Rica, and Panama – have presidential elections scheduled within the next six months. We expect all three elections to be narrowly contested, increasing uncertainty related to policy trajectories in a region that is already facing persistent economic and security challenges.

Ceren Could Face Strong Challenge In A Run-Off
El Salvador – Voting Intentions For February 2014 Presidential Election, %



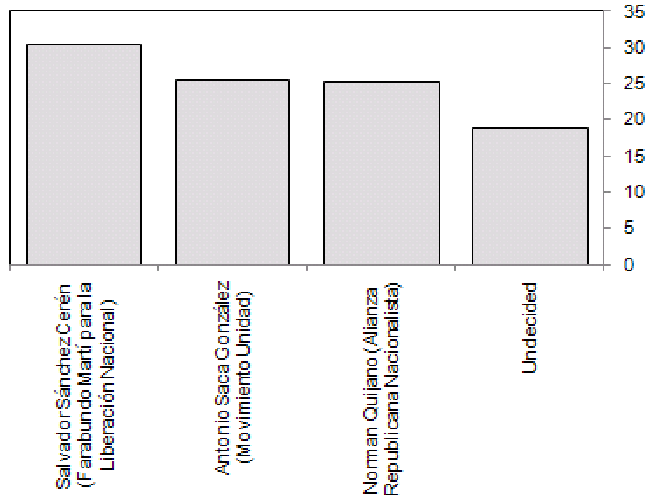
Source: BMI, Universidad Francisco Gavidia

Central America is entering a period of heightened political risk, as three countries will hold national elections by May 2014, all of which we expect to have narrow margins of victory. That candidates representing ruling parties are struggling to establish decisive leads speaks to the economic challenges facing the region, including relatively weak demand for exports from the United States, low coffee prices, and tepid investment inflows due to poor business environments.

While in some instances new leadership could offer the potential for much needed-reform, we believe that uncertain policy trajectories will keep political risk heightened until election results offer more clarity.

Moreover, as we have previously highlighted, closely-contested races could increase potential for rising social tensions to feed through to election-related violence (*see 'Regional Political Risk: Growth And Elections In Focus', October 11*). While crime and violence have long plagued Central America, in recent years gangs and cartels have become more sophisticated and regional in focus, and security problems remain the region's most significant institutional weakness (*see 'Regional Integration S ignals New Approach To Security', September 10*). Security is a particularly salient political issue in the 'Northern Triangle' of El Salvador, Honduras, and Guatemala, where the murder rates are among the highest in the world.

Election Still Too Close To Call
El Salvador – Voting Intentions For February 2014 Presidential Election, %



Source: BMI, Data Research

El Salvador: Centre-Right's Re-Emergence Could Threaten Gang Truce

In El Salvador, the outcome of the closely contested presidential election in February 2 2014 has the potential to disrupt current government efforts to fight crime. Our long-held view is that a return to power by either of the centre-right candidates – former president and current Movimiento Unidad nominee, Antonio Saca González, or Norman Quijano, of Alianza Republicana Nacionalista – could threaten the fragile truce between El Salvador's two largest gangs, M-13 and M-18, that has been in place since March 2012 (*see 'Tight Election Campaign To*

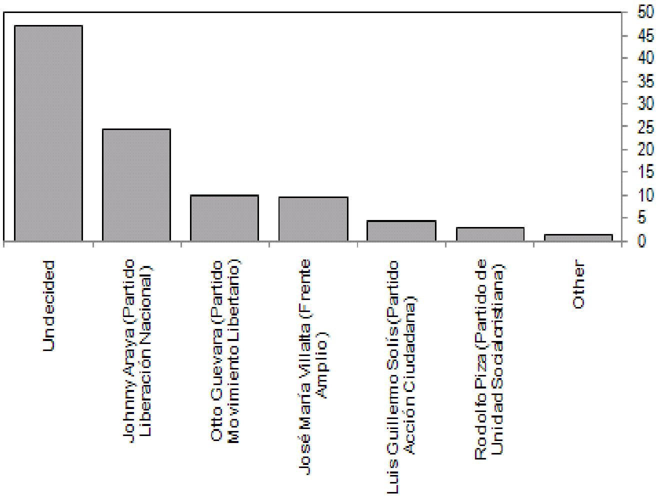
TABLE: PRESIDENTIAL ELECTION SCHEDULE

Country	Election Date
El Salvador	February 2 2014
Costa Rica	February 2 2014
Panama	May 4 2014
Guatemala	September 2015
Nicaragua	November 2016

Source: BMI, IFES Election Guide

Keep Policy Trajectory Uncertain', August 19). The truce saw both the number of homicides drop by 41.1% last year, and inbound foreign investment rise by 33.8% to US$515.8mn in 2012, the highest level since 2008. A victory by the centre-right could see a return to the prior 'firm hand' approach to fighting crime, threatening the progress that has been made under the current government to facilitate a pacification of the gang wars by engaging in more dialogue (*see 'Proposed Fiscal Reforms To Keep Political Risk Elevated', October 11*).

Araya Yet To Attract A Majority Of Voters
Costa Rica – Voting Intentions February 2014 Presidential Election, %



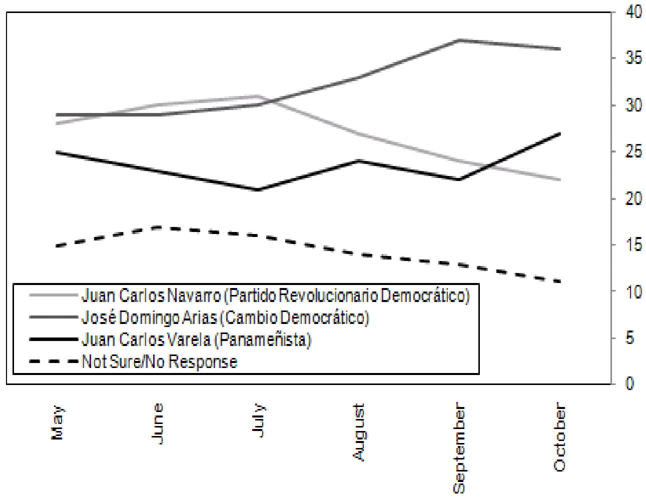
Source: BMI, University of Costa Rica Centre for Political Studies and Investigation

While the ruling party's candidate, Salvador Sánchez Cerén of the Farabundo Martí para la Liberación Nacional (FMLN), has pulled ahead of the centre-right candidates (see chart below) in recent polls, we believe that a return to power by the centre-right remains the most likely outcome, given our view that Cerén is unlikely to attain the 50% of the vote needed to avoid a runoff election on March 9. As such, we believe that voters from the centre-right are likely to unite behind whichever of the two candidates – Quijano or Saca – emerges from the first round.

Costa Rica: Araya Remains Frontrunner Amidst Mounting Economic Headwinds

In Costa Rica, Johnny Araya of the ruling Partido Liberación Nacional (PLN) has established himself as the frontrunner in the February 2 2014 presidential election, and we believe at present that he is likely to win. That said, our unfavourable economic outlook for the country due to weak fixed investment and sluggish export performance, combined with President Laura Chinchilla's low approval ratings, could see mounting headwinds for Araya in the coming months, potentially threatening his lead in the polls (*see 'Araya Leading In The Polls, But Headwinds On The Horizon,' August 9*). Indeed, while Araya received the support of 24.6% of voters in a poll from The University of Costa Rica's Center for Political Studies and Investigation (CIEP) released on October 23, well ahead of his nearest rival, Otto Guevara of Partido Movimiento Libertario, almost half of those surveyed remain undecided.

Arias Now Solidly Ahead
Panama – Voting Intentions For May 2014 Presidential Election, %



Source: BMI, Dichter & Neira

Panama: Ruling Party Establishing Firmer Lead

In Panama, polling data suggest that the ruling Cambio Democrático's (CD) candidate, José Domingo Arias, has opened up a lead over both of his opponents, Juan Carlos Varela of the Panameñista Party and Juan Carlos Navarro of the Partido Revolucionario Democrático, in the May 2014 presidential race. Arias' rebound in the polls is in line with our view that his high marks on economic and social issues, and positive sentiment for the CD, could bolster his candidacy by end-2013 (*see 'Tightening Polls Make 2014 Presidential Election Too Close To Call', August 20*). However, mounting public concerns over a lack of government transparency could still hit the polling numbers for ruling party and Arias in the coming months. Such a scenario could see voting intentions for Arias drop, potentially indicating a turning point in the presidential race.

Long-Term Political Outlook

Central America Facing Continued Challenges To Political Stability

BMI VIEW

Political stability will remain elusive for much of Central America over the next decade. Indeed, given the limited resources of most Central American economies, the elevated violence, corruption and social unrest that currently define the region's political risk profile are likely to remain continued obstacles to growth.

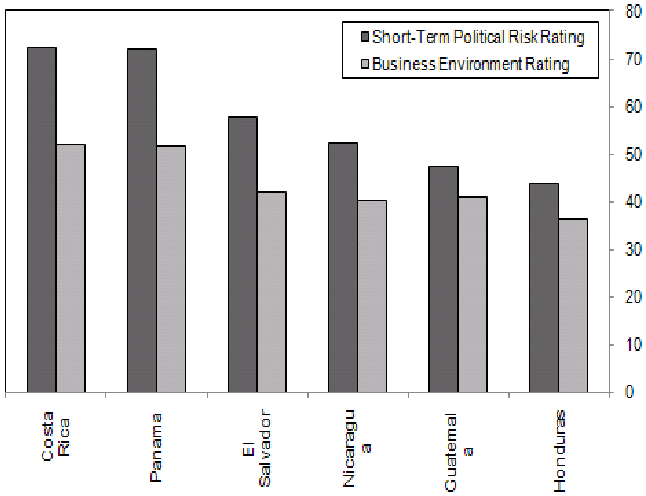
Locked In The Middle
Map Of Central America

Source: BMI

Central America will continue to face a multitude of threats to its political stability over the coming decade. The region's geographic position between the world's largest suppliers of cocaine (the Andean region) and the major consumer market for the drug (the US) will remain the biggest obstacle to greater stability, with potential for the security environment to get worse before it gets better. In addition, Central America is vulnerable to devastating natural disasters, high levels of income inequality and corruption, and a polarised political environment, all of which contribute to the region's poor risk profile.

Ultimately, we expect that a two-tiered political risk profile will remain in place, with substantial economic headwinds and limited fiscal resources constraining the ability of the Honduran, Guatemalan, Salvadoran and Nicaraguan governments to offset the effects of the violence and social unrest. Meanwhile, Panama and Costa Rica, benefiting from comparatively stronger economic outlooks, will retain far more stable political outlooks. This is reflected in our proprietary ratings, with Panama and Costa Rica scoring well above other Central American countries in terms of political risk and business environment. Meanwhile, the laggards – El Salvador, Honduras, Nicaragua and Guatemala – will continue to substantially underperform on both a regional and global basis.

Outperformers And Underperformers
Central America – Political And Business Environment Ratings, Out of 100



Source: BMI

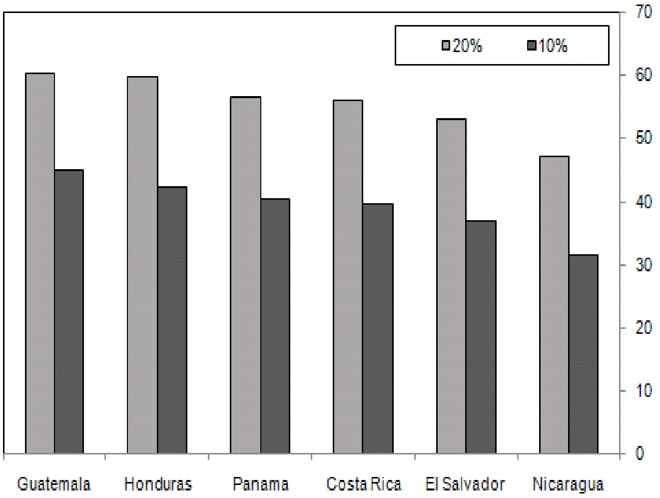
Five Key Challenges

1. Elevated Violence Continuing

A poor security environment has been a facet of life in Central America for several decades, and we see little to suggest the situation will improve dramatically in the coming years. Politically motivated violence dominated the region between the 1970s and mid-1990s, but has since been replaced by non-political violence in the form of street gangs (maras) – a legacy of Central America's civil wars. Indeed, the maras were originally formed in the US by Central American immigrants moving to Los Angeles to escape the civil wars, and spread to Central America in the mid-1990s due to a more aggressive US policy of deporting gang members after they served their prison sentences. Combined with large numbers of unemployed ex-combatants, the influx of deported immigrants saw the maras become increasingly powerful, helping to make the northern triangle region (Guatemala, Honduras and El Salvador) the worst in the world for non-politically motivated homicides

Since the end of 2006, violence in the region has been intensified by Mexican President Felipe Calderón's war against the drug cartels, which has driven powerful trafficking organisations to ramp up their activities in the Central American countries, where the institutional capacity to combat them is generally much weaker. Indeed, while the region's geographic position means that it has long served as a transit point for cocaine, in recent years, it has come to act as a key location for the Mexican cartels to manufacture marijuana and methamphetamines. Moreover, whereas the maras had previously been somewhat divorced from the cartels' efforts to move drugs throughout the region, increasingly, we have seen the Mexican cartels either fighting for territory with the local gangs (sharply increasing violence levels) or forming alliances with the groups, making them even more powerful.

Highly Unequal
Central America – Percentage Of Income Held By The Wealthiest 10% And 20%



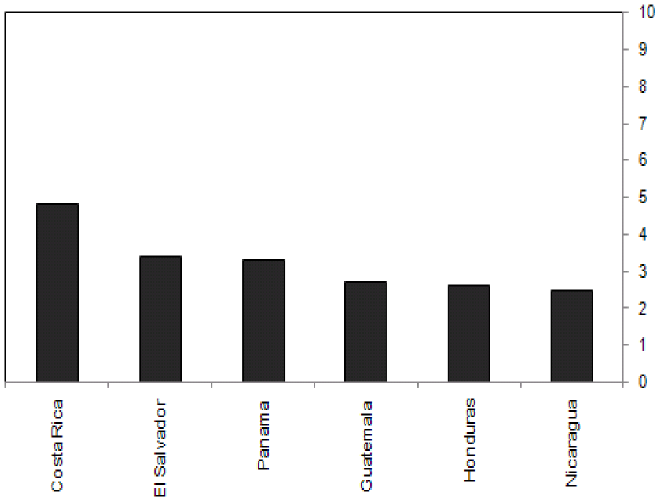
Source: BMI, World Bank

Going forward, while we have seen some evidence that multilateral intelligence-sharing could be successful in stemming the power of the cartels, such efforts would need to be backed by far greater financial and political support if they are to have a significant impact. Thus far, we have seen little evidence of a coordinated strategy or the political will to raise sufficient funds, either within Central America or by external partners such as the United States. Indeed, despite the US' creation of the Central America Regional Security Initiative in 2008 to combat organised crime, US aid to the region has totalled only US$362mn through 2011 – far less than the US$1.8bn given to Mexico through the Merida Initiative and insufficient to counter the multi-billion dollars that drug trafficking organisations have access to. As such, we remain pessimistic that violence will decrease dramatically in coming years, with our key scenario that the cartels will continue expanding their influence in Central America.

2. Inequality Driving Continued Social Unrest

Substantial income inequality will keep social tensions high in coming quarters, implying potential for continued social unrest and sharp policy reversals. The most notable manifestation of the dangerous effects of socio-economic polarisation was the 2009 coup in Honduras, which was driven in large part by a wealthy elite attempting to protect its privileges. Indeed, while the immediate catalyst for the coup was then-president Manuel Zelaya's attempts at constitutional reform, which had led many to believe he was attempting to revoke the single term limit, the underlying cause was that Zelaya's increasingly left-leaning policies had earned him the enmity of the traditional political elites. Elsewhere, deep divisions between a small wealthy elite and larger poor (and often indigenous) population have also encouraged large-scale protests over the past year in Panama, Guatemala and Nicaragua. Indeed, in Panama, widespread protests have forced the government to reverse course on everything from mining legislation to the sale of state assets.

A Deep-Rooted Problem
Central America – 2011 Corruption Perceptions Index, Out of 10



Source: BMI, Transparency International

Moreover, despite moderate economic improvement, World Bank data shows that in a majority of Central American economies, the top 20% of the population still hold well over 50% of the wealth, with the top 10% accounting for, on average, 39% of total income. These levels of income inequality imply continued social unrest, with potential for poor populations to demand further redistributive policies, threatening fiscal consolidation efforts, or to call for a reversal of business-friendly government policies, weighing on investor confidence in the region's business environment.

3. Divisive Political Processes Prompting Policy Deadlock

Compounding the region's high incidents of violence and social unrest, many Central American countries are faced with a highly divisive political environment. In part, we see this as yet another legacy of the civil wars. Indeed, while proxy warfare between the US and USSR, which fed the violence across the region is over, a sharp ideological polarisation between right- and left-leaning political parties remains in many countries, with potential to hinder the legislative policymaking process. For example, in El Salvador, legislators from the left-leaning Farabundo Martí National Liberation Front (FMLN) have been unwilling to work with the FMLN president, Mauricio Funes, as they believe he is too centrist. Meanwhile the centre-right Alianza Republicana Nacionalista has recently expelled several of its members for voting with the government to pass the budget.

The civil war in Guatemala left a different, though no less harmful legacy. After 36 years of fighting, the country's political institutions remain weak, with political parties struggling to organise on a national level, leading to the flourishing of a multiplicity of smaller parties, leaving no party with a clear majority. This has seen the legislature mired in policymaking deadlock, with agendas of the past two administrations effectively held hostage by legislators willing to engage in obstructionist tactics.

4. Pervasive Corruption Eroding Trust In Government

Corruption is likely to remain pervasive in coming years given the weak institutional capacity and increased presence of drug trafficking organisations. While the deep-rooted nature of corruption is at least partially due to the region's massive income inequality, which has engendered undemocratic practices and a broader culture of clientelism, we note that the drug trafficking organisations are likely to exacerbate the problem. Indeed, we have seen a number of countries in the region attempting to address the endemic corruption within law enforcement bodies in recent years with little success. Given limited resources and the cartels' substantial illicit revenue flows, we expect continued endemic corruption. This trend is reiterated by Transparency International's 2011 Corruption Perceptions Index, where, with the exception of Costa Rica, all Central American states score less than 4.0 out of 10.0. (A lower score denotes greater corruption.)

5. Severe Climatic Conditions Slowing Development

A final factor that will continue to blight Central America – exacerbating the above challenges – is natural disasters, including flooding, drought, earthquakes and in some cases volcanic eruptions. A severe climate can destroy infrastructure and place substantial upward pressure on food prices. Combined with the region's high poverty levels and weak institutional frameworks, which will worsen the impact of natural disasters, we believe that unfavourable climactic conditions could heighten social pressure, and slow progress toward broader developmental goals over the next decade.

Scenarios For The Next 10 Years

Mexican Cartels Move Into Central America: Violence Moderates Slightly (45% Probability)

The most likely scenario over the next decade remains that the Mexican cartels, facing continued pressure at home in the form of strengthening institutions, will continue to move operations into Central America. While the extent of their networks is likely to be curtailed by stronger institutions in Mexico and Colombia, this scenario would imply that the current drug trafficking organisations will remain the dominant players in the region over the next decade. This means that corruption is likely to rise, and violence will remain high, though not at the same levels we have seen in the last year. Indeed, we note that much of the bloodshed has been due to inter-cartel or cartel vs gang fighting, as the transnational groups move into new territory. Once the cartels establish their territory, violence is likely to diminish modestly, with occasional flare-ups.

Central American Gangs Usurp The Cartels: Violence Continues Rising (30% Probability)

Another potential scenario is that the larger Central American gangs grow more powerful and eventually supplant the Mexican cartels, resulting in increased violence and corruption. While the fractured nature of the maras makes it somewhat less likely that they will be able to grow from local operators to international narcotics traffickers, we note that this sort of shift is not without precedent, especially if the more powerful cartels face rising pressure at home. Indeed, a decade ago, it was still the Colombian cartels that dominated the drug trafficking trade, with the Mexican cartels acting as the junior partner. A number of analysts note that the power of the Mexican cartels has already begun to ebb, highlighting that many of the most infamous criminal syndicates, including the Beltran Leyva Organisation as well as the Gulf, Juarez and Tijuana cartels have seen their influence diminish substantially. That said, whether the maras are ready to go it on their own remains uncertain at this stage.

Cartels Pushed Out Of Central America: Violence Drops Substantially (25% Probability)

The least likely scenario is that the cartels are, to a large extent, forced to cease operations in the region, and violence and corruption decrease. This would require both considerable regional coordination as well as substantially increased foreign assistance. However, we note that while the US has increasingly come to consider the presence of drug cartels operating in Mexico a serious threat, Central America is much further removed and has received far less attention. As such, while aid is likely to slowly increase to Central America as the presence of the cartels becomes more noticeable, this will be a slow process. Moreover, despite the formation of a number of region-wide cooperation initiatives, weak institutions in many of the countries will likely hinder progress.

SWOT Analysis

Strengths

- Proximity to the US offers a competitive advantage to exporters over their Asian counterparts.
- With Spanish as the mother tongue and a relatively cheap labour force, there is potential for foreign multinationals to use Central America as a hub for Latin American operations.

Weaknesses

- Crime and natural disasters will continue to plague the region, acting as an impediment to growth and reducing necessary fiscal consolidation in many regional economies.
- Made up of small, relatively open economies, Central America suffers heavily from global commodity price volatility.

Opportunities

- The increasing role of China as a source of capital offers much-needed diversification of funding for many of Central American economies, which have relied heavily on investment from the US in the past.

Threats

- Remittances remain vital to the region and are a major source of private consumption for many economies in Central America. With the US economy recovering slowly, this key source of external financing will continue to record only weak expansion in the months ahead.

Economic Activity

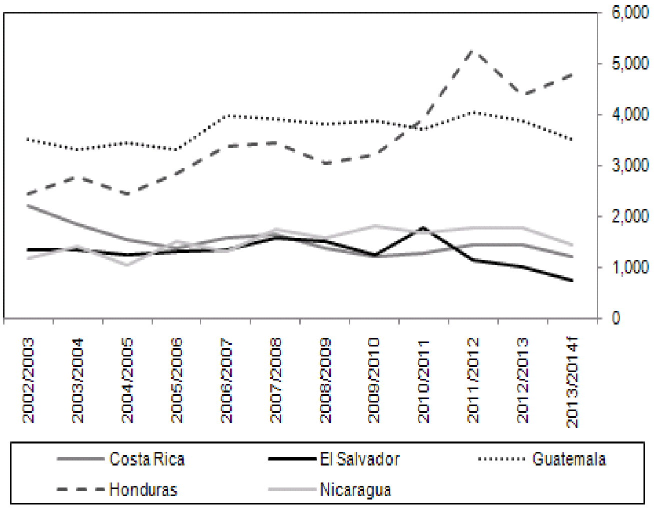
Output And Exports To Recover Slowly After Rust

BMI VIEW

We maintain our forecast for coffee production in Honduras and in most Central American producers to recover in 2013/14 after trees were affected by rust during 2012/13. Only Guatemala will see output decrease again in 2013/14, as the coffee sector also suffered from poor management and cuts to research budgets. While exports will remain below potential, stabilising exports, combined with recovering coffee prices and accelerating growth in the US (where Honduras exports its manufactured goods), will improve the country's external accounts.

Stabilising Exports

Selected Central American Countries – Coffee Exports ('000 bags)

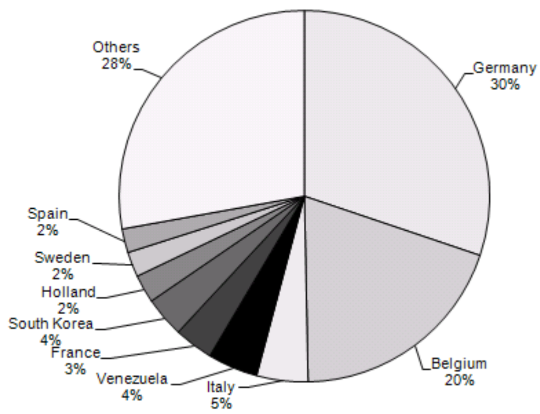


f = BMI forecast. Source: USDA

We maintain our forecast for coffee production in Honduras in 2013/14 to come in at 5.0mn 60kg bags, as we expect production to rebound from 2012/13, when the country's trees were affected by rust that limited yields. We forecast production to increase 8.7% year-on-year (y-o-y) in 2013/14 after output fell by 17.9% y-o-y in 2012/13. The rebound will be limited by subdued coffee prices and the limited potential for recovery in global prices in the near term, as we forecast recurring surpluses out to 2017. Still, the implementation of medium- and long-term strategies to control coffee rust, as well as renovation and rehabilitation of farms, will boost yields and output slightly in the coming season.

Europe Dominates

Honduras – Coffee Exports By Country In H113 (% of total volume)



Source: USDA

We forecast coffee production in most of the producers in the region to recover in 2013/14. Guatemala will be the exception, as the industry was hit particularly hard by the coffee rust outbreak in 2012/13. Poor crop management and cuts to research for the sector, in a context of low global coffee prices, have exacerbated the effect of climate change (higher temperature in altitude creating a more favourable environment for the development of the disease). As a result, we expect Guatemalan production to decrease again by 9.5% y-o-y to 3.8mn bags in 2013/14.

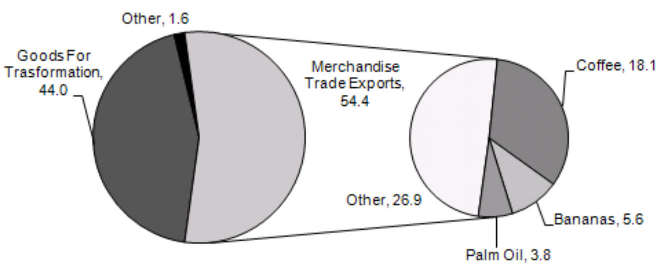
TABLE: COFFEE PRODUCTION & CONSUMPTION

		2012	2013f	2014f	2015f	2016f	2017f
Costa Rica	Coffee Production, '000 60kg bags	1,775.0	1,675.0	1,425.0	1,464.6	1,504.1	1,496.6
	Coffee Consumption, '000 60kg bags	420.9	416.7	425.7	435.3	461.4	506.4
Guatemala	Coffee Production, '000 60kg bags	4,400.0	4,200.0	3,800.0	4,090.0	4,270.0	4,450.0
	Coffee Consumption, '000 60kg bags	600.0	609.0	630.3	652.4	673.9	694.8
Honduras	Coffee Production, '000 60kg bags	5,600.0	4,600.0	5,000.0	3,900.0	4,000.0	4,200.0
	Coffee Consumption, '000 60kg bags	265.0	240.0	248.4	257.1	266.1	275.4
Nicaragua	Coffee Production, '000 60kg bags	1,880.0	1,850.0	1,890.0	1,930.0	1,990.0	2,050.0
	Coffee Consumption, '000 60kg bags	90.0	90.5	91.1	91.6	92.2	92.7
El Salvador	Coffee Production, '000 60kg bags	1,200.0	1,125.0	1,200.0	1,200.0	1,300.0	1,575.0
	Coffee Consumption, '000 60kg bags	250.0	251.3	255.8	261.1	267.2	273.8

f = BMI forecast. Source: USDA, BMI

Across the region, we expect exports to remain below previous levels as countries in the region replenish local stocks and as traditional markets experience slowing demand growth. The US Department of Agriculture (USDA) forecasts coffee exports from the region to decrease to 11.7mn bags in 2013/14, from 12.5mn bags in 2012/13 and 13.7mn bags in 2011/12. Domestic stocks in the region reflect the impact of the coffee rust disease, as local producers ran down domestic inventories in order to maximise exports for the 2012/13 season. Rising domestic demand, combined with slowing demand in key consumer markets in the US and the EU (where consumption per capita has reached a peak), will limit exports in 2013/14 and potentially in the years to come.

Dependence On Coffee A Significant Liability
Honduras – Breakdown Of 2012 Goods Exports (%)



Source: BMI, BCH

Still, a stabilisation in coffee exports in the coming years, combined with the continued acceleration of the US economy, will see export growth pick up, modestly bolstering the country's external accounts. Honduran exports have been hit hard by a combination of a virulent strain of coffee rust, which has weighed on production, and low coffee prices due to a supply glut in Brazil. Coffee exports (18.1% of total exports in 2012) contracted by 45.3% y-o-y during the first eight months of 2013, which has had a substantial impact on the country's goods trade balance in recent quarters. In addition, a mixed performance by exports in other sectors, such as manufactured goods, has been inadequate to offset such a large drop in the coffee sector, with total exports contracting by an average of 0.6% y-o-y in H113. The USDA forecasts a very modest increase in coffee exports from Honduras in 2013/14, but because we expect global coffee prices to recover slightly in 2014 and manufactured goods demand to improve, the country's external balance will improve in the coming months.

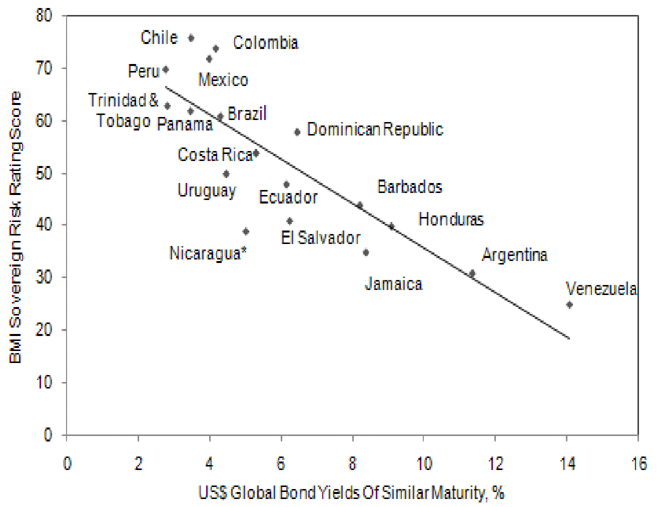
Sovereign Risk Ratings

Credit Deterioration Has Largely Run Its Course

BMI VIEW

The deterioration in the credit profile of Latin American and Caribbean sovereigns seen over the course of 2013 has largely come as far as it will go after a substantial re-pricing of credit risk in the region. Nevertheless, we have made additional downgrades to our Sovereign Risk Ratings for several countries this quarter, with some of our bearish 'Market Outlooks' on government bonds still justified. In this regard, we point towards an increasingly precarious picture for Venezuelan sovereign risk as economic mismanagement and confrontational rhetoric will continue to unnerve bond holders.

Long-End Yields Broadly Align With Our Risk Assessment
BMI's Sovereign Risk Rating Scores & Sovereign Bond Yields

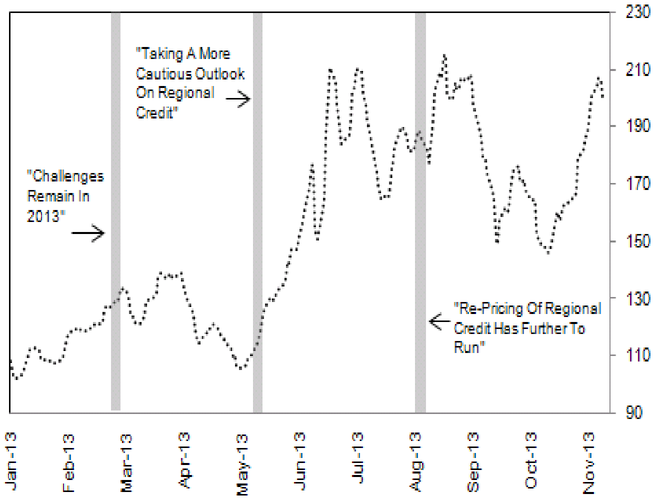


*Source: BMI, Bloomberg; *yield based on 5% coupon.*

We believe that the deterioration in Latin America and the Caribbean (LAC) region's sovereign credit profile seen over the past several quarters has largely run its course and could begin to gradually improve over the coming 12 months. This is on the back of our expectations for improving economic conditions in 2014 and regional currencies stabilising after the May/June sell-off. Indeed, we have already seen a considerable re-pricing of credit risk this year, in line with our region-wide downgrades to **BMI**'s Sovereign Risk Ratings (SRR) and below-consensus economic growth forecasts since the start of 2013. More recently, analysts' and investors' economic growth assumptions have increasingly been pared back in line with our own projections, while anticipation of monetary policy normalisation by the US Federal Reserve has already resulted in substantial capital flight, particularly from EM fixed income.

Accordingly, we feel that the re-pricing of sovereign credit in the LAC region seen this year has brought longer-dated bond yields mostly in line with where we see credit risk, as reflected in our SRR. We have therefore removed bearish 'Market Outlooks' (4) and turned neutral (3) on **Peru (70, B-)**, **Panama (62, C-)**, **Brazil (61, C-)** and **Argentina (31, E)**.

Cautious Since The Start Of The Year
Brazil – 5-Year Sovereign Credit Default Swap, bps



Source: BMI, Bloomberg. Annotation denotes previous Sovereign Risk Rating article titles.

Although anticipation of US Fed tapering, which we believe will be pushed back to H114, means that there could be another wave of 'hot money' outflows early next year, with scope for renewed exchange rate weakness and rising government bond yields, we believe that the bulk of de-rating of sovereign debt in LAC has largely played out over the course of 2013 and has only limited room to deteriorate further from current levels. Our view is in large part based on the assumption that while unlikely returning to previous highs, exchange rates in the region may have bottomed, at least for the time being, as monetary easing has largely run its course and inflation concerns have seen central banks prepare to intervene decisively in the exchange rate market.

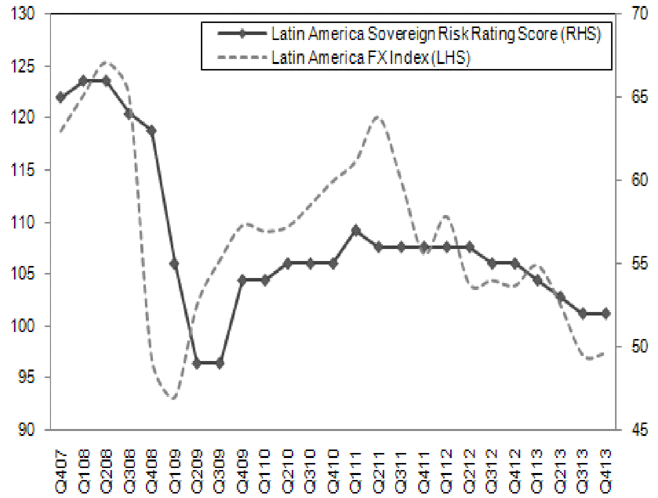
Having said that, our average SRR score for the LAC region has not changed in Q413, with the mean score remaining at 52 (D-) for the second quarter running. Despite the prospect of rising interest rate differentials with developed markets, which could place upside pressure on exchange rates, external accounts continue to look weak as commodity exporters face lower Chinese demand and weaker metals prices. This is likely to maintain downward pressure on commodity currencies over the medium term (*see 'Commodity Currencies Likely Peaked As Rebalancing Takes Hold', October 1*). Moreover, poor macro-economic data have seen a series of revisions to our forecasts, such as downgrades to real GDP growth, fiscal, and current

TABLE: LATIN AMERICA SOVEREIGN RISK RATINGS – EVOLUTION OF ABILITY TO PAY

	Total Score	Rating	Market Outlook	Ability To Pay					
	2013	2013	2013	2008	2009	2010	2011	2012	2013
Chile	76	B	3	69	76	64	82	75	69
Colombia	74	B	2	-	51	56	60	56	60
Mexico	72	B-	2	69	69	64	67	67	66
Peru	70	B-	3	73	69	67	76	75	69
Trinidad & Tobago	63	C	4	-	67	65	71	73	71
Panama	62	C-	3	44	33	44	44	42	42
Brazil	61	C-	3	73	60	73	69	67	62
Dominican Republic	58	D+	3	22	17	40	33	38	44
Costa Rica	54	D	3	45	42	49	45	45	40
Guatemala	54	D	3	32	42	55	53	53	55
Uruguay	50	D-	4	36	49	40	49	44	31
Ecuador	48	E	3	-	36	47	53	53	49
Barbados	44	E	3	-	24	25	24	31	26
El Salvador	41	E	4	16	12	33	29	29	27
Honduras	40	E	3	54	35	44	51	38	36
Nicaragua	39	E	-	18	9	11	20	29	26
Jamaica	35	E	3	20	5	15	24	7	13
Argentina	31	E	3	56	38	53	49	29	35
Venezuela	25	E	5	65	47	42	38	38	27

Sovereign ratings in ranges from A to E, with + indicating that a credit is in the top of its range (eg B+ is 77, 78, 79), and - indicating it is near the bottom (eg B- is 70, 71, 72). Market outlook is on a scale of 1 to 5, from very bullish to very bearish, with 3 being neutral. Total and 'ability to pay' is out of 100. Source: BMI account balance projections since our last SRR update for the LAC region in August (*see 'Re-Pricing Of Regional Credit Has Further To Run', August 6*).

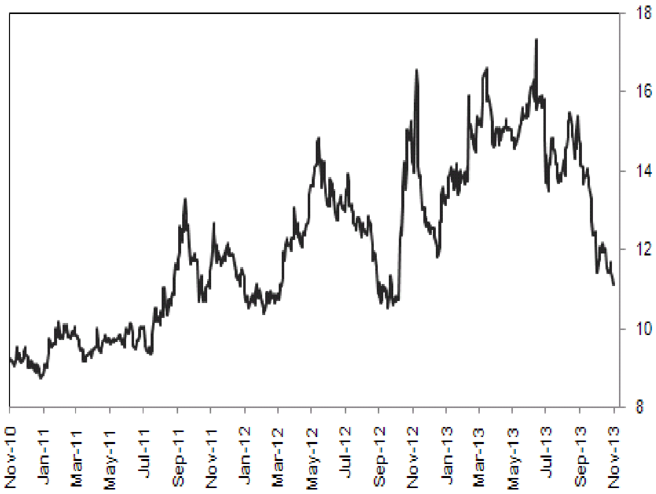
FX Weakness Affecting Regional Creditworthiness
BMI's Sovereign Risk Rating Score & JP Morgan Latin America Currency Index



Source: BMI, Bloomberg

We therefore continue to see scope for an increase in the sovereign bond yields of **Venezuela (25, E)**, **El Salvador (41, E)** and **Uruguay (50, D-)**, as well as having turned bearish in our 'Market Outlook' (4) on **Trinidad & Tobago (63, C)**, as we feel that lingering fiscal weaknesses are not fully priced into the twin-island Caribbean economy's sovereign debt. In Venezuela's case we believe that an adverse market reaction to the country's poor credit profile justifies a very bearish 'Market Outlook' (5).

A Turning Point?
Argentina – US$ Global 2033 Bond Yield, %



Source: Bloomberg

Another Wave Of Downgrades

Nine sovereigns have seen their overall SRR scores decline this quarter. Among them, Brazil saw the largest drop in the overall SRR score from 64 to 61, a downgrade from C to C-. This comes

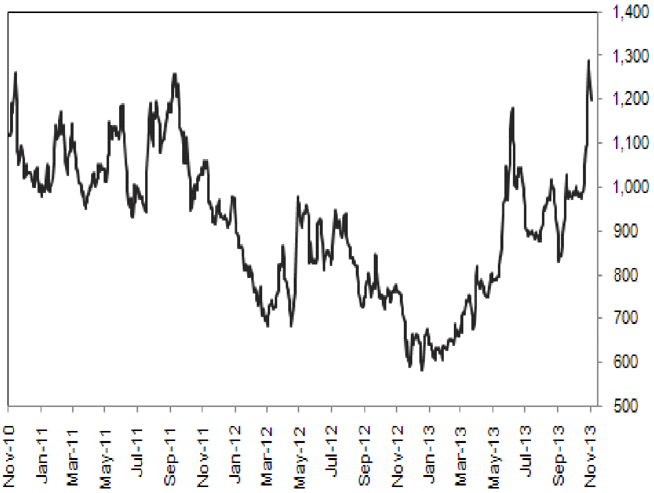
TABLE: LATIN AMERICA SOVEREIGN RISK RATINGS – EVOLUTION OF WILLINGNESS TO PAY

	Total Score	Rating	Market Outlook	Willingness To Pay				
	2013	2013	2013	2008	2009	2010	2011	2012	2013
Chile	76	B	3	79	93	91	89	86	83
Colombia	74	B	2	-	82	82	93	93	91
Mexico	72	B-	2	89	89	82	74	78	80
Peru	70	B-	3	71	72	79	64	66	70
Trinidad & Tobago	63	C	4	-	58	58	54	49	52
Panama	62	C-	3	82	89	89	88	87	86
Brazil	61	C-	3	87	78	78	73	68	60
Dominican Republic	58	D+	3	33	30	70	71	71	76
Costa Rica	54	D	3	78	80	79	76	73	70
Guatemala	54	D	3	34	60	56	50	52	52
Uruguay	50	D-	4	84	84	83	87	89	72
Ecuador	48	E	3	-	31	30	30	37	47
Barbados	44	E	3	-	76	79	70	64	66
El Salvador	41	E	4	34	34	76	69	62	57
Honduras	40	E	3	56	34	58	54	48	43
Nicaragua	39	E	-	44	44	46	44	54	56
Jamaica	35	E	3	73	57	62	61	57	61
Argentina	31	E	3	48	41	34	38	28	27
Venezuela	25	E	5	53	54	38	26	26	22

Sovereign ratings in ranges from A to E, with + indicating that a credit is in the top of its range (eg B+ is 77, 78, 79), and - indicating it is near the bottom (eg B- is 70, 71, 72). Market outlook is on a scale of 1 to 5, from very bullish to very bearish, with 3 being neutral. Total and 'willingness to pay' is out of 100. Source: BMI on the back of a three-point drop to its 'Ability To Pay' score to 62, after we lowered our 2013 real GDP growth forecast to 2.0% from 2.6% previously (*see 'Significant Headwinds To Weigh On Growth In 2013 And 2014', August 14*). In addition to the downgrade in growth and our forecasts for a lower primary budget surplus than the government this year (2.1% of GDP) and a wider current account shortfall than previously (4.2% of GDP), we have also lowered the sovereign's 'Willingness To Pay' score by two points to 60 since our last update. This reflects our increasing concern about public sector balance sheet deterioration amid a surge in credit from state-run financial institutions.

Post-Chávez Euphoria Proved Unfounded After All

Venezuela – 5-Year Sovereign Credit Default Swap, bps



Source: Bloomberg

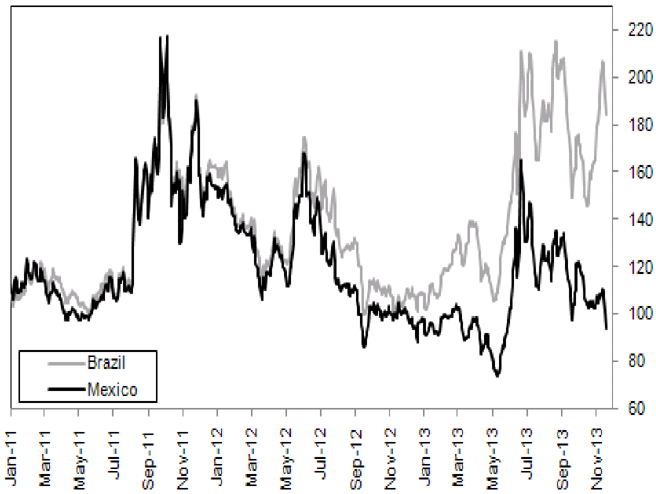
Costa Rica (54, D), **Barbados (44, E)** and **Honduras (40, E)** also saw considerable downgrades this quarter, with their overall SRR scores falling by two points for each. The sovereigns saw their 'Ability To Pay' scores decline by two, three and four points respectively, on the back of notable downward revisions to our real GDP growth forecasts. **Mexico (72, B-)** saw a one point drop to its overall SRR score after we lowered its 'Ability To Pay' score by one point to 66. This is the result of downgrading our 2013 real GDP growth forecast for Mexico from 3.0% to 2.3% and then to 1.6% following significant delays in public spending on infrastructure, and as more evidence emerged that the country's manufacturing and construction sectors continued to disappoint (*see 'Growth To Accelerate In 2014', November 5*).

Upgrading Riskier Sovereigns

However, the latest wave of downgrades in our ratings has largely been offset by sizeable upgrades elsewhere, particularly in the case of high default risk economies. **Ecuador (48, E)** has jumped five points thanks to a two-point upgrade in its 'Ability To Pay' score to 49 as the increasing prospect of allowing oil drilling in the Amazon region prompted us to raise our medium-term real GDP growth forecasts. However, it was the 'Willingness To Pay' score that saw the biggest jump this quarter (10 points to 47) after we observed increasing evidence that the government of President Rafael Correa has been softening its interventionist rhetoric and made further overtures to international investors that the country intends to return to international capital markets in 2014 (*see 'Improving Sovereign Credentials Ahead Of 2014 Return To Markets', October 28*).

Is Regional Divergence Justified?

5-Year Credit Default Swap, bps



Source: Bloomberg

Argentina saw the next-biggest upgrade this wave, despite staying second from the bottom of our SRR table for the region. Argentina's 'Ability To Pay' score went up six points to 35 after we raised the country's real GDP growth forecast for 2013 from 1.9% to 2.9% following stronger-than-expected private consumption growth, and the risks of a sizeable one-off exchange rate devaluation have significantly receded in recent months (*see 'Faster Depreciation Likelier Than A One-Off Adjustment', September 4*).

Despite being notorious for the government's confrontational tone towards 'holdout' bond holders as it fights a decision by the Second Circuit Court of New York, which earlier ruled that Argentina must either pay all holders of its restructured bond or declare default, we have upgraded the sovereign's 'Willingness To Pay' score by four points to 27. Still among the lowest scores in the region, the upgrade reflects the passing of the October midterm election, which much in line with our expectations, saw the ruling Frente Para la Victoria bloc of President Cristina Fernández's Peronist coalition emerge weaker – a development widely seen as positive by the market (*see 'Policy Moderation To Fuel Bond Rally, But Risks Remain', November 11*). Moreover, there have been indications of Argentina re-establishing relations with the World Bank, while the IMF opted not to impose sanctions on the country for misreporting inflation statistics.

Red Flags Emerge For Venezuela

Despite not making any changes to its rating, our low SRR score for **Venezuela (25, E)** aptly reflects what appears to be an increasingly worrying picture for credit risk in the country, and remains firmly at the bottom of our regional table and six points behind Argentina. Although interventionist economic policies have long been a common feature of the leadership of late Venezuelan president Hugo Chávez, we believe that both precarious economic fundamentals and an uncertain political environment will continue to materially affect the sovereign credit profile of Venezuela.

As far back as last year, when Chávez was re-elected, but disappeared from the public eye, we cautioned that an end to the Chávez era would generate significant uncertainty, rather than a solution to the country's macroeconomic problems, as a bullish bond market reaction seemed to imply at the time (*see 'The End Of Chávez: Major Uncertainty Ahead', December 10 2012*). Indeed, just after Chávez's passing was announced, we initiated a bearish view on Venezuelan sovereign credit, expecting the cost of default protection to soar (*see 'Asset Class Strategy Update: Bearish Outlook On Venezuelan CDS', March 7*). This view played out for us, and more recently, moves by the administration of Nicolás Maduro have made bond holders increasingly jittery. This underpins our decision to downgrade Venezuela's 'Market Outlook' score to 5, very bearish.

What has changed? In a bid to consolidate his political power, Maduro has signalled his willingness to go the extra step in imposing price controls by ordering troops to seize local stores and going after businesses, which have been raising prices. This is in a bid to rein in consumer price inflation, which is running around 50.0% y-o-y. With shortages of basic goods becoming more widespread, the political focus is increasingly shifting inwards, as Maduro's risk of losing power remains elevated. Moreover, as fiscal pressures mount, the coming quarters could see a major change to Venezuela's Petrocaríbe programme, through which it offers favourable financing terms to supply cheap fuel to Caribbean and Central American countries, particularly as losses at state-owned energy firm PdVSA continue to mount. Lastly, given Maduro's more aggressive rhetoric towards private enterprise and his newly awarded presidential decree powers, we cannot rule out a change in government policy towards future interest payments on existing debt. Unless a change in policy occurs, Venezuela's government bonds are likely to reflect an increasing realisation that a credit event is beginning to look more likely (*see 'Maduro's Decree Powers More Bad News For Private Sector, November 20*).

Differentiation Will Remain Key

In contrast to our neutral outlook for most of the region, we maintain bullish 'Market Outlooks' (2) on **Colombia (74, B)** and Mexico, as ongoing reforms and our expectations for rising foreign investment indicate a more positive economic outlook, and are likely to generate greater appetite for sovereign bonds. Our favourable macroeconomic outlook for both Colombia and Mexico, as well as scope for tighter monetary policy towards late-2014, bode well for exchange rate appreciation over the coming year, which should bolster the sovereign credit profile of both economies.

Indeed, the past several months have already seen perceived sovereign credit risk for Brazil diverge from Colombia and Mexico, highlighting our continuing concerns about Brazil's credit profile (*see 'Credit Risk To Remain Elevated', March 27*). Therefore, while still high beta and vulnerable to shifting investor perceptions towards EM assets, we believe that sovereign credit in Colombia and Mexico will continue to re-price towards a lower risk premium over the medium term, with the spread of Brazil over the more fundamentally sound economies in the region likely to remain substantial.

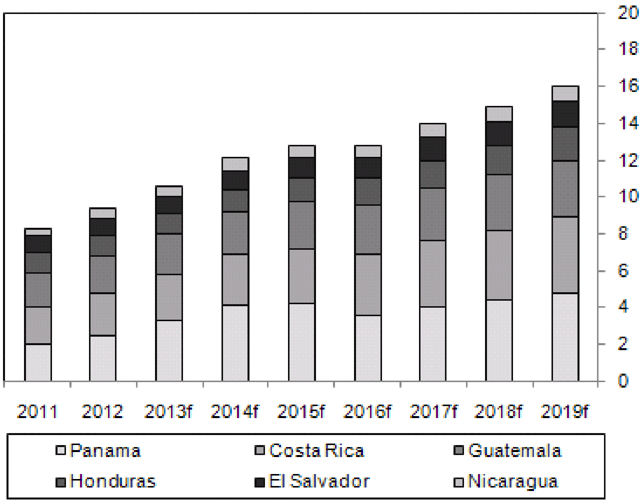
Investment Climate

Political Risk Advantage Favours Panama And Costa Rica Infrastructure

BMI VIEW

The Central American region has a vast variation in performance and the opportunities available in the infrastructure sector. Panama, Costa Rica and Guatemala are the largest markets in terms of total construction industry value and this will remain the case to the end of our forecast period in 2022. Panama's and Costa Rica's outperformance amongst Central American markets is to a large extent due to the relatively low political and security risk levels in the markets, an environment which has enabled project financing and project execution to proceed unhindered.

Panama, Costa Rica Leading
Construction industry value forecasts, US$bn

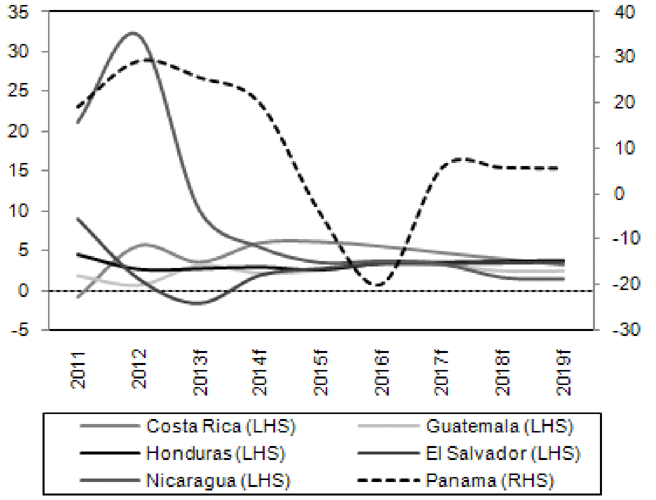


f=forecast. Source: Central Banks, BMI

A crucial factor underpinning our forecasts for infrastructure investments in the coming years is political risk. To a very large extent, the out performance of Panama and Costa Rica is down to their relatively superior political and security stability. **BMI** 's Country Risk team expects the two-tier political risk profile characteristic of Central America to remain in place for the coming years. On the one hand there are Panama and Costa Rica, while on the other, characterised by very high levels of violence and security threats, income and social inequality, pervasive corruption and divisive political environment, are El Salvador, Honduras, Guatemala and Nicaragua (*see 'Central America Facing Continued Challenges To Political Stability' 10 September*).

In real growth terms Panama has also dominated the regional table and will continue to do so until 2016 according to our forecasts, by which time the fuel behind that growth – the Panama Canal expansion- will be complete. Over 2013 we estimate that real growth in the construction industry value of Panama reached nearly 26% y-o-y.

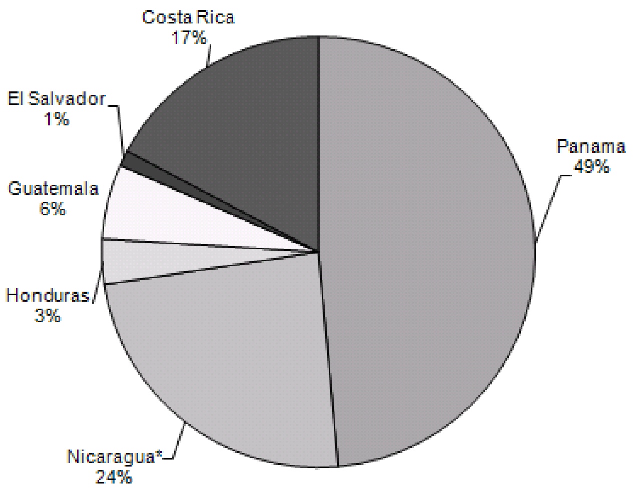
Panama Canal Completion Felt
Construction Industry Value Real Growth Forecast, %



f=forecast. Source: Central Banks, BMI

We forecast this to be 20% in 2014, the only market in Central America that will have double-digit growth. Belize and Nicaragua also exhibited very strong growth over 2013 with 14% and 10% respectively, but we forecast a deceleration for 2014.

Large Pipeline Ahead For Panama And Costa Rica
Share of Total Value Of Infrastructure Projects In Planning and Under Construction, US$bn

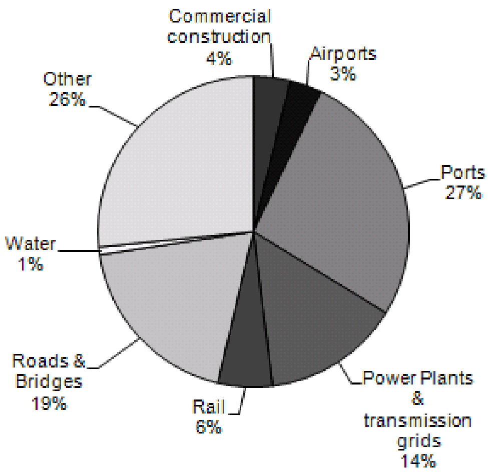


**Includes US$6bn oil refinery planned and does not include the canal. Source: BMI Infrastructure Key Projects Database.*

Deceleration of growth for construction industry value is a trend we see across the region for 2014 with the exception of El Salvador and Costa Rica. It should however be noted that volatility is the most prevalent characteristic across the Central American construction markets, with historical growth showing major peaks and troughs over the years. The small value of the industry means that even a small project can have a disproportionally large impact on growth. Therefore, our growth forecasts are not reflective of a structurally negative view of the markets prospects; rather, they are a reflection of macroeconomic variations coupled with projects going on and off the construction phase.

Diversity In Sectors Allocation

Share of Total Value of Infrastructure Projects Planned and Under Construction, by Sector



Source: BMI Infrastructure Key Projects Database.

The main change we have made this quarter, and the most significant project impact this decade on the region, is the completion of construction of the new locks in the Panama Canal. The project has fuelled the construction industry of Panama, we estimate adding about 25-30% of industry value each year. We factor in completion of construction in mid-2015 and the full effects of the absence of the project to be felt in 2016, when we forecast a 20% contraction in construction industry value. We forecasts a resumption in growth and a recovery in industry value from 2018 onwards when the third phase of the Panama Metro (another US$1bn-plus project) will likely enter construction.

There is an upside risk to our forecasts across the region and stems from the plethora of Presidential elections due in the first half of 2014, in Panama, Costa Rica, Panama and El Salvador (the latter in November 2013). It is not uncommon in election years to see several pledges of public spending ahead of the elections, therefore we could see some announcements of new projects.

Looking at the projects pipeline, there is also scope for Nicaragua to have a surge of growth in its construction industry value, if the US$6bn oil refinery project planned by the government and China Camc Engineering and the Canal proceed; however they both remain elusive prospects, especially the latter, which in our view has no reason for realisation in a region that already has the Panama Canal. While we have included the oil refinery in the projects pipeline, we have not included the Canal project.

Chapter 1.1:
Political Outlook – Costa Rica

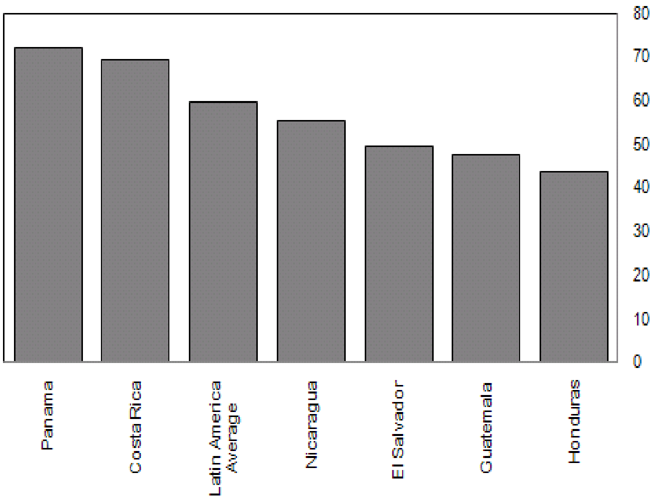
Domestic Politics

Weakening Social Stability Weighs On Political Risk Rating

BMI VIEW

A deterioration in social stability in Costa Rica has prompted us to revise down the country's score in our proprietary Short-Term Political Risk Ratings. However, Costa Rica continues to boast the second-highest rating in Central America, just behind Panama, and outperforms the Latin American average, indicating that political risk is still relatively low.

Costa Rica Still Well Above Average
Central America – BMI Short-Term Political Risk Ratings, Out Of 100



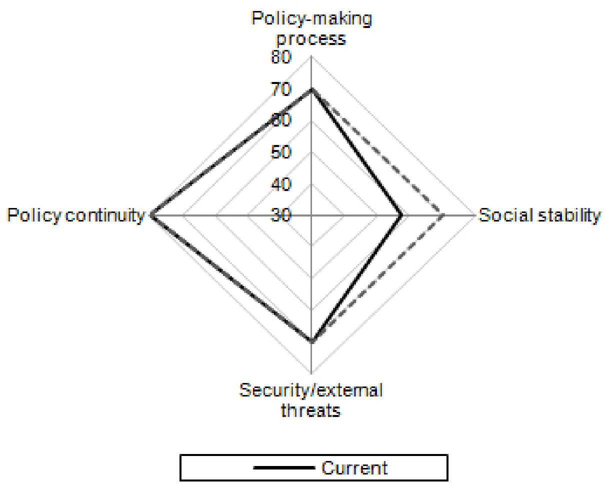
Source: BMI

We are revising down our Short-Term Political Risk Rating (STPRR) for Costa Rica to 69.4 from 72.5, due in large part to a deterioration in the social stability component in recent quarters. We have seen increasing incidences of public unrest, and with polls reflecting deep public dissatisfaction with the current government, despite Johnny Araya of the ruling Partido Liberación Nacional (PLN) being the frontrunner in the February 2014 presidential race, we believe that public unrest is unlikely to die down over the medium term. That said, relatively strong scores in the policy making, security and policy continuity components mean that the country remains the second highest ranked in Central America behind Panama in our STPRR, and continues to score well above the Latin American average of 59.8.

Policy-Making Process: Getting A Boost From Policy Enactment And Enforcement

Costa Rica continues to post a strong score in the policy-making component of our STPRR, as robust policy enactment and enforcement scores offset a relatively weak rating for policy formation. Despite the PLN and its coalition partners having earned a slim legislative majority in the 2010 election, shifting political alliances have seen some legislation get stopped in its tracks in recent quarters. We believe that this is likely to remain the norm in the coming years, as there is little to suggest that political unity is on the rise in the country at present. Costa Rica receives its strongest scores in this component for policy enactment and policy enforcement, as relatively well-entrenched democratic processes and some of the strongest institutions in Central America help to ensure that legislation is implemented once it is approved by the Legislative Assembly and president.

Public Unrest And Inflation Erode Social Stability
Costa Rica – BMI Short-Term Political Risk Rating Components, Out Of 100



Source: BMI

Social Stability: Likely To Remain On Shakier Ground

As mentioned above, the major downgrades to our STPRR for Costa Rica have come in the social stability component.

Higher inflation combined with more significant public unrest have prompted us to revise down Costa Rica's scores for these sub-components, causing the country's social stability score to fall from 70.0 to 57.5. Indeed, President Laura Chinchilla's administration has been beset by a number of problems in recent years, including the country's burgeoning fiscal deficit. The administration's flagship fiscal reform was the subject of significant protests in 2011 and 2012. Despite the fact that the reform was declared unconstitutional by the supreme court in April 2012 on procedural grounds, the government moved ahead with a number of piecemeal reforms in order to stem fiscal deterioration. Proposed measures to cut social spending, boost tax revenue and limit public sector salary increases have all faced significant pushback from public sector unions. These factors, combined with a number of government scandals, including the dismissal of several officials on the back of tax evasion allegations, have kept President Chinchilla's approval ratings some of the lowest in Latin America and seen public protests over corruption and government transparency crop up in recent quarters (*see 'Scandal To Provide Additional Headwinds For Chinchilla', May 17*). Substantial public spending has also put upward pressure on inflation in recent quarters, causing us to revise down the country's score in the inflation sub-component modestly.

Moreover, we believe that the next government will be faced with the same set of issues Chinchilla has struggled with throughout her term – putting the country's fiscal position back on steadier footing, addressing public outcry over rising inequality, and improving government transparency. With little indication that stakeholders are moving closer to a national consensus on these issues, we expect that public unrest is likely to remain an issue in the coming years.

Security/External Threats: Difficult Neighbourhood The Greatest Risk

With few major domestic security threats, a history of strong security backing from the US, and relatively constructive international relations, Costa Rica posts a relatively strong score in the security and external threats component of our STPRR, despite not having a standing military. The country's weakest score in this component comes from its regional profile. Central America remains one of the most violent regions in the world, and as such Costa Rica remains at risk of being impacted by spill-over from elevated political risk in the region. Furthermore, we believe that security will become an increasingly challenging issue in Costa Rica going forward, due to increasing signs that drug cartels are using the country's vast national parks to store and transport illegal narcotics (*see 'Security Situation Unlikely To Improve', August 23 2012*).

In addition, some of the longstanding border disputes between Costa Rica and neighbouring Nicaragua have flared up again in recent months, after Nicaraguan President Daniel Ortega reiterated a claim for the Costa Rican province of Guanacaste (see 'Territorial Dispute Aimed At Retaining Support', September 5). While we believe that these disputes will continue to be adjudicated by the International Court of Justice, with little chance of military conflict at present, they serve to reinforce the political risks of Costa Rica's location in Central America. That said, should we see signs that the border disputes are heating up or that drug or gang-related violence is increasingly spilling over into Costa Rica, we could be encouraged to revise down the security and external threats component of our STPRR for the country.

Policy Continuity: Holding Steady

With Costa Rica boasting the longest period of democratic rule in Central America, it should come as no surprise that the country posts a strong score in the policy continuity component of our SRR. Despite important medium-term political challenges, we see little to suggest that unconstitutional change would be likely in the coming years given entrenched democratic processes, relatively strong institutions and no standing military.

Chapter 1.2:

Economic Outlook – Costa Rica

Economic Activity

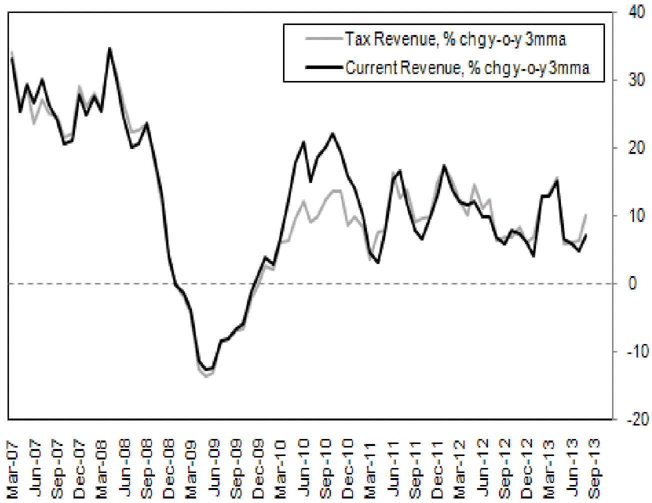
Fiscal Balance To Continue Deteriorating

BMI VIEW

We maintain our long-held negative outlook on Costa Rica's fiscal position and anticipate a continued widening of the fiscal shortfall over the next few years. While we believe that recently-announced fiscal reform proposals are a positive development, we remain sceptical that significant change is afoot.

No Return To Recent Highs

Costa Rica – Central Government Current & Tax Revenue Growth

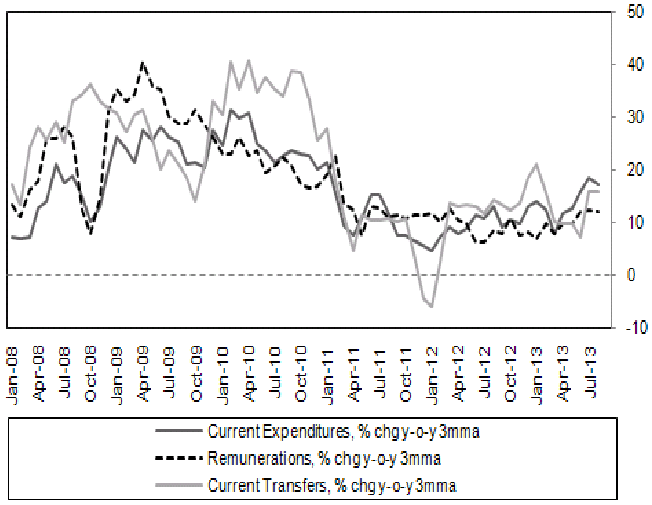


Source: BMI, BCCR

We have long held a negative view on Costa Rica's fiscal position, arguing back in 2010 that newly-elected President Laura Chinchilla would have difficulty breaking the profligate ways of previous administrations (see 'Development Heading The Wrong Way', November 18). Since then, her administration's flagship fiscal reform was struck down by the country's constitutional court in 2012, forcing the government to revert to piecemeal measures in an attempt to contain a burgeoning budget deficit. Indeed, substantial spending in recent years has seen the country's budget balance flip from a modest surplus in the mid-2000s to a 3.9% of GDP deficit in 2012. Moreover, given that we remain sceptical that the government will be able to implement recently-announced fiscal reforms in short order, due in part to a change of government in February 2014, we forecast that the nominal non-financial public sector shortfall will widen in 2013 and 2014 to 4.8% and 5.2% of GDP respectively.

Spending Edging Higher

Costa Rica – Central Government Expenditures And Selected Components



Source: BMI, BCCR

TABLE: FISCAL POLICY

	2009	2010	2011	2012	2013f	2014f	2015f	2016f	2017f
Fiscal revenue, CRCbn [1,3]	5,311.7	6,275.7	7,039.1	7,675.0	8,404.2	9,244.6	10,353.9	11,544.6	12,872.3
Revenue, % of GDP [1,3]	31.5	32.9	33.9	33.8	33.5	33.7	34.9	36.1	37.5
Fiscal expenditure, CRCbn [1,3]	5,828.8	7,199.1	7,783.7	8,550.3	9,619.0	10,677.1	11,744.9	12,919.3	14,340.5
Expenditure, % of GDP [1,3]	34.6	37.7	37.5	37.7	38.3	39.0	39.6	40.4	41.7
Budget balance, CRCbn [1,3]	-517.2	-923.4	-744.5	-875.2	-1,214.9	-1,432.6	-1,390.9	-1,374.7	-1,468.2
Budget balance, % of GDP [1,3]	-3.1	-4.8	-3.6	-3.9	-4.8	-5.2	-4.7	-4.3	-4.3

Notes: f BMI forecasts. 1 Non-Financial Public Sector (excl. Central Bank); 2 Fiscal balance stripping out interest payments on government debt. Sources: 3 Banco Central de Costa Rica/BMI.

Revenue Growth To Remain Moderate

In line with a significant slowdown in economic activity in recent quarters, we have seen revenue growth underperform our expectations in the year-to-date. As we expect economic activity to remain moderate through year-end on the back of slow fixed investment and persistent weakness in the external sector (*see 'Only Moderate Growth Ahead', October 17*), we have revised down our total non-financial public sector revenue growth forecast for this year to 9.5%, from 11.0% previously. This implies only a slightly stronger expansion than 8.6% y-o-y for central government inflows between January and August. In addition, we maintain our forecast for an uptick in total revenue growth to 10.0% next year, as modestly stronger economic activity will bolster tax revenues.

Spending Not Letting Up

We have revised up our 2013 total non-financial public sector expenditure growth forecast to 12.5%, from 10.5% previously, as piecemeal fiscal reforms in recent quarters have done little to stem rising government spending. Indeed, central government outlays have increased by 13.2% y-o-y during the first eight months of 2013, driven by a number of factors, including rising spending on wages and salaries, social expenditures, and current transfers. Moreover, with an election coming up in February, we believe that upward pressure on spending will persist. However, a recent decision by legislators to cut government funding for election campaigns by CRC20bn should help ensure that election spending remains more moderate than in recent years. Nevertheless, with the implementation of comprehensive fiscal reform still a ways off, we have revised up our 2014 total expenditure growth forecast modestly to 11.0%, from 10.0% previously, anticipating relatively strong spending through Q114 at least.

Still Sceptical Of Government Proposals

Several weeks after **Moody's** Investors Service downgraded Costa Rica's sovereign credit rating outlook from 'stable' to 'negative' on the back of deteriorating fiscal and debt dynamics, Costa Rican Finance Minister Edgar Ayales announced a number of proposals to cut the country's budget deficit, as part of a longer-term process to come to address the shortcomings of current fiscal policy. The proposals include boosting government revenue by increasing taxes on areas such as private healthcare and education, as well as changing the tax burden in the country's free trade zones, while also cutting spending. Ayales has said that the document will serve as a basis for a discussion of the country's fiscal situation, and the government plans to hold a number of roundtables on the issue in the coming months. While we believe that this development is an important step towards putting Costa Rica on a more sustainable fiscal trajectory, given previous failed fiscal reform attempts, we remain sceptical about their passage and implementation. Nevertheless, we will be keeping a close eye on these developments in the coming months for signs that significant change could be afoot, potentially causing us to revisit our medium-term fiscal forecasts for the country.

Domestic Politics

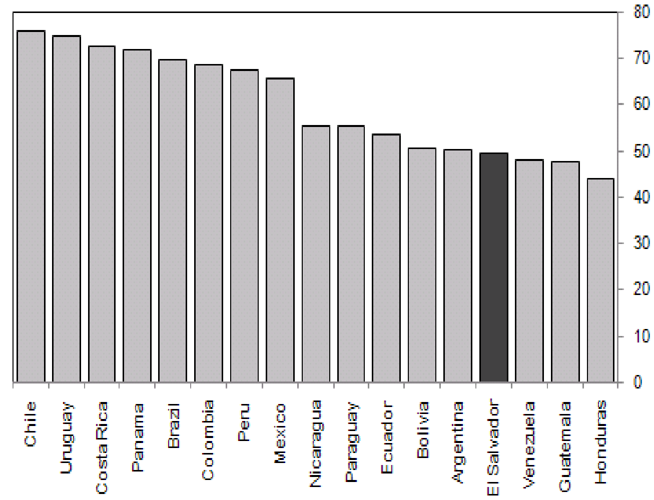
Proposed Fiscal Reforms To Keep Political Risk Elevated

We believe that El Salvador is entering a period of heightened political risk in the coming months, as proposed fiscal reforms drive public protests, and an upcoming presidential election creates uncertainty over the country's efforts to combat crime. As such we have moderately downgraded El Salvador's score in the 'social stability' sub-component of our proprietary Short-Term Political Risk Ratings, dragging the overall score down to 49.6, from 50.8 previously, placing it fourth worst out of 17 countries in Latin America. Indeed, El Salvadoran President Mauricio Funes' proposal to freeze health workers' salaries has driven protests by the Sindicato de Trabajadores de Salud (Sitrasalud) union, an indication that efforts to pull back on government expenditures to balance weak revenue inflows are likely to face resistance from unions and among the public. El Salvador's nominal fiscal deficit came in at 3.4% of GDP in 2012, and we forecast a deficit of 3.4% of GDP in 2013 and 3.1% in 2014. While Sitrasalud ended its most recent strike after nearly two weeks on October 7 as the national assembly began to debate the 2014 budget, we believe that further industrial action is likely going forward, given that an 8.0% increase in health salaries that is stipulated by law is not currently included in the government's proposed budget for the year.

Moreover, as we have previously written, political uncertainty in El Salvador is being compounded by a potential return to power by one of the centre-right political parties in narrowly contested presidential and legislative elections set for February 2 2014 (*see 'Tight Election Campaign To Keep Policy Trajectory Uncertain', August 19*). We expect that addressing El Salvador's high crime rate will be the central issue during the campaign, and note that a return to power by the centre-right could threaten the fragile truce between El Salvador's two largest gangs, M-13 and M-18, that has been in place since March 2012, and saw both the number of homicides drop by 41.1% last year, and inbound foreign investment rise by 33.8% to US$515.8mn in 2012, the highest level since 2008. A victory by former president of El Salvador, and current Movimiento Unidad nominee, Antonio Saca González, or Norman Quijano, the nominee from the other centre-right party, Alianza Republicana Nacionalista, could see a return to the prior 'firm hand' approach to fighting crime, threatening the progress that 's been made under the current government to facilitate a pacfication of the gang wars by engaging in more dialogue.

Cutback On Spending Driving Protests

Latin America – BMI Short-Term Political Risk Ratings, Out Of 100



Source: BMI

Chapter 2.2:
Economic Outlook – El Salvador

Economic Activitys

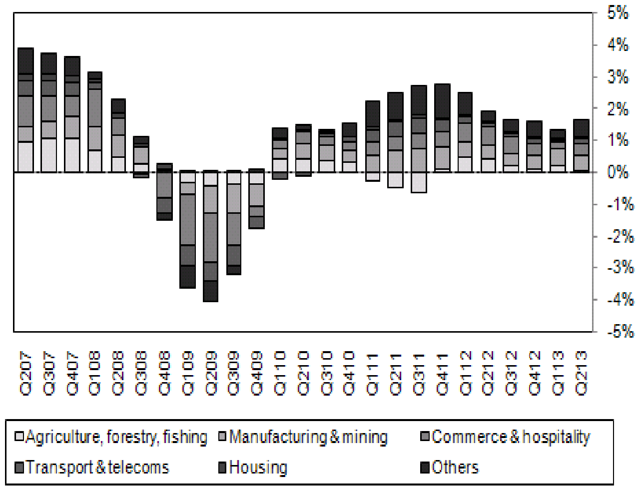
Levelling Growth Poses Risk To Forecasts, But Better Times Ahead

BMI VIEW

The most recent economic data suggest that the Salvadoran economy continues to struggle to regain its mid-2000's momentum, posing downside risks to our already-subdued forecast of real GDP expansion of 1.8% for 2013. Over the longer term, we believe that growth will gradually improve, mirroring the fortunes of the United States, to which the Salvadoran economy is closely tied.

Real GDP Growth Levelling Off At A Lacklustre Pace

El Salvador – Components Of Real GDP Growth, % chg y-o-y



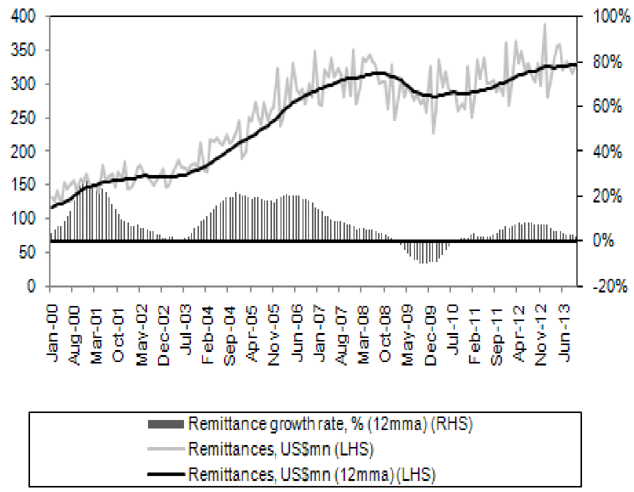
Source: BMI, Banco Central de Reserva de El Salvador

The most recent economic growth data from the Banco Central de Reserva de El Salvador indicate that the country's real GDP expanded by 1.6% y-o-y in Q213, up only slightly from the 1.4% growth seen in Q113, and still below our full-year target of 1.8% y-o-y.

The sluggishness is attributable in part to the continued decline in the growth rate of the agricultural sector (including forestry and fishing), which expanded by just 0.6% y-o-y in Q213, the lowest rate since Q311 and a significant decline from the 1.9% y-o-y growth seen in the previous quarter. The slowdown is likely due to the effects of coffee rust and other plant diseases which have hampered production.

Remittance Growth Slowing, But Better Times Ahead

El Salvador – Monthly Remittances, US$mn & %chg y-o-y



Source: BMI, Banco Central de Reserva de El Salvador

More positively, El Salvador's other major sectors saw signifi-

TABLE: ECONOMIC ACTIVITY

	2008	2009e	2010e	2011e	2012e	2013f	2014f	2015f	2016f	2017f
Nominal GDP, SVCbn [2]	21.4	20.7	21.4	23.1	23.8	24.4	25.7	27.5	29.2	31.1
Nominal GDP, US$bn [2]	21.4	20.7	21.4	23.1	23.8	24.4	25.7	27.5	29.2	31.1
Real GDP growth, % change y-o-y [1,2]	1.3	-3.1	1.4	2.0	1.6	1.8	2.0	2.2	2.3	2.3
GDP per capita, US$ [2]	3,484	3,341	3,444	3,692	3,777	3,855	4,032	4,275	4,520	4,780
Population, mn [3]	6.2	6.2	6.2	6.3	6.3	6.3	6.4	6.4	6.5	6.5
Industrial production index, % y-o-y, ave [2]	0.6	-3.1	1.1	1.5	1.5	2.0	2.9	3.2	3.1	3.0
Unemployment, % of labour force, eop [4]	7.3	7.3	7.1	6.6	6.1	6.0	6.0	5.8	5.5	5.5

Notes: e BMI estimates. f BMI forecasts. 1 Base Year = 1990. Sources: 2 Banco Central de la Reserva de El Salvador/BMI; 3 World Bank/UN/BMI; 4 IFS.

cant improvements compared to last quarter, with commerce and hospitality nearly doubling its y-o-y growth rate from the previous quarter, from 1.1% to 2.1%. Transport and telecoms growth accelerated from 0.7% y-o-y to 1.3% over the same period.

Looking further ahead to 2014, we expect that growth in El Salvador's economy will gradually increase, in line with our expectations for an improvement in economic performance of the United States. Family remittances are a huge source of revenue for El Salvador (amounting to over US$1bn in the second quarter of 2013, equivalent to 16.8% of GDP), and their contraction over the course of H208 and H109, and sluggish recovery since, have been a significant drag on the economy in recent years. As of October 2013, remittance growth had slowed to its lowest rate since 2011, coming in at 2.2% y-o-y. Given that an estimated 90% of El Salvador's remittances come from the United States, and we are forecasting US growth to pick up to 2.8% in 2014 versus 1.8% in 2013 (accompanied with a continued decline in the rate of unemployment), we believe that remittance growth will accelerate over the coming quarters, with positive implications for the broader Salvadoran economy.

Domestic Politics

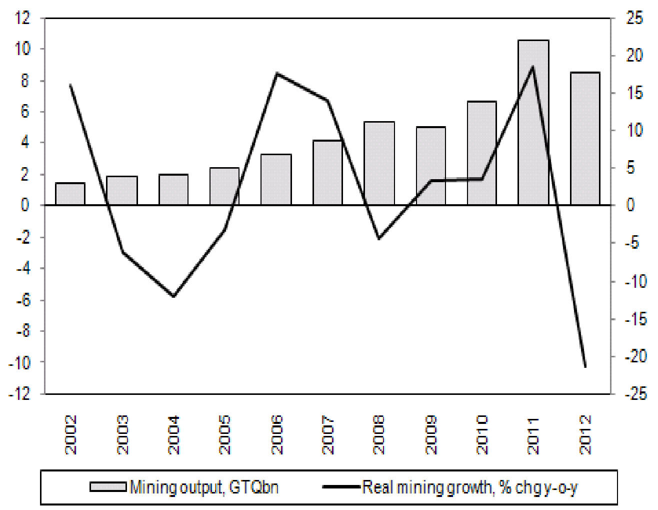
Indigenous Activism Signals Further Tensions Ahead

BMI VIEW

The formation of a new political party in Guatemala, a group which appeals to indigenous solidarity and a desire for sweeping changes to economic policy, underscores the growing dissatisfaction with the government among the electorate in the face of rising violence and lack of economic opportunity. It also highlights the fact that political risk will be a top concern for businesses and other stakeholders in the country for the foreseeable future.

Political Risk To Play A Major Role In Large Future Projects

Guatemala – Mining Sector Output



Source: BMI, Banco de Guatemala

According to local media, a new political party in Guatemala will be formally announced in October, a development which underscores the dissatisfaction that many in the country feel regarding the current political system. Rising violence, widespread poverty, and the perceived biased of the government in favour of large corporations in land disputes are all taking a toll on the authorities' credibility, and we expect that such efforts have the potential to gain traction.

The new party, which has not yet selected a name, hopes to build support gradually, leveraging off of grassroots campaigning at the local level, social-media branding, and a call to solidarity among Guatemala's sizeable indigenous (mainly Mayan) population. Edwin Xol, a former diplomat and one of the principle organisers of the movement, has said that one of the main objectives is to unite the existing civic committees, which have considerable influence at the local level, and place them under one umbrella to have a stronger voice in national debates.

Indigenous Indignation On The Rise...

It is not clear whether the organisation's strategy of grassroots funding will be able to compete with the major parties with more established financing methods, and as of yet no platform has been defined. However, the appetite for political reform is present, and recent indigenous demonstrations demanding change suggest that such an effort could bear fruit. On August 9, indigenous farmers blocked major roadways (including several sections of the Inter-American Highway) for seven hours, using burning tires, barricades, and boards with nails to prevent passage. The protests were held on the International Day of the World's Indigenous Peoples, first pronounced by the General Assembly of the United Nations in 1994.

Around two dozen other lower-profile demonstrations occurred around the country on the same day, further highlighting the growing political momentum behind indigenous collaboration. The aforementioned civic committees are often organised by indigenous groups, and have organised dozens of community referendums in recent years, mainly in protest to planned megaprojects including mines and hydroelectric dams. They also demand a cessation of evictions associated with these and other projects, which they allege violate their rights as indigenous people and as citizens. The groups have also called for increased rural development initiatives to help the country's poor, and government intervention to halt the rise in prices of electricity and basic food products.

The mining sector, already quite small in the country (accounting for only 2.2% of GDP), shrank by 21.3% in real terms in 2012, due to both poor global conditions and the rise in domestic political risk. As political risk remains elevated, and as explicitly anti-mine groups gain influence, we expect that the sector, along with others which rely on large-scale, disruptive investments, will continue to struggle to thrive in Guatemala.

Chapter 3.2:
Economic Outlook – Guatemala

Economic Activity

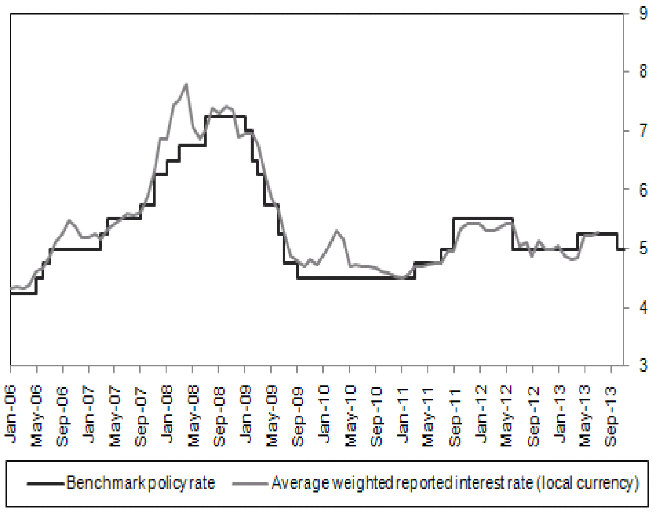
Overall Interest Rate View Intact, Despite Surprise Cut

BMI VIEW

Despite the Banco de Guatemala's decision to cut its benchmark policy rate by 25 basis points at its October meeting, we expect that further cuts are unlikely in the coming months. Indeed, given stronger economic growth, and the fact that inflation remains in the upper half of the bank's target range, we maintain our view for a hiking cycle to commence in 2014.

April Hike Remorse?

Guatemala – Benchmark Policy Rate & Weighted Interest Rate, %



Source: BMI, Banco de Guatemala

The Monetary Board of the Banco de Guatemala (Banguat) cut its benchmark policy rate by 25 basis points (bps) at its meeting on October 30, citing in a communiqué that the policymakers do not foresee significant inflationary pressures over the medium term. We had anticipated that the Banguat would keep rates on hold, given the fact that inflation remains within the target range of 4.0% ±1 percentage point, while real economic growth has stabilised. Indeed, the communiqué provided little detail as to the motivation for the cut; authorities claimed that economic activity, measured by real growth, remittances, and bank credit had all 'conformed to estimates'. Nevertheless, the monetary board said that the external environment posed some 'downside risks' and we expect that given the US Federal Reserve's decision to delay withdrawing their asset purchases programme, the Guatemalan authorities concluded that they had the room to lower interest rates and bolster growth.

The cut is effectively a withdrawal of the 25bps hike enacted in April of this year, which we believe policymakers judged in retrospect to be premature. As a result, we do not believe that the October cut is a signal of further monetary easing, and in fact we retain our view for a hiking cycle to commence in 2014. We are presently forecasting an end-2014 benchmark policy rate of 5.50%, implying 50bps of hikes over the course of the year.

Real economic growth in Guatemala stood at 3.3% y-o-y in August, up slightly from the 3.1% y-o-y print reported in July. Nevertheless, month-on-month economic growth has been much more volatile, with two of the past three months posting

TABLE: MONETARY POLICY

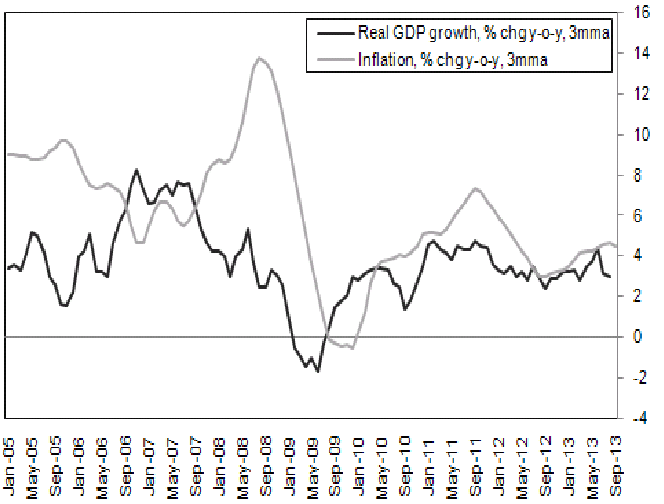
	2012	2013f	2014f	2015f	2016f	2017f
Lending rate, %, eop [1,5]	13.5	13.0	13.0	13.0	13.0	13.0
Real lending rate, %, eop [2,5]	10.0	9.0	8.2	8.5	8.8	9.0
Consumer price index, % y-o-y, eop [3,6]	3.4	4.0	4.8	4.5	4.2	4.0
Consumer price index, % y-o-y, ave [4,6]	3.8	4.8	4.8	4.5	4.2	4.0
Exchange rate GTQ/US$, eop [7]	7.80	7.82	7.80	7.85	7.90	7.95
Exchange rate GTQ/US$, ave [7]	7.83	7.85	7.80	7.75	7.80	7.80
M1, GTQbn [8]	61.2	65.8	71.0	76.7	82.8	89.5
M1, % change y-o-y [8]	6.7	7.5	8.0	8.0	8.0	8.0
Exchange rate GTQ/EUR, ave [7]	9.95	10.44	9.91	9.53	9.36	9.36

Notes: f BMI forecasts. 1 Average; 2 Real rate strips out the effects of inflation; 3 Base Year = 2001; 4 Base Year = 2002. Sources: 5 IMF/BMI; 6 INE; 7 BMI; 8 Banguat.

real contractions. Since the beginning of 2012, monthly real y-o-y growth has averaged 4.2%, respectable given the global macroeconomic environment, but still likely below the country's potential (*see 'Private Consumption To Drive Moderately Stronger Growth', August 15*). The reduction in interest rates following the rate cut will help to bolster private sector credit, which despite recent improvement – expanding by 15.3% y-o-y in September 2013, up from single digit growth as recently as mid-2011 – has failed to return to pre-global financial crisis levels of nearly 30%. Inward investment from abroad has also been hampered by the prevalence of drug-related violence in the country, which suffers from one of the highest murder rates in the world.

Growth Trend Still Relatively Weak

Guatemala – Inflation & Real GDP Growth, %, Three-Month Moving Average



Source: BMI, Banco de Guatemala

Inflation, meanwhile, stood at 4.2% y-o-y in September, the third consecutive decline since June, when the rate stood at 4.8%. Month-on-month figures are also relatively subdued, averaging 0.4% since the beginning of the year and coming in at 0.3% in September. With subdued price pressures on the major components of the CPI (including oil and food prices) over the medium term, we believe that inflationary concerns are likely to be muted over the coming months, precluding the need for a hawkish stance. However we expect price growth to tick up slightly over the longer term as the global economy picks up, private sector credit and the money supply expand, and prices normalise compared to the below-trend experience of recent quarters.

Apart from growth and inflation concerns, we expect that the strength of the quetzal will also be on the Banguat authorities' radar for determining future monetary policy decisions. The currency has weakened marginally, by 2.2% since the beginning of April, to GTQ7.9405/US$. We believe that risks remain to the downside, given recent weakness in Guatemala's external position, given the aforementioned sluggishness of foreign investment, as well the poor performance of the critical coffee sector due to the prevalence of coffee rust. If the quetzal experiences further significant depreciation, the Banguat may feel compelled to hike rates earlier, or by a greater magnitude, than we currently anticipate.

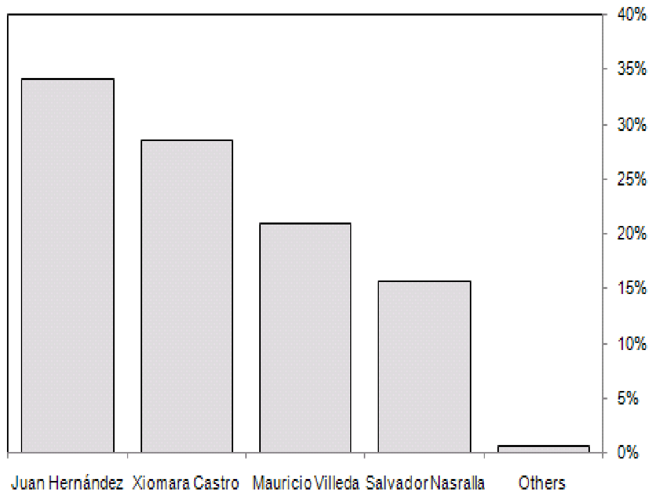
Domestic Politics

Hernández Appears Victorious, But Political Risk Still Elevated

BMI VIEW

Preliminary poll numbers indicate that the incumbent Honduran president, Juan Orlando Hernández, has retained his position following the election on November 24, but at the time of writing the main challenger has vowed to fight the results, suggesting that protests and political unrest may be on the cards over the near term. Over a longer time horizon, the bitter-fought nature of the campaign and narrow margin of victory are likely to hamper the mandate of the president, potentially adversely affecting policymaking.

Hernández On Top
Honduras – Preliminary Results Of November 24 Presidential Elections, % Of Vote



Source: BMI, Supreme Electoral Tribunal of Honduras

We believe that given the confrontational reaction to the results so far released by the electoral authority in Honduras's recent general election, the prospect of political unrest, including protests, will remain elevated over the near term. Nevertheless, we believe that ultimately the president's re-election will stand. Over the longer term, we believe that the deep divisions among the electorate and political leadership will add another layer of difficulty to the policymaking process, which already struggles with inefficiency and corruption.

At the time of writing on November 25, early indications suggest that the incumbent president of Honduras, Juan Orlando Hernández, will remain at his post following the country's general elections on November 24. According to the Supreme Electoral Tribunal, the president had 34.2% of the 1.37mn votes counted so far (46% of the total according to the voting authority), compared to 28.5% for Xiomara Castro, his nearest competitor. Mauricio Villeda comes in third with 21.0%. There is no provision for a run-off election in Honduras, meaning that the winner of the poll is poised to win the presidency, despite only garnering about a third of the total vote.

Although there were some minor irregularities (including some polling stations running out of voting material), international observers, including monitors from the US and the EU, declared the vote to be fair and urged participants to respect the results.

Based on these preliminary results, Hernández claimed victory. Meanwhile, Castro, the standard-bearer for the left-of-centre Libertad y Refundación (LIBRE) party who is best known as the wife of the former president Manuel Zelaya (ousted in 2009), announced that based on the national results that she had seen, she was the president of Honduras. She urged supporters to 'defend the vote with the certainty of victory'. On her Twitter account, she echoed the sentiments of the LIBRE leadership which announced that it would 'not recognise' the data being released by the electoral authority, and would take legal action to challenge the results.

Over the near term, the lack of concession by Castro, along with the ongoing confusion in Honduras regarding the legitimate winner of the election, has the potential to spur political unrest, including potentially violent protests. Nevertheless, we believe that Hernández's victory will ultimately stand, a testament to the popular appeal of his hard-line stance against the widespread violence and impunity which plagues Honduras. In his campaign, Hernández promised to expand the role of the military in cracking down on violence, which is fuelled primarily by gangs and drug traffickers. Castro, in contrast, promoted the idea of community policing, with a diminished role of the military, expressing reservations about the implications of further militarisation of routine security.

Taming violence was a common theme among all the candidates throughout the campaign, but the challenges inherent in tackling the well-organised, well-funded, and heavily-armed drug cartels, coupled with the serious disagreements among leading policymakers about the appropriate strategy to accomplish this goal, will likely make progress on the issue slow. More broadly, the fractured nature of the legislature and the lack of a clear mandate from the electorate are likely to hamstring progress on the multitude of other challenges facing the country, including diversification of the economy, strengthening democratic institutions, and reversing the widening of the trade deficit. Due to the uncertainty surrounding the election, in recent months we have assigned Honduras the lowest Short-Term Political Risk rating in the region, at 43.8/100. Due to the ongoing challenges that the country faces on the social stability and policymaking, we will forgo an upgrade for the time being, despite the fact that the election has now passed.

Balance Of Payments

Modest Improvement In Current Account Shortfall Ahead

BMI VIEW

We have revised our current account outlook for Honduras to account for modestly narrower deficits in the next few years, anticipating that the waning effects of coffee rust and a pick-up in US economic activity will provide some upside for the country's goods exports. Nevertheless, with elevated political risk likely to keep financial inflows relatively moderate, we believe that the financial account surplus may be insufficient to cover the current account shortfall.

While we expect that Honduras's current account shortfall will remain substantial, we are revising our balance of payments outlook for the country to account for slightly narrower deficits in the next few years. This revision follows slower import growth than we anticipated in H113, as well as indications that the income account shortfall will be narrower than we previously expected. In 2014, we believe that the easing effects of a virulent strain of coffee rust, as well as continued acceleration of the US economy will see a pick-up in export growth, modestly bolstering the country's external accounts. Nevertheless, with political risk associated with the upcoming presidential election likely to keep investors wary in the coming months (*see 'Hotly Contested Presidential Race Remains Too Close To Call', October 9*), we believe that investment inflows are likely to be relatively moderate, and potentially insufficient to cover the current account shortfall.

Current Account To Improve Modestly

Honduran exports have been hit hard by a combination of a virulent strain of coffee rust, which has weighed on production,

TABLE: CURRENT ACCOUNT

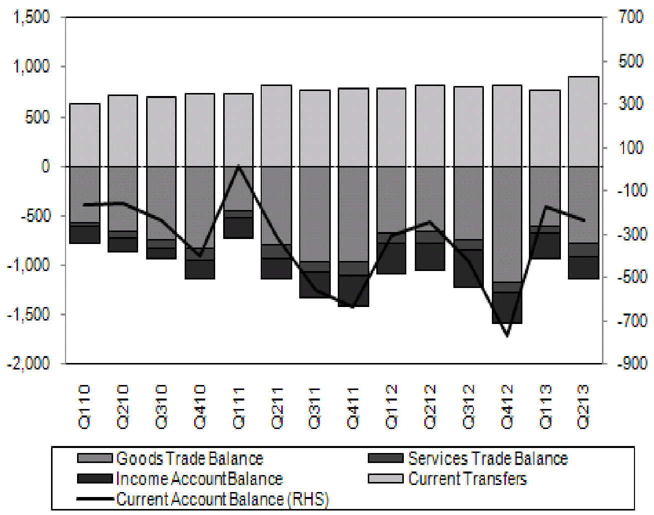
	2009	2010	2011	2012	2013f	2014f	2015f	2016f	2017f
Goods imports, US$bn [2]	7.3	8.9	11.0	11.2	11.4	11.8	12.4	12.8	13.2
Goods imports, % of GDP [2]	50.0	56.2	62.1	60.2	59.5	59.5	58.5	57.0	54.3
Goods exports, US$bn [2]	4.8	6.1	7.8	7.9	8.0	8.4	8.7	9.0	9.4
Goods exports, % of GDP [2]	33.1	38.6	44.1	42.7	41.9	42.1	41.2	40.1	38.4
Goods exports, % of imports [2]	66.1	68.6	70.9	70.9	70.4	70.8	70.4	70.3	70.8
Balance of trade in goods, US$bn [2]	-2.5	-2.8	-3.2	-3.2	-3.4	-3.5	-3.7	-3.8	-3.8
Balance of trade in goods, % of GDP [2]	-17.0	-17.7	-18.0	-17.5	-17.6	-17.4	-17.3	-16.9	-15.8
Services imports, US$bn [2]	0.5	0.6	1.5	1.5	1.6	1.7	1.7	1.8	2.0
Services imports, % of GDP [2]	3.2	3.7	8.3	8.0	8.2	8.3	8.3	8.2	8.1
Services exports, US$bn [2]	0.9	1.0	1.0	1.1	1.1	1.2	1.3	1.4	1.5
Services exports, % of GDP [2]	6.5	6.2	5.8	5.8	5.9	6.1	6.1	6.2	6.2
Goods and services exports, US$bn [2]	5.8	7.1	8.8	9.0	9.2	9.6	10.0	10.4	10.8
Goods and services exports, % of GDP [2]	39.6	44.7	49.8	48.5	47.8	48.2	47.3	46.3	44.6
Balance of trade in goods and services, US$bn [2]	-2.0	-2.4	-3.6	-3.7	-3.8	-3.9	-4.1	-4.3	-4.3
Balance of trade in goods and services, % of GDP [2]	-13.7	-15.2	-20.5	-19.7	-19.9	-19.7	-19.5	-19.0	-17.7
Income account balance, US$bn [2]	0.1	0.0	-1.0	-1.3	-1.2	-1.1	-0.9	-0.8	-0.8
Income account balance, % of GDP [2]	0.4	0.3	-5.5	-6.9	-6.3	-5.6	-4.3	-3.3	-3.1
Net transfers, US$bn [2]	2.6	2.9	3.1	3.2	3.3	3.4	3.5	3.5	3.5
Net transfers, % of GDP [2]	18.1	18.2	17.6	17.2	17.2	17.2	16.6	15.6	14.4
Current account balance, US$bn [2]	-0.6	-0.8	-1.5	-1.7	-1.7	-1.6	-1.5	-1.5	-1.6
Current account balance, % of GDP [2]	-3.8	-5.3	-8.5	-9.4	-8.9	-8.1	-7.1	-6.7	-6.4
Openness to international trade, % [1,2]	83.1	94.8	106.2	102.9	101.4	101.7	99.7	97.1	92.7

Notes: f BMI forecasts. 1 Imports plus exports, % of GDP. Sources: 2 BCH/BMI.

and low coffee prices due to a supply glut in Brazil. Coffee exports (18.1% of total exports in 2012) contracted by 45.3% y-o-y during the first eight months of 2013, which has had a substantial impact on the country's goods trade balance in recent quarters. In addition, a mixed performance by exports in other sectors, such as manufactured goods, has been inadequate to offset such a large drop in the coffee sector, with total exports contracting by an average of 0.6% y-o-y in H113. While we expect the knock-on effects of coffee rust to wane in the coming months, bolstering exports, unfavourable base effects in Q313 are likely to keep any improvement muted. As such, we have revised our full-year export growth forecast to 1.2%, from 1.8% previously.

Weakness To Persist, But Return To 2012 Low Unlikely

Honduras – Current Account Components & Balance, US$mn



Source: BMI, BCH

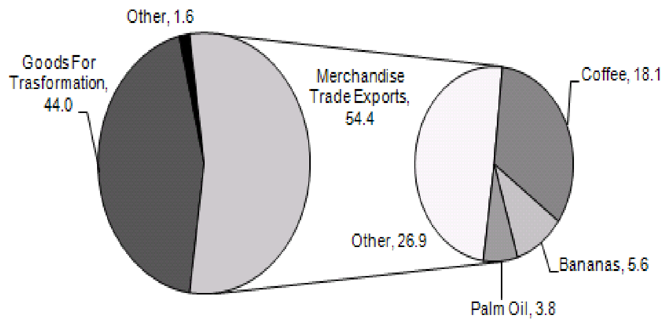
In line with slowing economic activity and some weakness in manufactured goods exports, imports have underperformed our expectations in recent months, posting average growth of just 0.4% y-o-y in H113. As we expect these dynamics to largely persist in the coming months, we have revised down our 2013 import growth forecast to 2.0%, from 3.8% previously. This revision, combined with our view for a less substantial income account deficit this year on the back of less significant direct investment outflows, has seen our 2013 current account deficit forecast improve to 8.9% of GDP, from 10.0% previously. We anticipate a continued modest improvement in the current account shortfall in 2014 to 8.1% of GDP, as stronger goods exports bolster the trade balance.

Political Risk To Continue Weighing On Financial Inflows

We have long highlighted that heightened political risk in advance of the November 24 general election was likely to weigh on financial inflows this year, particularly with third-party candidate, and wife of deposed former president Manuel Zelaya, Xiomara Castro continuing to perform relatively well in the polls (*see 'Central America: 2013-14 Election Outlook', November 5*). While we believe the race remains too close to call, a Castro victory would likely see the country's political trajectory move solidly to the left, taking on some of the populist policies of her husband, which would have important implications for the country's business environment.

Dependence On Coffee A Significant Liability

Honduras – Breakdown Of 2012 Goods Exports, %



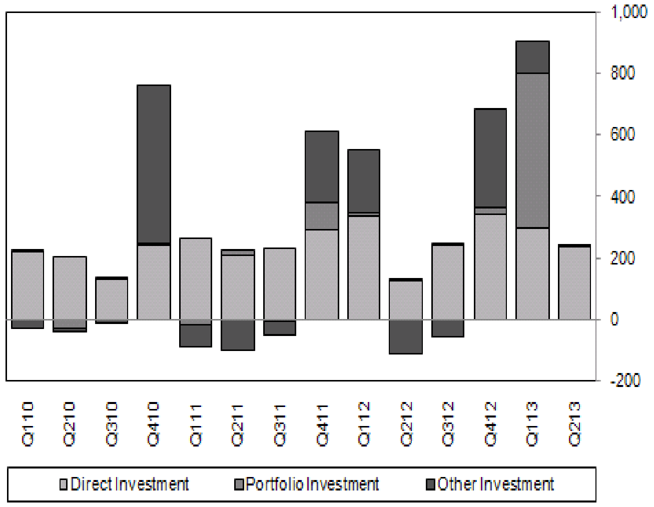
Source: BMI, BCH

Indeed, after portfolio and other investment helped to bolster the financial account in Q412 and Q113, both receded in Q213, causing a significant drop in the financial account balance. With the financial account surplus likely to remain insufficient to offset the current account shortfall in the next few quarters, we expect that pressure will remain on the country's reserve position. As such, we do not rule out potential for the central bank to dip into reserves in order to cover such a shortfall, although with reserves having recovered from their 2012 lows in recent months, we believe that the likelihood of a severe balance of payments correction has moderated (*see 'Risks Loom Amid Political Uncertainty And Fiscal Opacity', July 3*).

BOP Weakness Has Far-Reaching Implications

Honduras's weak balance of payments position has had significant impacts on the economy and exchange rate this year. After a significant depreciation of the lempira in May, which likely eased some of the pressure on the central bank's reserve position, the unit has traded sideways-to-lower. Given that we expect this trend to persist in the coming months, we have revised our average and end-2013 exchange rate forecasts to HNL20.11/US$ and HNL21.00/US$, from HNL19.70/US$ and HNL20.00/US$ respectively. Moreover, we see only modest upside for the unit in 2014, forecasting the unit to average HNL20.00/US$, ending the year at HNL20.50/US$.

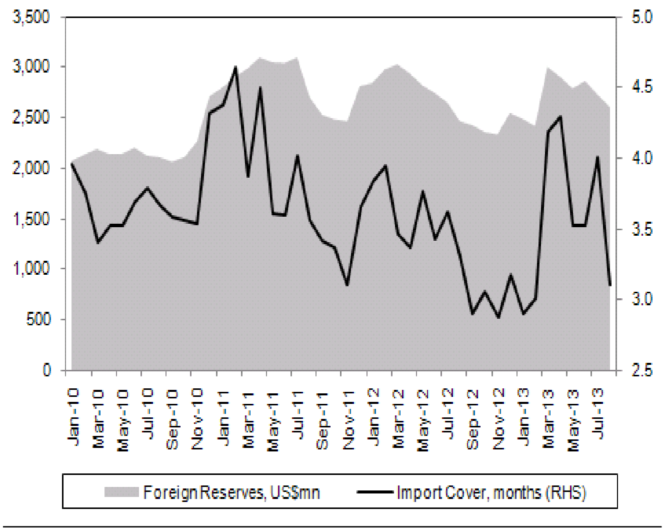
Surplus Set To Remain Moderate
Honduras – Financial Account Components, US$mn



Source: BMI, BCH

In addition, we have downgraded our 2013 real GDP growth forecast to 3.1%, from 5.0% previously. This revision is underpinned by our view that weakness in the agricultural and, to a lesser extent, manufacturing sectors are likely to weigh on consumer confidence, while a weaker exchange rate erodes consumers' purchasing power. Meanwhile, we believe that both fixed investment and net exports will provide little support to headline growth.

Back From 2012 Lows, But Not Reserve Position Not Robust
Honduras – Foreign Reserves & Import Cover



Source: BMI, BCH

Chapter 5.1:
Political Outlook – Nicaragua

Domestic Politics

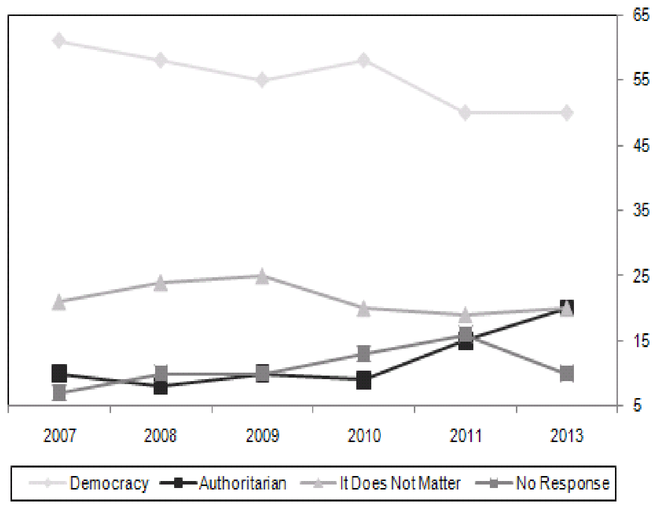
Constitutional Reforms To Have Long-Term Policy Implications

BMI VIEW

We believe that reforms to Nicaragua's constitution, recently proposed by the ruling Frente Sandinista de Liberación Nacional, are likely to become law, bolstering Presiden t Daniel Ortega's power and increasing the Nicaraguan military's presence in the country's political system. While we do not foresee the reforms significantly elevating short-term political risk, we believe that a shift towards a more authoritarian system of government w ould have substantial long-term implications.

Democracy Becoming Less Preferable

Nicaragua – Poll question: 'Which is the most preferable form of government?'

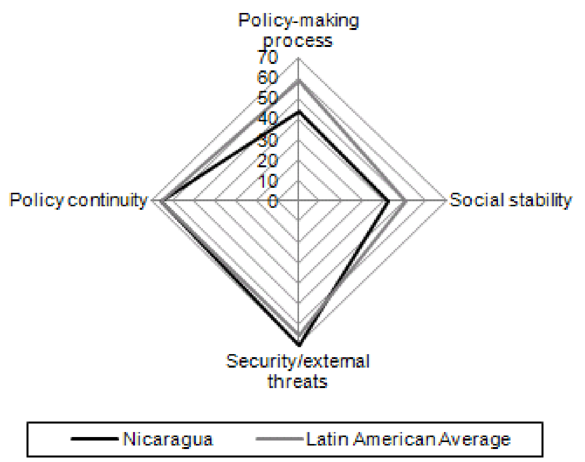


Note: Poll was not conducted in 2012; Source: BMI, Latinobarómetro

We believe that the 39 amendments to Nicaragua's constitution proposed by the ruling Frente Sandinista de Liberación Nacional (FSLN) on October 31 stand a high chance of being approved by the legislature, a development that will have far-reaching implications for the country's political system. We believe that the proposed constitutional reforms will have two major repercussions: one, a strengthening of the executive branch, paving the way for President Daniel Ortega to serve an unlimited number of consecutive terms in office, and two, a significant increase in the Nicaraguan military's role in policymaking. While the proposed reforms have caused an outcry from members of the opposition Partido Liberal Independiente (PLI), we do not expect the opposition to gain widespread public support for its position, given the popularity of Ortega and the military. A recent poll by Mitovksy gave Ortega a 66% approval rating, while the military has long been seen as one of the country's most trustworthy institutions. Moreover, in a poll by Latinobarómetro released on November 1, only 50% of Nicaraguans agreed with the statement that democracy was the most preferable form of government, down from 61% in 2007 when Ortega began his current tenure in office. The FSLN controls 63 of the unicameral legislature's 92 seats, which should allow it to garner the two-thirds majority necessary to pass the reform package.

Ortega's Popularity Will Keep Short-Term Political Risk In Check

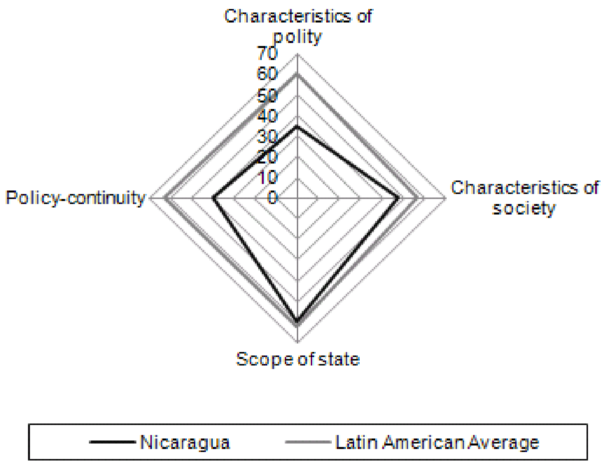
Nicaragua – BMI Short-Term Political Risk Rating Components, Out Of 100



Source: BMI

Given Ortega's popularity and the FSLN's strong grip on policymaking, our core view is that the constitutional reforms are unlikely to lead to a significant uptick in political risk in the near term. As such, we are maintaining Nicaragua's score in our proprietary Short-Term Political Risk Ratings at 55.2, which, we note, already rates well below the regional average of 59.9. That said, we will be monitoring the situation closely, due to the significant nature of these reforms, and Nicaragua's historically fragile political system. If, for instance, the PLI begins to take its protests to the streets, or we see signs of internal pushback within the FSLN, we would downgrade the 'social stability' and 'policy-making process' components of our ratings.

Long-Term Implications Could Be Substantial
Nicaragua – Long-Term Political Risk Rating, Out Of 100



Source: BMI

In the long term, we believe that the consequences of these reforms are likely to be more significant. Should the changes to Nicaragua's constitution be formalised, we will downgrade Nicaragua's score in the 'characteristics of policy' component of our Long-Term Political Risk Ratings, given that an increasingly autocratic political system is likely to see greater social instability over a long-term time horizon, given the potential for a more disruptive transition between future governments. Indeed, among the most notable of the new amendments is a proposal to eliminate wording that raises questions about the legality of presidents serving consecutive terms. While Nicaragua's constitutional court previously ruled that Ortega's current second term is legal under the constitution, amending the wording of the constitution could pave the way for him to serve an unlimited number of terms in office. Moreover, the reforms would allow Ortega to unilaterally legislate through a vaguely defined 'administrative decree.' With regards to the military, the proposed reforms would allow military officers, when required by the 'supreme interest of the nation,' to hold non-elected positions in national political institutions.

On the policymaking front, we believe that a consolidation of power in Ortega's hands is likely to ensure that the country's current fiscal consolidation drive remains on track. As we have previously noted, we believe that stronger revenue inflows and lower public spending will see the country's nominal budget balance flip from a deficit to a small surplus in 2014, and will also feed through to a reduction of the country's public debt burden (*see 'Fiscal Consolidation Set To Continue In 2014', November 20*). Despite Nicaragua's austerity programme, which has seen a reduction in the overall rate of government spending, Ortega has been skillful at retaining mass public support through targeted food subsidy programmes and redistributive economic policies. In the same Latinobarómetro poll cited previously, Nicaragua scored second highest out of 18 Latin American countries in the percentage of respondents who agreed that domestic income distribution is fair, and third in terms of food security. That said, one risk to our fiscal consolidation view stems from the country's loan agreement with Venezuela, which we believe is unlikely to continue under its current terms. Due to substantial financial pressures, Venezuelan state oil firm Petróleos de Venezuela SA has signalled that it is looking to alter the terms of the preferential treatment, through which Nicaragua meets 90.0% of its oil consumption demand. Such a change could have significant implications for our fiscal forecasts.

In terms of foreign policy, a greater role for the military in policymaking could see the Nicaraguan government, which already has strained relations with a number of its neighbours (including territorial disputes with Costa Rica and Colombia), become increasingly belligerent on the international stage over the long term (although we do not foresee a violent military conflict emerging at present). Indeed, as we have previously noted, although Ortega enjoys very high approval ratings, we see potential for the type of international dispute seen with Costa Rica in August – when Ortega publically reiterated his claim to the Costa Rican province of Guanacaste – to persist, as Ortega and the military seek to maintain domestic support while expanding their authority (*see 'Territorial Dispute Aimed At Retaining Support' September 5*).

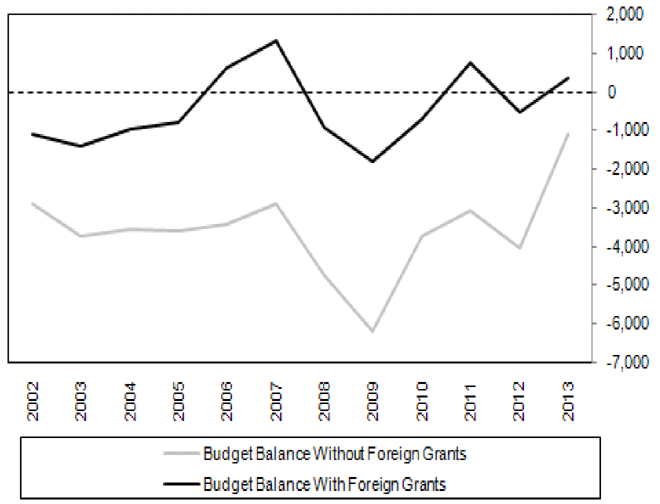
Economic Activity

Fiscal Consolidation Set To Continue In 2014

BMI VIEW

Nicaragua's fiscal consolidation will continue in 2014, leading its nominal budget balance to flip from a deficit to a small surplus. Stronger revenue inflows and lower public spending will also feed through to a reduction of the country's public debt burden. That said, we note a risk to Nicaragua's fiscal position stemming from its membership in Petrocaribe, which could be placed under increasing strain in the coming months due to Venezuela's mounting financial difficulties.

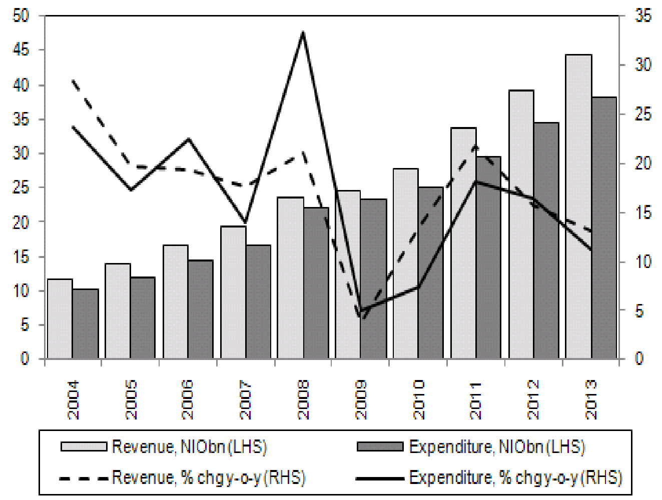
Budget Becoming Less Reliant On Foreign Grants
Nicaragua – Nominal Budget Balance, NIOmn



Note: 2013 data is Jan-Aug; Source: BMI, BCN

We believe that growth in Nicaraguan government revenues will continue to outpace growth in expenditures in 2014, leading to an improvement in the country's fiscal position following a spate of tax reforms implemented since 2010. As such, we forecast that Nicaragua's nominal budget balance will shift to a small surplus of 0.04% of GDP in 2014, from a forecasted deficit of 0.3% of GDP in 2013. Significantly for the country's fiscal stability, we note that the Nicaraguan government's fiscal discipline is allowing the country to rely far less on foreign assistance to fund its budget than in the past, with foreign grants down 16.6% y-o-y between January-August. Fiscal consolidation will also see Nicaraguan public debt as a percentage of GDP shrink to 49.1% in 2014 from forecasted 49.9% in 2013, marking the continued narrowing of the country's debt burden from a peak of 151.7% of GDP in 2003.

Government Revenues Outpacing Expenditures
Nicaragua – Jan-Aug Central Government Revenue And Expenditure



Source: BMI, BCN

On the revenue front, we believe that a modest acceleration in economic growth in 2014 will boost government inflows.

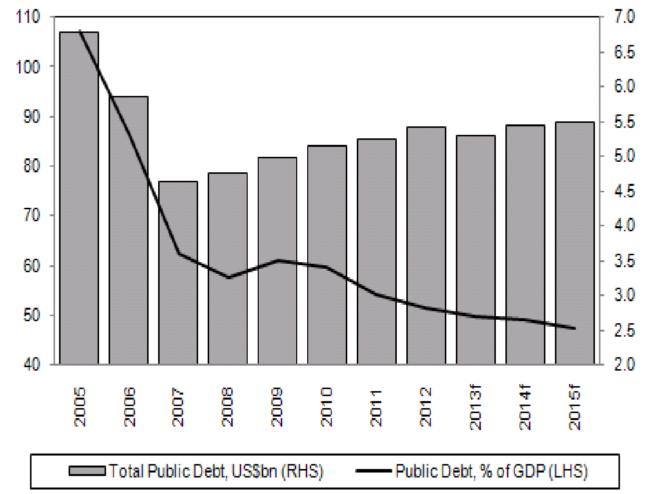
TABLE: FISCAL POLICY

	2009	2010	2011	2012	2013f	2014f	2015f	2016f	2017f
Fiscal revenue, NIObn [2]	36.5	42.3	51.3	59.2	66.8	74.2	81.6	89.0	70.0
Revenue, % of GDP [2]	22.0	23.1	23.8	23.9	25.5	25.8	25.9	25.9	18.4
Fiscal expenditure, NIObn [2]	36.6	40.4	46.7	54.2	51.0	55.0	57.9	65.0	71.6
Expenditure, % of GDP [2]	22.0	22.0	21.6	21.9	19.4	19.1	18.4	18.9	18.8
Budget balance, NIObn [1,2]	-1.8	-0.7	0.8	-0.5	-0.3	0.1	0.4	-0.4	-0.5
Budget balance, % of GDP [1,2]	-1.1	-0.4	0.4	-0.2	-0.3	0.0	0.1	-0.1	-0.1

Notes: f BMI forecasts. 1 Excluding Donations. Sources: 2 BCN/BMI.

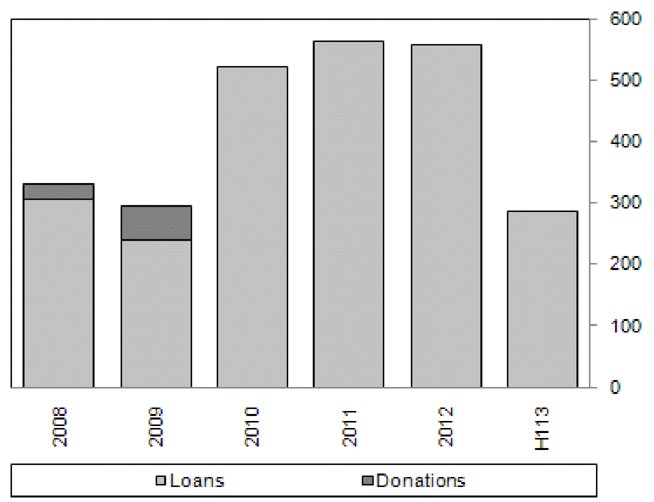
Indeed, as we have previously noted, we expect that strengthening US consumer demand will benefit Nicaragua's growing manufacturing sector, underpinning our 2014 real GDP forecast of 4.1%, up from forecasted 3.9% in 2013 (*see 'Weaker Coffee Outlook Will Cap Growth Potential', August 22*). We believe stronger economic growth, combined with a boost to revenues stemming from reforms in recent years to remove several VAT exemptions and raise tariffs on exports, will see robust growth in government revenues of 11.0% in 2014 and 10.0% in 2015.

Public Debt Burden Is Stabilising
Nicaragua – Public Debt



Note: f=BMI forecast; Source: BMI, BCN

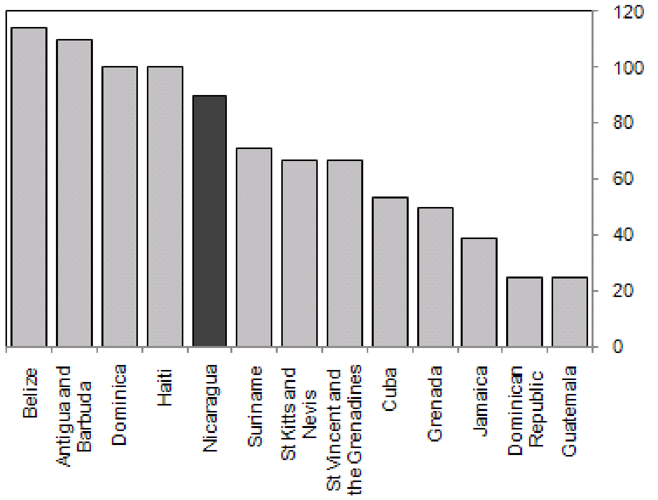
Loan Agreement With Venezuela Poses Downside Risks To Forecasts
Nicaragua – Foreign Aid From Venezuela, US$mn



Source: BMI, BCN, Petrocaribe

Moreover, with the next national election not scheduled until November 2016, and economic growth likely to be buoyed by a strengthening US recovery, we believe the current government's political incentives will be weighted towards keeping spending in check. As such, we forecast that government expenditures will rise by only 10.0% and 9.0% in 2014 and 2015, down from forecasted 12.0% in 2013. Government expenditures are up only 11.2% y-o-y in the year-to-date through August, indicating that Ortega remains on track with his commitment to reign in spending.

Exposed To Petrocaribe's Financial Struggles
Nicaragua – Daily Oil Import Quota Of Petrocaribe Members, % Of Daily Oil Consumption



Source: BMI, BCN, Petrocaribe

Risks Stem From Membership In Petrocaribe

Despite the improvements in Nicaragua's fiscal position, we note a significant risk stemming from the country's loan agreement with Venezuela, which we believe is unlikely to continue under its current terms. Currently, Nicaragua meets 90.0% of its oil consumption from imports from Venezuela, which provides oil shipments in return for a 50% payment after 90 days, and the remaining 50% spread over 25 years at a low interest rate. Loans from Venezuela amounted to US$557.7mn in 2012, accounting for 13.0% of Nicaragua's external debt stock last year.

Given substantial financial pressures, Venezuelan state oil firm Petróleos de Venezuela SA (PdVSA) has signalled that it is looking to alter the terms of the preferential treatment it gives to Petrocaribe members (*see ' End Of Petrocaribe Would Elevate Systemic Risk', August 2*). Should a dismantling of the Petrocaribe programme by the Venezuelan government occur, Nicaragua's energy costs would likely rise, posing downside risks to our fiscal forecasts. The end of Petrocaribe could also see the Nicaraguan government forced to borrow money to cover a higher energy import bill, posing risks to our public debt forecasts. Furthermore, in additional to altering its fiscal outlook, Nicaragua's external account stability could also be put at risk by larger import costs, given the country's wide current account deficit (*see 'Coffee Rust And Struggling Benefactors To Hamper External Accounts', October 21*).

Domestic Politics

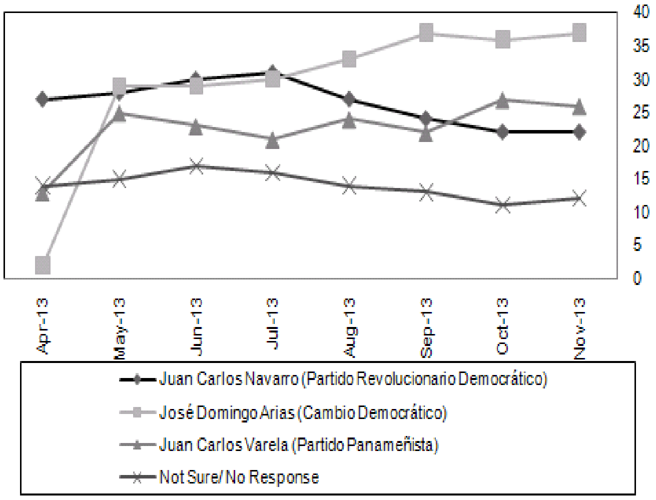
Arias Victory Looking Increasingly Likely In 2014

BMI VIEW

With recent polling data for Panama's 2014 presidential race indicating that José Domingo Arias of the ruling Cambio Democrático (CD) has begun to break away from the pack, we believe that he will be the likely victor of the May 2014 election. However, we remain cautious that suggestions of undue CD influence on the judicial system could weigh on public support for the frontrunner.

Leaving The Pack Behind

Panama – Voting Intentions For May 2014 Presidential Election, %



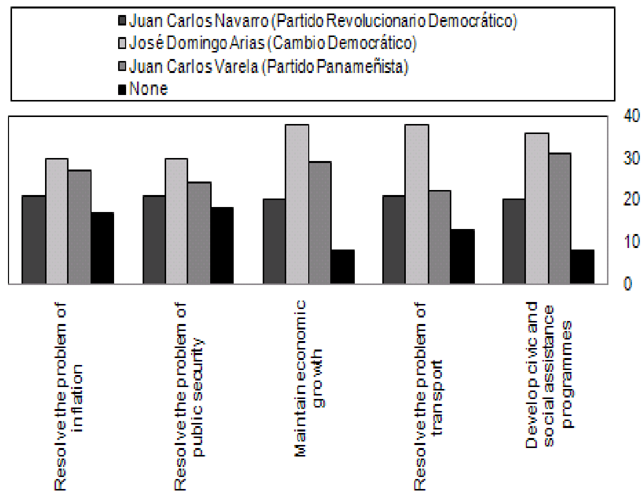
Note: November 2013 poll. Data does not sum too 100; Source: BMI, Dichter & Neira

Although Panama's ruling Cambio Democrático (CD) has faced a number of challenges in recent weeks, polling data suggests that voting intentions for José Domingo Arias, the party's candidate for the May 2014 presidential election, have continued to climb, cementing his status as the race's frontrunner.

Respondents' increasing confidence in Arias's ability to handle specific issues further bolster this view, and we now believe he will be the likely victor of the May 2014 election, succeeding the sitting president, Ricardo Martinelli, who is also of the CD but ineligible to run next year. New polling data represents a departure from earlier this year when Arias was polling neck-and-neck with Juan Carlos Navarro of the opposition Partido Revolucionario Democrático (*see 'Tightening Polls Make 2014 Election Too Close To Call', August 20*). Nevertheless, we will be watching closely for signs that recent events, particularly suggestions of undue judicial influence on the part of the CD, are beginning to weigh on sentiment towards the ruling party. That said, we believe that only a major scandal would be likely to change the current trend in polling data.

Arias Holding The Top Spot

Panama – Candidate Best Able To Address Specific Issues, %



Note: November 2013 poll. Data does not sum to 100; Source: BMI, Dichter & Neira

In addition to headline voting intentions for Arias rising in recent months, voters have increasingly indentified him as the candidate most capable of resolving specific issues. Indeed, data from pollster Dichter & Neira shows that the percentage of respondents who view Arias as the candidate best able to address the issue of public security increased from 24% in August to 30% in November, placing him ahead of his closest competitor, Partido Panameñista candidate Juan Carlos Varela at 24%. Similarly, Arias tops his competitors in terms of maintaining economic growth, with 38% of respondents identifying him as the most capable, as compared to Varela at 29%. While Navarro has stated that he remains open to an alliance with Varela, local media reports suggest that Varela has not responded to such an offer, and we expect that a fragmented opposition will continue to benefit Arias and the CD.

While polling data is increasingly positive for Arias, we still caution that sentiment towards the CD and its presidential candidate could deteriorate modestly on the back of recent allegations of overly strong media and judicial influence by the ruling party. Indeed, in early November, Panama's electoral court (Tribunal Electoral/TE) warned that the judicial security of the 2014 general election could be at risk. This statement followed a decision by the nine-member supreme court of justice (Corte Suprema de Justicia/CSJ) to revoke an early October ruling by the TE in favour of opposition presidential candidate Navarro, effectively bolstering the position of Panamá Avanza, a group aligned with the CD. The controversy was heighted by the fact that five of the nine CSJ justices were appointed by Martinelli, while two of the three TE judges are opposition aligned, raising questions about judicial independence and undue influence by the ruling party. Although the president has steered clear of weighing in on the issue, we will be watching for any signs of deteriorating sentiment towards the CD in the coming weeks, which could see the government's approval rating drop from the current 64% level, and voting intentions for Arias decline somewhat.

Chapter 6.2:
Economic Outlook – Panama

Economic Activity

Weak Exports To Drive Wider Current Account Shortfall

BMI VIEW

In light of very weak exports in the year-to-date, we are revising our goods trade and current account deficit forecasts for Panama to account for wider shortfalls in the next few years. Nevertheless, with investment inflows set to remain relatively robust on the back of the ongoing Panama Canal expansion project, as well as a relatively significant infrastructure project pipeline, we expect that a strong financial account surplus will help anchor the country's balance of payments position.

Following a weak H113, we are revising our balance of payments forecasts for Panama to account for wider trade and current account shortfalls. We previously anticipated that despite a slightly wider trade deficit in 2013, the country's current account shortfall would narrow as a percentage of GDP this year (*see 'Services Surplus To Bolster Current Account', May 30*). However, significant weakness in exports in H113 has caused us to revise our view. Indeed, with weak import demand from Venezuela following the devaluation of the bolívar in February weighing on exports from the country's Colón free trade zone, we have seen the trade deficit widen significantly in recent quarters. Moreover, given that we expect shortages of US dollars in Venezuela to continue affecting importers in the coming quarters, we believe that weakness in Panama's export sector will persist (*see 'Growth Slowdown Taking Hold', September 16*). As such, we are downgrading our goods export growth forecast to 0.0% this year, from 14.0% previously. This dynamic combined with modestly positive import growth on the back of demand for capital goods imports associated with the continued expan-

TABLE: CURRENT ACCOUNT

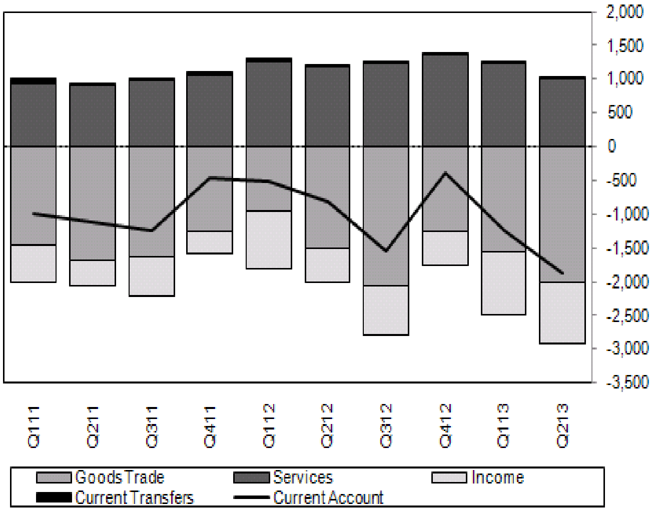
	2009	2010	2011	2012	2013f	2014f	2015f	2016f	2017f
Goods imports, US$bn [2]	14.2	17.2	22.9	24.6	25.1	27.6	30.4	33.1	36.4
Goods imports, % of GDP [2]	58.8	63.6	73.3	68.4	61.2	60.3	59.6	58.6	58.8
Goods exports, US$bn [2]	12.0	12.7	16.9	18.9	18.9	20.8	22.8	25.6	28.9
Goods exports, % of GDP [2]	49.8	46.9	54.1	52.4	46.0	45.3	44.8	45.2	46.6
Goods exports, % of imports [2]	84.7	73.6	73.8	76.6	75.1	75.1	75.1	77.2	79.3
Balance of trade in goods, US$bn [2]	-2.2	-4.5	-6.0	-5.8	-6.2	-6.9	-7.6	-7.5	-7.5
Balance of trade in goods, % of GDP [2]	-9.0	-16.8	-19.2	-16.0	-15.2	-15.0	-14.8	-13.3	-12.2
Services imports, US$bn [2]	2.2	2.7	3.4	3.9	4.4	5.2	6.1	7.0	8.0
Services imports, % of GDP [2]	9.1	10.1	10.8	10.7	10.8	11.4	12.0	12.4	12.9
Services exports, US$bn [2]	5.5	6.2	7.3	8.9	9.4	10.2	11.2	12.4	13.7
Services exports, % of GDP [2]	22.9	23.0	23.2	24.8	22.8	22.3	22.0	21.9	22.1
Goods and services exports, US$bn [2]	17.6	18.9	24.2	27.8	28.2	31.0	34.1	38.0	42.6
Goods and services exports, % of GDP [2]	72.7	69.8	77.2	77.2	68.8	67.5	66.8	67.2	68.8
Balance of trade in goods and services, US$bn [2]	1.1	4.4	4.6	-0.7	-1.3	-1.9	-2.5	-2.1	-1.8
Balance of trade in goods and services, % of GDP [2]	4.7	16.3	14.8	-1.9	-3.2	-4.1	-4.8	-3.8	-2.9
Income account balance, US$bn [2]	-1.4	-1.8	-1.9	-2.7	-2.8	-3.0	-3.2	-3.4	-3.7
Income account balance, % of GDP [2]	-6.0	-6.8	-5.9	-7.4	-6.9	-6.6	-6.2	-5.9	-5.9
Net transfers, US$bn [2]	-46.9	9.0	21.4	-51.4	84.7	0.0	145.7	-4.4	-7.7
Net transfers, % of GDP [2]	0.5	0.5	0.5	0.2	0.4	0.3	0.7	0.6	0.5
Current account balance, US$bn [2]	-0.2	2.7	2.9	-3.3	-4.0	-4.8	-5.3	-5.1	-5.1
Current account balance, % of GDP [2]	-0.7	10.0	9.4	-9.1	-9.7	-10.4	-10.3	-9.1	-8.3
Openness to international trade, % [1,2]	108.7	110.5	127.3	120.9	107.1	105.5	104.3	103.8	105.4

Notes: f BMI forecasts. 1 Imports plus exports, % of GDP. Sources: 2 IMF/BMI.

sion of the Panama Canal, we forecast the goods trade deficit to widen to US$6.2bn (9.5% of GDP) in 2013, from US$5.8bn (8.9% of GDP) in 2012. Furthermore, although we expect that favourable base effects and a slight uptick in global growth, including in nearby Colombia, should bolster exports from the country's free trade zones, our expectation of relatively strong import growth next year means that we forecast the trade deficit to widen further to US$6.9bn in 2014 (10.2% of GDP).

Little Relief Ahead For Current Account

Panama – Current Account Components & Balance, PABmn



Source: BMI, INEC

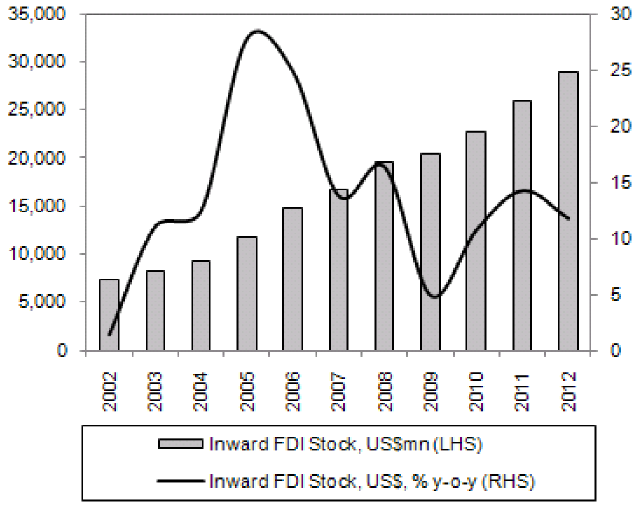
Nevertheless, a relatively substantial services surplus will remain an important positive contributor to Panama's current account in the coming years, helping to offset some of the weakness in the trade account. That said, transport services, the largest component of the services account at 54.4% of the total in H113, has declined significantly in the year-to-date. Indeed, we have seen increasing anecdotal evidence to suggest relatively weak traffic in the Panama Canal in recent months due to a slowdown in global trade, as well as delays in the canal's expansion, which have prompted major shipping companies to seek alternative routes, like the Suez Canal. With these factors unlikely to ease significantly in the coming months, particularly given our view for a notable slowdown in Chinese economic activity in 2014, as well as our view that the canal expansion will be completed in 2015, we believe that Panama's services surplus will remain off its recent highs in the next few years. We forecast the services surplus to come in at US$4.9bn in 2013 and US$5.0bn in 2014, down slightly from US$5.1bn in 2012.

Infrastructure Opportunities To Continue Driving Investment Inflows

We anticipate that a sizeable financial account surplus will offset Panama's current account shortfall in the next few years, due in large part to substantial foreign direct investment inflows. Although we believe that the canal expansion is moving into a less construction-intensive phase, significant investment will continue to flow in to support the project.

Strong Investment Inflows To Continue Bolstering Financial Account

Panama – Foreign Direct Investment



Source: BMI, UNCTAD

In addition to the canal expansion, Panama boasts a relatively robust infrastructure project pipeline, including the US$1.8bn Panama City metro and a number of road and air transport projects. Continued opportunities in the country's infrastructure sector, as well as one of the most stable business environments in Latin America, will keep investor interest rooted in the country in the coming years, bolstering investment inflows and helping to anchor the country's balance of payments position.

Chapter 7:
BMI Global Assumptions

Global Outlook

Mixed Q313 Data, But Outlook Has Not Changed

The global growth outlook has improved in the past few months, in line with our constructive view. We continue to forecast a stronger global economy in 2014 than in 2013, with our global real GDP growth forecast for 2014 rising to 3.1%, from 2.6% in 2013. Despite poorer-than-expected Q313 growth in the eurozone, US economic activity shows continued signs of picking up. Although the prospect of less easy US monetary policy looms large, the Federal Reserve is still expanding its balance sheet substantially every month, while the European Central Bank and Bank of Japan are likely to ease further going into 2014. This indicates that, globally, policy is not becoming substantially tighter at this stage. Nonetheless, yields are set to rise as growth improves, and several key emerging markets are likely to suffer from this, with previous rounds of easy global monetary policy stoking major imbalances from Asia to Latin America that will eventually correct. That said, the biggest challenge facing emerging markets is our below-consensus view on Chinese growth, which is being confirmed somewhat by poor technical outlooks for China-sensitive market instruments such as copper and Latin foreign exchange.

Developed States

Our developed states real GDP growth estimate for 2013 has risen slightly, by 0.1 percentage point to 1.3%, but our forecasts for 2014 and 2015 remain 2.0% and 2.1% respectively.

The advance estimate of US Q312 real GDP growth broadly confirms our view that a slow and somewhat erratic economic

TABLE: GLOBAL ASSUMPTIONS

		2012	2013f	2014f	2015f	2016f	2017f	2018f
Real GDP Growth (%)								
	US	2.8	1.8	2.8	2.6	2.4	2.4	2.4
	Eurozone	-0.6	-0.4	1.0	1.3	1.3	1.5	1.5
	Japan	1.9	2.4	1.3	1.1	0.9	1.0	0.9
	China	7.7	7.6	6.7	6.0	5.8	5.8	5.8
	World	2.9	2.6	3.1	3.3	3.3	3.4	3.4
Consumer Inflation (ave)								
	US	2.1	1.7	2.1	2.1	2.1	2.1	2.1
	Eurozone	2.6	1.8	1.6	1.7	1.8	1.9	1.8
	Japan	0.0	0.3	0.9	1.3	1.8	2.3	2.7
	China	2.7	2.8	2.9	2.8	2.7	2.7	2.7
	World	3.4	3.3	3.3	3.1	3.1	3.1	3.2
Interest Rates (eop)								
	Fed Funds Rate	0.00	0.00	0.00	0.75	2.00	3.00	3.50
	ECB Refinancing Rate	0.75	0.25	0.25	0.50	1.00	1.50	2.00
	Japan Overnight Call Rate	0.10	0.10	0.10	0.10	0.25	0.50	0.75
Exchange Rates (ave)								
	US$/EUR	1.27	1.33	1.27	1.23	1.20	1.20	1.20
	JPY/US$	79.85	98.00	102.00	102.00	102.00	102.00	102.00
	CNY/US$	6.31	6.22	6.16	6.23	6.25	6.25	6.25
Oil Prices (ave)								
	OPEC Basket (US$/bbl)	109.50	105.03	101.75	100.00	99.00	97.00	96.00
	Brent Crude (US$/bbl)	111.70	107.63	102.75	102.00	101.00	99.00	99.00

f = forecast. Source: BMI

recovery continues. We believe that this snapshot of US growth is consistent with our forecast for the US economy to accelerate to 2.8% growth in 2014, from 1.8% real GDP growth in 2013. While we have raised our 2013 growth estimate for the eurozone to -0.4% (from -0.5% previously), Q313 data was less positive there. Although aggregate eurozone GDP expanded by 0.1% quarter-on-quarter in Q3, this follows a stronger 0.3% reading the previous quarter. Since we expected a turnaround to have set in by now, the deterioration in Q3 data provides some cause for concern.

While we have revised up our GDP forecast for Japan in 2013 to 2.4%, from 1.8%, this largely reflects past GDP revisions and slower-than-expected winding down of the boost from 'Abe-nomics'. Our outlook for Japanese 2014 GDP growth remains unchanged at 1.3%.

Emerging Markets

Our emerging markets aggregate forecasts are unchanged, with projected growth of 4.7% in 2013, 4.8% in 2014 and 4.9% in 2015, signalling a modest improvement in activity in the emerging world.

TABLE: DEVELOPED STATES, REAL GDP GROWTH, %

	2012	2013f	2014f	2015f
Developed States Aggregate Growth	1.4	1.3	2.0	2.1
G7	1.7	1.4	2.1	2.0
Eurozone	-0.6	-0.4	1.0	1.3
EU-27	-0.4	0.0	1.3	1.6
Selected Developed States				
Australia	3.7	2.4	2.0	2.5
Austria	0.8	0.7	1.5	1.9
Belgium	-0.3	0.3	1.2	1.9
Canada	1.7	1.7	2.3	2.5
Czech Republic	-1.3	-0.9	1.3	2.3
Denmark	-0.4	0.4	1.4	1.6
Finland	-0.8	-0.2	1.7	2.0
France	0.1	0.0	0.5	0.9
Germany	0.7	0.5	1.9	1.5
Hong Kong	1.4	2.4	3.0	3.7
Ireland	0.2	0.6	2.1	2.3
Italy	-2.4	-1.7	0.3	0.7
Japan	1.9	2.4	1.3	1.1
Netherlands	-1.1	-0.6	1.1	1.5
Norway	3.1	0.9	1.9	2.7
Portugal	-4.7	-3.0	-0.5	0.9
Singapore	1.3	3.6	3.2	3.2
South Korea	2.1	2.5	3.0	4.1
Spain	-1.6	-1.2	0.7	1.1
Sweden	0.7	1.1	2.7	2.9
Switzerland	1.0	1.9	2.0	1.7
Taiwan	1.3	2.1	3.0	4.1
United Kingdom	0.0	1.5	1.8	2.2
United States of America	2.8	1.8	2.8	2.6

f = forecast. Source: BMI

TABLE: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH FORECASTS, %

		US	Eurozone	Japan	Brazil	China	Russia	India
2013	Bloomberg Consensus	1.7	-0.1	1.9	2.5	7.6	1.8	5.1
	BMI	1.8	-0.4	2.4	2.0	7.6	2.0	5.0
2014	Bloomberg Consensus	2.6	1.0	1.6	2.5	7.4	2.8	4.7
	BMI	2.8	1.0	1.3	2.5	6.7	2.5	5.6

Source: BMI, Bloomberg

Among major forecast changes, we have revised down our 2013 real GDP growth forecast for Mexico from 2.3% to 1.6% owing to weaker-than-expected performances by the manufacturing and construction sectors in recent months. However, we forecast an acceleration in growth in 2014 to 3.3%, driven by an improvement in private consumption and investment in light of the government's ongoing reform drive, as well as stronger US demand. Our Latin America regional aggregate growth forecast has fallen to 2.5% in 2013 (from 2.7%) and 3.0% in 2014 (from 3.1%).

In emerging Europe, for which we have bumped up our 2013 forecast to 2.3% (from 2.2%) and our 2014 projection down to 2.7% (from 2.8%), the major changes are in Turkey and Hungary. We have revised up our 2013 projection for Turkish real GDP growth to 3.3% from 2.8%, but have lowered the 2014 forecast to 2.6% from 3.1%. Although the short-term outlook has improved, we remain fundamentally bearish on Turkey's medium-term growth potential relative to consensus expectations. In Hungary, Q313 growth came in at a surprisingly high 1.7% y-o-y (versus consensus estimates of 0.6%), and we have revised up our 2013 forecast from 0.3% to 0.8%.

None of our other regional aggregate growth forecasts have changed. Emerging Asia is forecast to grow by 6.8% in 2013, slowing to 6.3% in 2014. We project growth in the Middle East and North Africa of 3.3% in 2013, improving to 4.1% in 2014. And Sub-Saharan Africa will maintain its status as the fastest-growing region outside of Asia, with growth of 5.3% in 2013 rising to 5.5% in 2014.

TABLE: EMERGING MARKETS, REAL GDP GROWTH, %

	2012	2013f	2014f	2015f
Emerging Markets Aggregate Growth	**5.1**	**4.7**	**4.8**	**4.9**
Latin America	2.8	2.5	3.0	3.5
Argentina	1.9	2.9	2.5	3.1
Brazil	0.9	2.0	2.5	3.1
Mexico	3.8	1.6	3.3	3.7
Middle East And North Africa	3.5	3.3	4.1	4.4
Saudi Arabia	5.1	3.6	4.3	3.3
UAE	6.2	4.1	3.4	3.6
Egypt	2.2	1.9	2.7	4.2
Sub-Saharan Africa	4.3	5.3	5.5	5.6
South Africa	2.5	2.1	2.5	3.0
Nigeria	6.5	6.7	7.3	7.4
Emerging Asia	6.9	6.8	6.3	5.9
China	7.7	7.6	6.7	6.0
India*	5.0	5.0	5.6	6.2
Indonesia	6.2	5.7	5.3	6.5
Malaysia	5.6	4.6	4.4	4.2
Philippines	6.8	6.9	6.0	5.4
Thailand	6.4	4.0	4.3	4.4
Emerging Europe	2.7	2.3	2.7	3.3
Russia	3.4	2.0	2.5	3.3
Turkey	2.2	3.3	2.6	3.4
Hungary	-1.7	0.8	1.7	1.9
Romania	0.7	2.4	2.8	3.3
Poland	2.0	1.2	2.3	2.8

*f = forecast; *fiscal years ending March 31 (2012 = 2011/12). Source: BMI*

Business Monitor International Limited,
85 Queen Victoria Street, London, EC4V 4AB, UK

Tel: +44 (0)20 7248 5162
Fax: +44 (0)20 7248 0467
Email: subs@businessmonitor.com
Website: www.businessmonitor.com

Analysts: Katherine Weber, Gregan Anderson, Noah Schumer
Editor: Mark Schaltuper
Sub-Editor: Jenny Kendall
Subscriptions Manager: Nuria Bernardez
Marketing Manager: Joanna Ashton
Production: Umra Khan
Publishers: Richard Londesborough, Jonathan Feroze