About the Central American Bank for Economic Integration
The Central American Bank for Economic Integration (CABEI), is an international multilateral development financial institution. Its resources are continuously invested in projects that foster development to reduce poverty and inequality; strengthen regional integration and the competitive insertion of its member countries in the global economy; providing special attention to environmental sustainability.

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About OMFIF
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FOREWORD

GREATER INTEGRATION, GREATER OPPORTUNITIES

Integration has helped Central America outperform other blocs in terms of economic growth recently. It has also put the region on strong footing to recover from the pandemic. Reaching out to the wider world will build on this achievement.

Dante Ariel Mossi Reyes, Executive President, Central American Bank for Economic Integration
THE Central American region has made significant progress in terms of economic and social integration in the past 60 years. Despite its high vulnerability to financial, economic, climate and health-related events, the region has moved closer to achieving its long-held goal of integration. This has led to higher economic growth over the past five years compared with other economic blocs. This has enabled the region address the Covid-19 pandemic and be better prepared for a stronger recovery.

The ‘Central America: Integration, investment and trade opportunities’ report presents relevant, updated information on the region structured in five pillars: a macroeconomic overview; commerce, external trade and foreign direct investment; integration; finance, tax and transparency; and sustainable investment.

This is the first of a series of reports that will share key insights on the region. It will provide valuable information for stakeholders, including government entities in the Central American region; governments with political, economic, and social interests in the region; the donor community; international financing institutions; and local, regional and international investors to make data-driven decisions. Thus, the report is meant to be a tool for anyone who is interested in doing business in Central America.

The Central American Bank for Economic Integration is proud to be part of this initiative. As the financial arm of the Central American region, CABEI will continue working and collaborating with its member countries, the private sector and the international community to fulfil its mission of a balanced economic and social development in the region.

After 60 years since its creation, CABEI is committed to its pivotal role in linking the opportunities of the Central American region with the world. Through its efforts, it continues to improve the region’s competitiveness in global markets and create favourable, innovative investment climates in its member countries.
EXECUTIVE SUMMARY

INTEGRATION PROVIDES CENTRAL AMERICA WITH RESILIENCE AND OPPORTUNITIES

At a time of global uncertainty, Central America presents opportunities for growth and sustainable recovery driven by the region’s dynamism and economic integration.

The ‘Central America: Integration, Investment and Trade Opportunities’ report, in its inaugural year, comes at a key moment in the region’s economic development. Despite global economic and social challenges, there are clear pointers to Central America’s resilience and growth potential. Its economy is forecast to have one of the strongest rebounds in Latin America and the Caribbean, supported by the agility and responsiveness of individual economies in coping with the pandemic’s disruptions. The region’s initiatives aimed at promoting sustainable growth and investment create important opportunities to build back better.

This report takes us into one of the blocs with the most member countries in Latin America and the Caribbean. It looks at the results of an integration project that goes back more than 60 years. The report covers eight countries: Belize, Costa Rica, the Dominican Republic, El Salvador, Honduras, Guatemala, Nicaragua and Panama. It presents a wide-ranging view of the region through five pillars: a macroeconomic overview; commerce, external trade and foreign direct investment; integration; finance, tax and transparency; and sustainable investment. The aim is to show where the region and its countries stand within each pillar and how they can improve to meet yardsticks for foreign investors as they begin to consider post-Covid-19 opportunities.
STRONG REBOUNDS FROM PANDEMIC
Central American economies have been growing steadily over the past five years. Although Covid-19 has interrupted growth, Central America is forecast to experience a less pronounced economic decline than other regions in Latin America and the Caribbean. Its recovery is set to be stronger too. The Dominican Republic and Panama are the region’s fastest-growing economies. Inflation has remained stable and living standards have improved across the region in recent years, with Panama and Costa Rica enjoying the highest gross domestic product per capita.

Central American economies have demonstrated sound fiscal management in recent years, with most public deficit to GDP ratios under 3%. The regional average ratio of external public debt to GDP was 35% in 2019, with Guatemala and Costa Rica having the lowest rates in the region. This positive past performance has helped confront the fiscal challenges brought by the pandemic and has allowed all countries to implement a mix of fiscal and monetary policy measures to counteract the economic crisis prompted by Covid-19.

BUILDING A STRONG GLOBAL PLAYER THROUGH REGIONAL CO-OPERATION
While agriculture, mining, and the manufacturing and construction industries remain important sectors, wholesale and retail trade contributes the most to the region’s economy. Costa Rica is the outlier with its internationally renowned medical devices and equipment industry, which forms the largest part of the country’s GDP. Foreign direct investment inflows are highly concentrated, with 85% coming from the US and the rest of Latin America. The highest recipients in the region are Panama, the Dominican Republic and Costa Rica.

The region’s exports have increased steadily, with steep growth since 2016. Central America stood out from the rest of Latin America and the Caribbean as the only bloc to have year-on-year export growth in the first quarter of 2020, with Guatemala taking the lead. The region’s main trading partner is the US, with intraregional trade also playing a significant role. Regional co-operation will help Central American economies break into new markets like Europe.

BEYOND ECONOMIC INTEGRATION
At the centre of the progress towards integration in Central America is the region’s aim to build strong and resilient economic ties. However, integration across the region has extended beyond the economic. Central American countries have been working together on a unified front in social matters, climate change, institutional strengthening and security. Integration has further benefited Central America as international co-operation from global partners has been aimed at supporting growth and development in the region as a whole. The European Union has been the primary partner in such direct co-operation and development projects since 2014.

Within the region, Guatemala, Honduras and El Salvador have achieved a common customs union that facilitates intraregional trade and reduces its cost. These countries, along with Nicaragua, also have achieved free movement of both nationals and foreigners across their borders.

SOUND FINANCIAL INFRASTRUCTURE
The region is catching up with internationally recognised standards. Half of the region’s countries are already partially implementing Basel III, and most of them require domestic and foreign companies to follow international financial reporting standards. Overall, financial soundness indicators reveal that Central America’s banking system entered the Covid-19 economic recession in a strong position, outperforming minimum international benchmarks.

International tax treaties can help reduce complexity. Only Costa Rica, the Dominican Republic and El Salvador have at least one. However, almost all countries in the region grant tax incentives for investments in specific sectors.

MOBILISING FINANCE FOR SUSTAINABILITY
Central American economies offer meaningful opportunities for sustainable investments, particularly in the areas of green transport and energy infrastructure. The region has made substantial progress in renewable energy. In four out of eight Central American countries, over three-quarters of energy generated is from renewable sources, with Costa Rica approaching 100%.

The region has taken significant steps in other climate change mitigation efforts, launching projects that cover biodiversity conservation, the blue economy, sustainable water, waste management and more. Five green bonds have been issued in Central America to fund these and other climate-related initiatives.
CENTRAL AMERICA READY TO BOUNCE BACK

Compared to other blocs, Central America suffered less economic decline from the pandemic. Its recovery is set to be stronger too.

CENTRAL American economies have been growing steadily over the past five years. Although Covid-19 has interrupted growth in the region, a healthy rebound is expected compared to Latin America and the Caribbean as a whole. Based on estimates from the International Monetary Fund, Central America’s economy is projected to shrink by 4.5% in 2020 but will grow by 6.8% in the following year. In contrast, the whole of the Latin American and Caribbean economy is expected to contract by 9.4%, with an estimated growth of 3.7% in 2021 (Figure 1).

Rapid growth in recent years has created policy space for pro-growth measures boosting the region’s macroeconomic outlook. The region’s fastest-growing economies stand out. On average, the Dominican Republic’s...
economy grew by 6.1% between 2015 and 2019, partly due to its strong external position. Without tourism to drive growth, it is expected to contract by 1% in 2020. Panama grew by an average of 4.6% over the last five years. The Panama Canal, despite seeing a decline in traffic, remains an important logistics route. The Panamanian economy is expected to shrink by 2.1%. Both economies are expected to rebound by 4% in 2021, above the estimated 3.7% for Latin America and the Caribbean.

Inflation across the region has remained stable. Dollar appreciation in 2019 created a deflationary environment for Belize, El Salvador and Panama. The Belize dollar is pegged to the US dollar, while the Salvadoran colón and the Panamanian balboa are completely dollarised. Since 2016, annual change in average consumer prices in the region has remained in a range of 1.8% to 2.6%.

Living standards have improved across the region in recent years. Panama ($15,734) and Costa Rica ($12,309) enjoy the highest GDP per capita in the region, surpassing the global average of $11,436. The six remaining countries have lower living standards than the world in aggregate, but 2019 figures for the Dominican Republic, Guatemala, El Salvador and Honduras all showed improvement from the previous year.

Remittance-dependent economies are likely to struggle from the effects of the global slowdown. These include El Salvador, Honduras and Guatemala. An estimated 4.7m Central Americans live in the US, indicating that its recovery from the crisis will have an impact on economies of the region.

Every country in Central America has at least two sovereign credit ratings from a major ratings agency (Standard & Poor’s, Moody’s and Fitch). Panama is the only country with investment-grade credit ratings, but Guatemala and the Dominican Republic are close to achieving this as well. Effective pandemic response and economic management during this period of contraction will prove critical in avoiding any rating downgrades.

PANDEMIC RESPONSE
Countries have responded to the Covid-19 crisis with a mix of fiscal and monetary policy measures (Figure 2). Governments provided cash relief to the most vulnerable households. Most countries postponed due dates for utility payments, with some doing the same for social security contributions. El Salvador granted temporary tax holidays for tourism workers, while the Dominican Republic did the same for the hotel sector. Other forms of exemptions and deferrals on income tax and value-added tax were given.

To support businesses, special credit facilities were established for small and medium enterprises as well as larger companies. Every country in the region granted some form of debt restructuring or temporary moratorium on loan repayments. Banks’ reserve requirements were relaxed to encourage lending. The central banks of Belize, Costa Rica, the Dominican Republic, Guatemala and Honduras eased monetary policy through policy rate reductions.

The pandemic brings difficult fiscal challenges. Countries in Central America have demonstrated sound fiscal management in recent years, with most public deficit to GDP ratios under 3%. El Salvador has kept its deficit ratio under 2% in the last five years, while Honduras has brought this down to 2.5% in 2019 from 4.4% in 2014. While public deficits are expected to rise sharply as economies contract, governments in the region have demonstrated an ability to move closer to a balanced budget after the 2008 financial crisis.

With the exception of Nicaragua, every government in the region has tapped loans from multilateral organisations, including the Central American Bank for Economic Integration, the IMF, the World Bank, the Inter-American Development Bank and the Latin American Development Bank. Managing external public debt levels will be key to governments’ ability to return to a sustainable growth path. In 2019, Guatemala had the lowest ratio of external public debt to GDP (11.9%) followed by Costa Rica (21.2%), well below the regional average of 35%. Other countries have

MACROECONOMIC HIGHLIGHTS
Source: OMFIF analysis

<table>
<thead>
<tr>
<th>Country</th>
<th>Greatest improvement in fiscal management (2015, down to 1.0% in 2018)</th>
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<tr>
<td>Belize</td>
<td>7.8%</td>
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<td>Costa Rica</td>
<td>6.1% compound annual growth rate, 2015-19)</td>
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<td>Dominican Republic</td>
<td>Strongest growth record (6.1% compound annual growth rate, 2015-19)</td>
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<td>Guatemala</td>
<td>Lowest external public debt to GDP ratio in 2019 (11.9%)</td>
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<td>Honduras</td>
<td>Declining unemployment rate (7.3% in 2015 down to 5.7% in 2018)</td>
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<td>El Salvador</td>
<td>Lowest public deficit to GDP ratio in 2019 (1.6%)</td>
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<td>Nicaragua</td>
<td>Stable outlook from international ratings agencies</td>
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<td>Panama</td>
<td>Highest living standards ($15,734 GDP per capita, 2019)</td>
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kept debt to GDP ratios under 40%, with the exception of Belize (66.5%) and Nicaragua (50.2%). External public debt includes all fiscal and public sector debt owed to foreign entities but excludes debts of public enterprises.

During a difficult year, the macroeconomic record and pandemic response of Central American economies indicate that it is poised to make a sustainable recovery. It must demonstrate continued fiscal discipline while providing adequate support and relief to workers in affected sectors. Crucial to the recovery is the region’s ability to maintain diversified trade flows, strong economic integration and healthy financial systems.

‘Crucial to the recovery is the region’s ability to maintain diversified trade flows, strong economic integration and healthy financial systems.’

2. Effective pandemic response critical to continued growth

Overview of Covid-19 response measures

Source: IMF, IADB, CABI, Secretaría Ejecutiva del Consejo Monetario Centroamericano, Economic Commission for Latin America and the Caribbean, Organisation for Economic Co-operation and Development, System of Central American Integration, OMFIF analysis

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<td>Salary compensation for workers</td>
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BELIZE successfully reduced its unemployment rate to 9.4% in 2019 from 11.1% in 2014. This positive trend is forecast to reverse by the International Monetary Fund as a result of the pandemic. Covid-19’s grave impact on tourism is leading Belize to experience the highest increase in unemployment in the region, which is expected to rise to 18.7% in 2020.

Although Belize tends to receive the lowest level of foreign investment in the region, it may see some improvement as the country received 366% more FDI in 2018 compared to the year before. To boost investor confidence, the country has adopted the latest financial and accounting standards that help ensure transparency and financial soundness. Belize requires domestic companies to adhere to international financial reporting standards, while the financial system already has a plan to implement Basel III.

In 2018, Belize had the second-highest share of renewable sources in its energy mix (83%), second only to Costa Rica in the region.

As part of the country’s climate change mitigation efforts, Belize has undertaken various green projects. A water treatment plant is under construction, and a project to produce biogas and renewable energy from biomass and organic waste is being planned. Belize is one of the few countries globally that are part of the Climate Change Policy Assessment. CCPA is a joint initiative between the IMF and World Bank aimed at assisting small states in the management of their climate change response, considering its expected economic and fiscal impacts.

Belize has successfully reduced its fiscal deficit in recent years, to 1% of its gross domestic product in 2018 from 7.8% in 2015. However, the country faces significant fiscal challenges, especially as a result of the government’s efforts to cope with the pandemic. Before the outbreak, it already had the highest public external debt in the region, which represented 67% of its GDP in 2018.

Macroeconomic indicators
- GDP growth: 0.3%
- GDP per capita: $4,784
- Inflation: 0.6%
- Unemployment rate: 9.4%*
- Public external debt to GDP: 66.5%*
- Public deficit: 1%*

Trade indicators
- FDI inflows: $120m*
- Total exports in 2019: $931m
- Free trade agreements: 2

*2018

83%
Belize gets most of its energy from renewable sources
PILLAR 2: COMMERCE, EXTERNAL TRADE AND FOREIGN DIRECT INVESTMENT

DIVERSIFYING MARKETS KEY TO CONTINUED GROWTH

Central America relies on the US and intra-regional trade as its major export markets. Regional co-operation will help Central American economies break into new markets, such as Europe.

KEY to Central America’s continued growth are its well-diversified economies. While agriculture, mining, and the manufacturing and construction industries remain important sectors, wholesale and retail trade contributes the most to the region’s economy. In Costa Rica, the medical devices and equipment industry forms the largest part of the country’s gross domestic product. This fast-growing subsector reflects the success of fiscal incentives for new medical technology firms that have attracted multinational corporations.

Central American economies are externally oriented, with fruits, coffee and sugar amongst the region’s top exports. Mineral fuel and oils are the main imported goods. Strong export growth in the first quarter of 2020 and sustained foreign direct investment inflows highlight the region’s potential.

Although Central American exports have increased steadily (Figure 1), more sophisticated merchandise destined for international markets can improve
1. Historically, Central American exports have increased steadily
Total exports, $m
Source: World Bank, OMFIF analysis

revenue prospects. While the goods exported from Central America are diverse, it is important that countries increase efforts to improve their technological content. Costa Rica is already taking significant steps in this direction. In 2017, it ranked 46th out of 133 in the world’s economic complexity ranking, closely followed by Panama (52) and El Salvador (54).

While exports plunged in most of Latin America, Central America experienced 9.1% year-on-year growth in the first quarter of 2020 (Figure 2). The main driver of Central American export growth was demand from the US, followed by the rest of Latin America and Asia. Central America’s performance was hampered by weaker appetite for foreign goods in the US, the global epicentre of Covid-19.

Within Central American countries, Guatemala outperformed its peers with a 16.9% year-on-year increase in external sales. Latin America was the main driver for this demand, followed by the US and European Union. Guatemala was followed by Costa Rica with 9.4% year-on-year growth.

Central America adapted quickly to the technological boom that Covid-19 brought, allowing it to overcome the challenges presented by the pandemic. The Centre for Economic Integration Studies launched the Central American Trade Network in June, a free digital platform of commercial intelligence that connects enterprises from more than 28 countries around the world.

Free trade agreements contribute to economic activity and job creation as they open doors to new markets. All countries in Central America have free trade agreements in place. Costa Rica stands out with 14, followed by Honduras with 11.

Free trade agreements are designed to promote regional economic integration, and Central America is a case in point. Greater coordination of trade policy at the regional level has been the result of countries negotiating almost half of their free trade agreements as a bloc.

The significant number of free trade agreements in place has yet to translate into a greater diversification of the region’s export markets. Its sales are heavily dependent on the US, which received 39% of total exports in 2018, followed by intra-regional commerce, with 23%.

Although the intra-regional market is gaining momentum, the diversification of the region’s export destinations is essential to reduce its dependency on North American markets. The EU could be an important trading partner. According to 2019 figures, almost all Central American countries had at least one country from the European single market among their top 10 trading partners. All Central American countries are part of free trade agreements with the EU. A value chain analysis performed as part of the Central American Regional Economic Integration Project revealed that Europe could be a top export destination for the region’s

FOREIGN DIRECT INVESTMENT HIGHLIGHTS
Source: CEPAL, OMFIF analysis

Belize
Main recipients of FDI in 2018 were real estate (30%) and construction (26%)

Costa Rica
Manufacturing received 51% of FDI in 2018, partly due to fast-growing medical equipment industry

Dominican Republic
Santo Domingo ranks sixth globally for business service outsourcing centres

El Salvador
Largest aeronautics maintenance centre in Latin America

Guatemala
Main sources of FDI in 2018 were the US (24%), Mexico (18%) and Colombia (13%)

Honduras
High growth of FDI in export processing industry (55.6%, 2018)

Nicaragua
New investments in mining, including $120m from Condor Gold

Panama
Top recipient of FDI in the region and fifth in Latin America and the Caribbean in 2018
coffee. Considering there is robust competition for this market, Central American countries could benefit from engaging in intra-regional co-operation to take advantage of economies of scale in getting to know and exporting to the European market.

FDI inflows give an indication of which countries are attracting attention with high levels of economic activity and stable environments that are providing foreign firms with business certainty. FDI in Central America came mostly from the US, representing 48% of total inflows in 2018. The rest of Latin America followed, with 37%. These two sources form 85% of foreign investment, revealing a high level of concentration.

Recipients of the the highest levels of FDI in Central America are Panama, the Dominican Republic and Costa Rica. The latter two finished 2019 with FDI growth rates of 19% and 16%, respectively. Panama attracts more investment from abroad, as a result of projects to expand the Panama Canal and the country’s successful development as a logistics and transport hub. In Costa Rica, the medical devices and equipment industry has attracted substantial investment from transnational corporations from the US, Germany and Denmark. In the Dominican Republic, where Santo Domingo was ranked as sixth among the world’s best outsourcing centres by the fDi Intelligence World Ranking, expanding business service centres are drawing the most amount of foreign capital into the country.

South Korea’s investments abroad have been growing significantly, making it the world’s ninth largest overseas investor in 2018. Panama was the top recipient country in Central America, with South Korean investments directed at the construction, transport and storage sectors. Since 2018, the manufacturing industry has been a key investment area for South Korea, presenting an opportunity for the rest of the Central American economies. As manufacturing is a major economic driver for the region, second only to wholesale and retail trade, Central America should be able to attract more business from investors seeking to offshore manufacturing activities.

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2. Central America’s integration has proven its resilience

Export growth rate, %, Q1 2020 vs Q1 2019
Source: Inter-American Development Bank (IDB), OMFIF analysis

'Free trade agreements are designed to promote regional economic integration, and Central America is a case in point. Greater coordination of trade policy at the regional level has been the result of countries negotiating almost half of their free trade agreements as a bloc.'
COUNTRY FOCUS:

COSTA RICA

COSTA Rica is leading the region in climate change mitigation efforts. In 2018, it announced its plan to achieve carbon-neutral status by 2021 and has already made important steps towards this goal, including getting almost 99% of the country’s energy from renewable sources. Costa Rica’s work on climate change has drawn international attention, notably when it led the creation of the San Jose Principles for High Ambition and Integrity in International Carbon Markets. The Principles, which 31 other countries have adopted, were drafted as part of initiatives leading up to COP25 in late 2019.

Costa Rica has experienced a slight deceleration in the growth rate of its real GDP since 2016. The downward trend is set to continue through the pandemic, although improvements in manufacturing and trade openness bode well for its future economic performance. Costa Rica’s fast-growing health sector contributes significantly to GDP, with the production of medical equipment attracting investment from multinational companies. The country has managed consumer prices well in recent years, lowering the inflation rate to 2.1% in 2019 from 4.5% in 2014, still within its 2-4% target.

To encourage exports, Costa Rica is part of 14 free trade agreements, the highest in Central America. Growth of foreign direct investment to the country (16.2%) was among the highest in the region for 2019, second only to the Dominican Republic. It also has the highest number of international tax treaties.

Job creation remains a challenge, with Costa Rica’s unemployment rate of 12.4% at the end of 2019. Costa Rica also needs to take caution in fiscal management, especially during the Covid-19 crisis, as it has the highest public deficit to GDP ratio (7%) within the region.

Macroeconomic indicators
• GDP growth: 2.1%
• GDP per capita: $12,310
• Inflation: 2.1%
• Unemployment rate: 12.4%
• Public external debt to GDP: 21.2%
• Public deficit: 7%

Trade indicators
• FDI inflows: $2.6bn
• Total exports: $21bn
• Free trade agreements: 14

‘Costa Rica’s work on climate change has drawn international attention, notably when it led the creation of the San Jose Principles for High Ambition and Integrity in International Carbon Markets.’

Costa Rica gets nearly all of its energy from renewable sources.
PILLAR 3: INTEGRATION

INTEGRATION UNDERPINNED BY SHARED OBJECTIVES AND VALUES

Central America’s integration stems from a desire to be economically unified. Beyond economic links, integration has become an important facet of democratic security and climate change mitigation.

ECONOMIC integration can accelerate regional and national development, supporting growth. It achieves this through reducing trade barriers, encouraging cross-border investment, and sharing technology and employment opportunities. Stronger economic ties also improve political co-operation and stability, and reduce policy uncertainty. Central America is a prime example.

Economic integration within the region has brought numerous advantages. One of them is in exports. Historically, intra-regional trade has been the second main destination of Central American countries’ exports, after the US. This is pivotal for the region’s resilience in times of stress, such as the 2008 financial crisis and the Covid-19 pandemic. While exports plummeted in most of Latin America, Central America experienced a 9.1% year-on-year growth during the first quarter of 2020.

The story of economic integration in Central America goes back more than 60 years. In 1958 the Central American Free Trade and Economic Integration Multilateral Treaty was signed by Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica, with the aim of promoting economic integration in the region.

Since then, an intricate web of overlapping multilateral treaties has developed, linking different countries of Central America and the Dominican Republic in projects aimed at increasing their economic association. An important one was signed in 1991. The Tegucigalpa Protocol to the Charter of the Organization of Central American States created the Central American Integration System composed,
initially, of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama. The success of this caught the attention of others. Belize and the Dominican Republic joined in 2000 and 2013, respectively.

The General Treaty of Central American Economic Integration, signed by El Salvador, Guatemala, Honduras and Nicaragua in 1960, is another cornerstone of integration. This agreement was modified by the Guatemala Protocol in 1993, signed by the original countries as well as Costa Rica and Panama. At first, Panama remained as a signatory of the Guatemala Protocol. However, drawn by the success brought by this economic union, it joined the Central American Economic Integration Subsystem in 2012.

The shared economic goals of Central American countries have helped them enter into free trade agreements as a bloc. There are nine of these accords, in which at least two Central American countries have come together to form links with trade partners from outside the region, such as the European Union, US and Asia (Figure 1). These broad-ranging agreements are complemented by more targeted mechanisms, including treaties, intra-regional agencies and projects. For example, a treaty on investment and trade in services between Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua was signed by Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua in 1960, is another cornerstone of integration. This agreement was modified by the Guatemala Protocol in 1993, signed by the original countries as well as Costa Rica and Panama. At first, Panama remained as a signatory of the Guatemala Protocol. However, drawn by the success brought by this economic union, it joined the Central American Economic Integration Subsystem in 2012.

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signed in 2002. It established a legal framework for trade liberalisation in services and investment. Another, signed in 1996, helps develop a competitive regional electricity market through transmission lines that connect national networks and through the promotion of regional projects for electricity generation. To enhance this, the region created the Electricity Interconnection System for the countries of Central America which provides electricity transmission facilities that benefit Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama, increasing reliability and security of electricity.

The region has been working towards achieving a customs union since 1984. While there have been various efforts on this front, only Guatemala, Honduras and El Salvador have created a common customs union.

Beyond trade, economic integration has taken the form of common standards for financial institutions. A treaty on payments and securities settlement in 2006 has helped align regional standards with global benchmarks and reinforce supervision. Free movement of people has also enhanced integration. The CA-4 agreement, among Guatemala, El Salvador, Honduras and Nicaragua, signed in 2006, allows non-work travel across borders for citizens carrying their national identity cards. The same four countries issue a unified visa for foreign tourists, easing travel between their countries and boosting tourism.

To promote the economic integration and social development of Central America as well as to implement coordinated solutions to common challenges in the region, the Central American Bank for Economic Integration was established in December 1960. CABEI acts as a regional partner for the promotion and implementation of projects aimed at reinforcing integration and increasing development within the region. These projects cover a wide spectrum, ranging from the expansion of the use of natural gas to the introduction of more efficient transport alternatives and the creation of new routes that facilitate trade. This multilateral bank also supports projects aimed at combating climate change, achieving sustainable growth and increasing the region’s resilience through adaptation.

Central America and the Dominican Republic form a unified front with regards to democratic security. The 1995 framework treaty for democratic security in Central America is the bedrock for this. Different treaties, strategies and commissions have been constituted to coordinate policies aimed at safeguarding the region’s democratic institutions. Moreover, supranational institutions have been created, such as the Central American Parliament and the Central American Court of Justice.

Countries in the region has also joined forces to achieve social integration, including through the 1995 Central American Social Integration Treaty and the Central American Social Integration Secretariat. Air navigation is another area in which the region has coordinated efforts through the Central American Corporation for Air Navigation Services, aimed at creating common standards to achieve safety, efficiency and quality in a sustainable manner within this sector.

Integration benefits the region through a systematic approach to development that makes investment projects more worthwhile and scalable for foreign partners.

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2. The EU is Central America’s major partner in direct co-operation for development projects

<table>
<thead>
<tr>
<th>% of total direct co-operation for development between 2014-19, by partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source: Central American Integration System, OMFIF analysis</td>
</tr>
</tbody>
</table>

'Integration benefits the region through a systematic approach to development that makes investment projects more worthwhile and scalable for foreign partners.'
**COUNTRY FOCUS:**

**DOMINICAN REPUBLIC**

The Dominican Republic consistently receives high levels of foreign direct investment. FDI inflows grew by 18.8% in 2019, the greatest increase in the region for that year. Export growth has been equally strong, averaging 5.2% annually since 2012.

The Dominican Republic is home to a growing banking sector and has the second-highest number of banks in the region, surpassed only by Panama. To reassure international investors of the country’s financial development and stability, the Dominican Republic should work towards the implementation of Basel III standards.

The Dominican Republic is the region’s fastest-growing economy, expanding an average of 6.1% annually over the last five years. Despite these positive results, growth in the Dominican Republic may be unsustainable since it has been partly debt-fueled, with external public debt forming about a quarter of gross domestic product. While this is still low compared to other countries in the region, it could become a hindrance to the Dominican Republic’s long-term growth if not managed well. During the crisis, the country must focus on managing its debt burden.

Despite the pandemic’s disruption, GDP is expected to shrink by only 1% in 2020, the smallest contraction projected in the region. The country successfully lowered its unemployment rate to 6.2% in 2019 from 8.5% in 2017, but this may be reversed by job losses in pandemic-hit sectors, like tourism.

Despite a promising economic outlook, the Dominican Republic needs to ensure that its long-term growth is sustainable. It should increase efforts to transition away from carbon-intensive energy production.

While other countries in the region have taken significant steps to switch to cleaner energy, the Dominican Republic is an outlier, with 85% of its energy coming from non-renewable sources in 2018.

Macroeconomic indicators
- GDP growth: 5.1%
- GDP per capita: $8,284
- Inflation: 1.8%
- Unemployment rate: 6.2%
- Public external debt to GDP: 26.6%
- Public deficit: 2.2%

Trade indicators
- FDI inflows: $3bn
- Total exports: $18.7bn
- Free trade agreements: 4

6.1%

The Dominican Republic has experienced the fastest annual growth rate in the region over the last five years.
COUNTRY FOCUS: EL SALVADOR

FOR the past five years, El Salvador has shown stable growth, with annual gross domestic product growth ranging between 2.3% to 2.5%. The pandemic will disrupt this steadiness as projections show that the country’s economy will suffer one of the deepest contractions in the region in 2020 (-5.4%). Although the unemployment rate has been rising as a result of the pandemic, it is projected to be one of the countries in the region where this rate increases the least. Living standards, as measured by GDP per capita, have improved over time, climbing by an average of 3% annually since 2014.

El Salvador is taking significant steps towards cleaner energy, with 77% of its energy coming from renewable resources in 2018. Numerous solar farm projects are underway. Such efforts will boost El Salvador’s self-sufficiency and improve its energy security, reducing its dependence on electricity imports.

Debt sustainability is key for El Salvador. Although external public debt has remained somewhat stable since 2015, averaging around 38% of GDP, it is among the highest in the region. The country’s total public debt rose to 73.3% of GDP in 2019 and could increase up to 90% in 2020 as a result of the government’s efforts to cope with the pandemic.

El Salvador receives a relatively low level of foreign direct investment. To raise investor confidence, El Salvador should continue efforts to maintain law and order throughout the country.

Macroeconomic indicators
- GDP growth: 2.4%
- GDP per capita: $4,187
- Inflation: 0.1%
- Unemployment rate: 6.3%
- Public external debt to GDP: 36.9%
- Public deficit: 1.6%

Trade indicators
- FDI inflows: $662m
- Total exports: $8bn
- Free trade agreements: 9

‘El Salvador is taking significant steps towards cleaner energy, with 77% of its energy coming from renewable resources in 2018.’
PILLAR 4: FINANCE, TAX AND TRANSPARENCY

REGION CATCHING UP WITH GLOBAL STANDARDS

A stable, predictable and internationally competitive tax system must stand on strong financial infrastructure to ensure that foreign investment benefits economic development. The region is catching up with global standards, but disparities remain.

A transparent, well-structured financial market infrastructure is critical for domestic and foreign investor confidence. Central banks and regulatory authorities play a key role in ensuring price and financial stability, with interest and exchange rates acting as vital tools in this endeavour. Due to their physical proximity to the US market as well as historic factors, most Central American economies are closely linked to the American financial system and are heavily dollarised. This is reflected in their monetary and exchange rate policy regimes. Of the regions’ eight countries, six have a fixed exchange rate regime as either a peg, crawl-like or stabilised arrangement targeting the dollar. Panama and El Salvador are completely dollarised with no separate legal tender. In terms of monetary policy regimes, the majority target the exchange rate under fixed rate arrangements. Costa Rica, the Dominican Republic and Guatemala are under an inflation-targeting regime. Fixed exchange rate systems broadly remove the risk of currency volatility but come at a cost of reduced room for manoeuvre for monetary policy-makers when idiosyncratic shocks hit.

On regulatory and reporting issues, most countries in the region are catching up with fast-changing global financial regulations and standards such as the International Financial Reporting Standards and the Basel accords. Half of Central American countries
1. Implementation of Basel rules
I, II or III

<table>
<thead>
<tr>
<th>Country</th>
<th>Basel Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belize</td>
<td>III</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>III</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>II</td>
</tr>
<tr>
<td>El Salvador</td>
<td>III</td>
</tr>
<tr>
<td>Guatemala</td>
<td>II</td>
</tr>
<tr>
<td>Honduras</td>
<td>III</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>III</td>
</tr>
<tr>
<td>Panama</td>
<td>III</td>
</tr>
</tbody>
</table>

(Belize, Costa Rica, Honduras and Panama) are already at least partially implementing the Basel III international regulatory framework for banks (Figure 1). This is a stricter framework compared to former iterations, with an increased level of regulatory capital designed to ensure the resilience of the banking system. The remaining countries are implementing Basel II, except for Guatemala, the only country in the region still implementing Basel I. The pace of progress in the region aligns with that of other regional alliances. In Mercosur, the Pacific Alliance and Andean Community, all but two countries (Paraguay and Ecuador) are implementing Basel III.

Overall, financial soundness indicators reveal that Central America’s banking system entered the Covid-19 economic recession in a strong position, outperforming minimum international standards.”

FINANCE, TAX AND TRANSPARENCY HIGHLIGHTS
Source: OMFIF analysis

**Belize**
Implementing Basel III banking standards

**Costa Rica**
Highest number of non-financial corporates (12) rated after Panama

**Dominican Republic**
All three major rating agencies (S&P, Moody’s and Fitch) rate the Dominican Republic’s sovereign debt

**El Salvador**
IFRS reporting standards in place for SMEs and local and foreign companies

**Guatemala**
Low withholding tax rates on dividend (5%) and interest (10%) income

**Honduras**
Provides tax incentives for companies in special economic zones and SMEs

**Nicaragua**
Banking sector with highest liquid asset ratio (32.2%, 2019)

**Panama**
Highest score (56) on minority shareholder protection in World Bank Doing Business 2020
GUATEMALA has been experiencing a steady acceleration in real gross domestic product growth since 2016, after a slight deceleration that followed a political crisis in 2015. Although the pandemic will reverse this upward trend, the country is expected to have one of the lowest economic contractions in the region (-1.96%), worse only than that in the Dominican Republic.

Living standards have been improving, although very slowly. The country reduced inflation to 3.7% in 2019 from 4.5% in 2016 and, while still within its 3-5% target, there is room for improvement. Guatemala has the third-highest inflation rate in the region, after Honduras and Nicaragua.

Guatemala had the lowest ratio of public external debt to GDP in the region in 2019, at 11.9%. While its public deficit has increased gradually relative to GDP since 2016, the ratio is still one of the lowest in the region. Both fiscal advantages have given the government ample room for manoeuvre in its pandemic response. Guatemala’s fiscal policies have ranged from packages to stimulate economic activity and the disbursement of economic and salary subsidies, to an increase in investment expenditure, especially on infrastructure and housing projects.

Overall foreign direct investment inflows have been decreasing over time, but certain recipient sectors are growing. Investment in the commercial sector rose to 32% in 2018 from 23% in the previous year. To further draw investment from abroad, it should continue its efforts towards strengthening its democratic institutions and addressing crime and corruption.

Guatemala should ramp up its efforts towards increasing its financial development by adopting international banking standards. It is the only country within the region that is still only partially implementing Basel I.

Guatemala is an outlier in sustainability efforts, ranking lowest in the region in the Environmental Performance Index (149th out of 180). It can improve its ranking by taking important steps like decreasing fossil fuel dependence of its energy sector, as well as executing its metro rail project to reduce traffic congestion and carbon dioxide emissions.
COUNTRY FOCUS:
HONDURAS

HONDURAS is the region’s third fastest growing economy, expanding an average of 3.8% annually in the last five years. Living standards, as measured by gross domestic product per capita, have improved gradually since 2014 but remain among the lowest in Central America. Moreover, inflation has increased steadily to 4.4% in 2019 from 2.7% in 2016.

Honduras has achieved outstanding results in job creation, having one of the lowest unemployment rates in Central America. The unemployed share of the labour force has declined to 5.7% in 2018 from 7.3% in 2015. While unemployment is forecast by the International Monetary Fund to increase as a result of the pandemic, Honduras is expected to have a healthy rebound in 2021. The levels of public external debt have remained somewhat steady since 2017 and represented 31% of the country’s GDP in 2019. Honduras has 11 free trade agreements in force, the second-highest number in the region. However, this has yet to translate into increased exports, remaining virtually unchanged since 2011.

Foreign direct investment has fallen sharply since 2017. Foreign investors’ confidence may improve in coming years as Honduras continues with significant improvements in strengthening the country’s institutions, and maintaining peace and stability.

Macroeconomic indicators
• GDP growth: 2.7%
• GDP per capita: $2,557
• Inflation: 4.4%
• Unemployment rate: 5.7%*
• Public external debt to GDP: 30.7%
• Public deficit: 2.5%
*2018

Trade indicators
• FDI inflows: $498m
• Total exports: $6.3bn
• Free trade agreements: 11

3.8%
Average annual growth in Honduras was the third highest in the region over the past five years.
The capital adequacy ratio, at an average of around 17% across the region, reflects the banking system's capital strength to withstand shocks and absorb losses. It is well above the Basel III minimum requirement of 10.5%. All countries have an appropriate liquid asset ratio that would allow their banking system to respond with confidence to unexpected changes in cash flows. Nicaragua and Guatemala closed last year with the region's highest ratios, 32.2% and 31.2% respectively.

With the exception of Belize, most Central American countries require or permit foreign companies to follow the IFRS for their listings. For domestic companies, only Guatemala, Nicaragua and Panama do not require these standards to be followed. In the case of small and medium enterprises, IFRS rules are either required or permitted across the entire region. Adopting such reporting standards helps enhance investors’ knowledge about the region and improve decision-making processes. Convergence to global standards helps simplify access to the region for investors seeking to complement existing investments elsewhere. More broadly, regulatory harmonisation reduces complexity and compliance costs for foreign and local investors and supports market development.

Sovereign and corporate credit ratings can improve investors’ information environment. All three major ratings agencies (S&P, Moody’s and Fitch) rate sovereign debt for six Central American countries. Fitch does not rate Honduras, and only Moody’s rates Belize. In terms of corporates, Panama ranks the highest with 79 ratings (around three-quarters are financial institutions). El Salvador, the Dominican Republic and Guatemala follow with more than 50 ratings each. Costa Rica and Honduras have 26 and 15 respectively. Nicaragua only has four, while in Belize no corporates are rated by any of the three agencies (Figure 2).

The corporate ratings landscape seems to align with other indicators of market development. For example, the de jure and de facto process for the protection of minority shareholders can be a deal-maker or breaker for investors seeking to enter the region. Here again Panama ranks highest on the World Bank’s ‘protection of minority shareholders’ ranking, with a score of 56. It is followed by Costa Rica (48) and Honduras (42). El Salvador, the Dominican Republic and Guatemala all rank above 30, while Belize and Nicaragua are the weakest in the group.

Linked to the information environment, stable, predictable and internationally-competitive tax systems are key to attract investor interest in the region. Especially at the earlier stages of financial market development, it is important to ensure the tax framework is designed in a way that encourages financial market transactions to help the market reach a healthy stage.'
PILLAR 5: SUSTAINABLE INVESTMENT

UNLOCKING POTENTIAL FOR SUSTAINABLE GROWTH

Initiatives to promote sustainable growth and investment are becoming increasingly important within global financial markets. Central American economies are exceptionally vulnerable to natural disasters and climate change, and require a focus on resilience-building and planning.

FINANCIAL market participants are becoming increasingly alert to the risks of working under a ‘business as usual’ economic model. These risks can be direct and sudden, such as the loss of economic assets when infrastructure and real estate are hit by natural disasters. Central American economies are particularly vulnerable. Numerous hurricanes, floods, droughts and other disasters have hit the region in recent years. The pandemic has provided additional challenges. There are also medium- and long-term risks to investors: changing regulations associated with governments’ commitment to the climate transition imply shifts in relative prices with dirty-sector ‘losers’ and sustainable-sector ‘winners’. With global investors seeking to rebalance portfolios towards a more resilient model, Central American economies can present important opportunities for sustainable investments, particularly in the areas of green transport and energy infrastructure.

The region has made strides in this area with the creation of various programmes, such as the Co-financing for Renewable Energy and Energy Efficiency between the Inter-American Development Bank and the government of Japan. Under this programme, the Japan International Co-operation Agency channelled around $120m in financing to the region, including in an energy efficiency project in the Dominican Republic. The Dominican Republic also runs a project on resilient transport infrastructure, supporting the development of infrastructure adaptable to climate change, with technical assistance from the IDB’s 1. Costa Rica leads shift to cleaner energy

Share of renewable energy in total energy generation, %, 2018
Source: CEPAL, OMFIF analysis
NDC Invest programme.

NDC Invest seeks to mobilise funds to accelerate the deployment of electric buses in the broader Latin American region, with projects already running in Costa Rica and Guatemala. The former is also in the process of designing a project for an electric train. Overall, the region has made strong progress in renewable energy. In four out of eight Central American countries, over three-quarters of energy generated is from renewable sources, with Costa Rica approaching 100% (Figure 1). Only the Dominican Republic presents a relatively low percentage, at just over 15%.

There is growing recognition of the need for a holistic understanding of ecosystem dynamics and interactions, and for projects that address these accordingly. Biodiversity conservation is at the heart of several such initiatives. For example, the Global Environment Facility and the IDB approved a series of projects related to ecosystem services, channelling close to $20m to Costa Rica. A separate consortium, supported by the German government, established the Adaptation Facility as part of the Caribbean Biodiversity Fund that covers the Dominican Republic, alongside other Caribbean nations. A separate partnership between the IDB and British government established the Blue Carbon Fund. The BCF uses blended finance to catalyse public and private investments in the ‘blue economy’, such as in a project aiming to protect and enhance coastal natural capital scheduled for Panama.

Given the region’s proximity to large marine ecosystems, Central America has been home to several initiatives aimed at the sustainable management of shared marine resources. These have included programmes to eliminate toxic chemicals and marine litter, as well as projects to improve governance and management of transboundary marine resources. A notable example is the Reef Resilience Network, a partnership led by The Nature Conservancy, which strives to build marine management capacity to effectively manage, protect and restore coral reefs and reef fisheries around the world.

It is imperative that the strong momentum behind such initiatives continues. In absolute terms, Central American economies still lag neighbouring countries and other regions when it comes to environmental protection policies. Most countries featured in our research earn a score of close to or below 40 (out of 100) in the 2020 edition of the Environmental Performance Index (Figure 2). The index ranks countries on 32 environmental performance indicators including the stage of implementation of environmental policy targets, the state of pollution emissions and protection of ecosystem services, and water and waste management. This compares to scores of between 40–50 for most other Latin American countries. Costa Rica is an exception, ranking fourth overall in the region with a score of 52.5, behind Chile, Colombia.
and Mexico. Costa Rica is also the only country in Central America whose central bank has joined the Central Banks and Supervisors Network for Greening the Financial System, a network dedicated to ‘mobilising mainstream finance to support the transition towards a sustainable economy’. Brazil, Chile, Colombia and Mexico have representation in the NGFS.

In Central America, governments and policy-makers have made a start at implementing policies related to climate change and biodiversity at varying degrees (Figure 3, p. 27). The protection of natural reserves, and the conservation and management of water resources draw the most attention, while policies focused on erosion reduction are the least popular, only implemented in Honduras.

Governments, regulators, investors and corporates in the region can look to develop new initiatives that focus on the development of sustainable financial markets and the effective management of non-financial sources of risk. Some suggestions in that vein are presented in Figure 4.

<table>
<thead>
<tr>
<th>4. Policy recommendations for the design of sustainable financial markets</th>
<th>Actor</th>
<th>Category</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sustainable taxonomy</td>
<td>Governments/Intra-regional bodies</td>
<td>Underlying infrastructure</td>
<td>Central America can extend its work on the Toolkit for Strengthening Official Environmental Statistics by adopting some of the work done in the European Union’s sustainable taxonomy and adapting it to the region. This framework helps facilitate green investments while avoiding ‘greenwashing’.</td>
</tr>
<tr>
<td>Sustainability certification schemes</td>
<td>Governments</td>
<td>Underlying infrastructure</td>
<td>Other Central American economies can follow the examples of Costa Rica and Honduras which have issued certification schemes for sustainable tourism.</td>
</tr>
<tr>
<td>Disclosure frameworks</td>
<td>Governments/regulators</td>
<td>Underlying infrastructure</td>
<td>Regulators in the region can help advance disclosure standards within green investment projects following the principles of the Financial Stability Board’s voluntary task force on climate-related financial disclosures guidelines, as well as the more recent task force on nature-related financial disclosures.</td>
</tr>
<tr>
<td>Sustainable bonds</td>
<td>Governments/corporates</td>
<td>Sustainable capital markets</td>
<td>Sovereigns and the private corporate sector in Central America could follow the example of Chile and others in issuing sovereign green (or blue) bonds. The Central Bank of Costa Rica, Ecosolutions, a Costa Rican provider of energy efficiency solutions, CABEI and the infrastructure financial institution CIFI in Panama have already issued green bonds.</td>
</tr>
<tr>
<td>Sustainable stock exchanges</td>
<td>Stock exchanges</td>
<td>Sustainable capital markets</td>
<td>Only the stock exchanges of Costa Rica and Panama have joined the UN’s sustainable stock exchanges initiative, while the Dominican Republic launched the first green finance forum in July 2019. Similar initiatives to support green finance could be followed by other stock exchanges in the region.</td>
</tr>
<tr>
<td>Green investment bank</td>
<td>Governments/international organisations</td>
<td>Sustainable capital markets</td>
<td>Central American countries could follow the example of the UK Green Investment Bank, to create a dedicated vehicle for green investments.</td>
</tr>
<tr>
<td>Climate stress tests</td>
<td>Central bank</td>
<td>Regulation/supervision</td>
<td>Several central banks in Europe and Asia have begun introducing climate stress tests on the institutions they supervise, evaluating the banking and insurance sectors’ resilience to adverse climate scenarios. Central America should consider implementing similar processes.</td>
</tr>
<tr>
<td>Climate-related research and sharing of best practice</td>
<td>Central bank</td>
<td>Regulation/supervision</td>
<td>The Central Bank of Costa Rica is the only central bank in the region to have joined the NGFS. Its peers should follow the same path.</td>
</tr>
</tbody>
</table>
NICARAGUA has achieved outstanding results in job creation, having one of the lowest unemployment rates in Central America. In 2019 this stood at 6.1%, the second-lowest in the region after Honduras. However, the International Monetary Fund forecasts almost a doubling of unemployment to 11.1% as a result of the pandemic.

Nicaragua has a sound financial system. The statutory capital requirements in the country are higher than international standards, even though it has not implemented Basel III. The country has the highest ratio of regulatory capital to risk-weighted assets in the region, 19.5%, which is well above Basel’s requirement of 10.5%. Likewise, its 11.5% regulatory tier 1 capital to risk-weighted assets surpasses the 6% requirement of Basel III.

Nicaragua has entered into eight free trade agreements with various counterparties, including some of its main trading partners, such as the US, China and Mexico. However, this has yet to translate into increased exports. The country has one of the lowest export values in the region and these have remained virtually unchanged since 2011.

Nicaragua has the second-highest public external debt to gross domestic product ratio of the region after Belize, which amounted to 50.2% in 2019. This is despite a relatively low public deficit, which stood at 2% of the country’s GDP in 2018.

‘Nicaragua has a sound financial system. The statutory capital requirements in the country are higher than international standards.’

Nicaragua is one of the two countries in the region that receives the least amount of foreign direct investment. Inflows plummeted in 2018, although they had been continuously falling since 2015. To foster confidence, Nicaragua should work towards a more stable political climate.
COUNTRY FOCUS:
PANAMA

PANAMA has the highest living standards in the region with a gross domestic product per capita of $15,735, well above the global average of $11,456. Moreover, it has one of the lowest inflation rates in the region, which has remained below 0.9% since 2015. Since Panama is completely dollarised with no separate legal tender, dollar depreciation in 2019 created a deflationary environment as inflation fell to -0.4%.

The country has outperformed others in the region in terms of foreign direct investment, which increased during most of the last decade. Panama has created an environment that enhances confidence from international investors. In the World Bank’s Doing Business 2020 report, it was top-ranked in the region for protection of minority shareholders. Moreover, it is the only country in Central America with investment-grade sovereign credit ratings, and it stands out in the region with a total of 79 corporate ratings, 58 of which are banks and other financial institutions.

Panama is the region’s second-fastest-growing economy, expanding an average of 4.6% annually in the last five years, outperformed only by the Dominican Republic. Despite these positive results, the fast growth in the country has been partly debt-fueled. Public external debt has increased steadily since 2014, amounting to 36% of GDP in 2019. Similarly, the country has the second-highest public deficit in the region, after Costa Rica, representing 3.8% of its GDP. The pandemic will exacerbate both these situations as the country funds policies to cope with it.

Except for a slight increase in job creation between 2017 and 2018, the unemployment rate has been increasing steadily in Panama since 2014. The pandemic will worsen this as unemployment is expected to rise to 8.8% in 2020 from 7.1% in 2019.

Macroeconomic indicators
• GDP growth: 3%
• GDP per capita: $15,735
• Inflation: -0.4%
• Unemployment rate: 7.1%
• Public external debt to GDP: 36.3%
• Public deficit: 3.8%

Trade indicators
• FDI inflows: $4.8bn
• Total exports: $23.9bn*
• Free trade agreements: 10
*2017

Panama’s GDP per capita is the highest in Central America
CONCLUSION

NETWORK EFFECTS OF INTEGRATION POISED TO DELIVER

Central America has been working for decades toward integration. That effort, as well as sound management, has put it in a strong position to overcome the repercussions of the pandemic and build back better.

The ‘Central America: Integration, investment and trade opportunities’ report presents a multi-faceted look at the region through five pillars, ranging from a macroeconomic overview to the sustainable investment projects underway. Our intention in launching this as an annual publication is to regularly keep track of the region’s development across these areas and highlight what can be improved to bolster investor access and sustainable growth.

This inaugural edition comes at a crucial point in the region’s economic development. Our analysis suggests that Central America entered the pandemic in a strong position. Integration efforts, which date back more than 60 years, have proven vital for the resilience of the region during these challenging times.

In the months ahead, countries will need to find the correct balance between restarting economic activity, and implementing health policies to confront a second wave of Covid-19.

Central America’s economic growth over the past five years has created supportive economic conditions. These have enabled it to manage the shock and prepare for a stronger recovery compared with other blocs in Latin America and the Caribbean. Central America was the only bloc in the region that grew its exports in the first quarter of 2020 from the same period in the year before, demonstrating resilience at the start of the virus outbreak.

Sound fiscal management has contributed to the region’s resilience, with governments having run finances in a balanced way in the aftermath of the 2008 financial crisis. Like many other countries globally, most Central American economies had to acquire loans from multilateral organisations to support the fiscal and monetary policy measures they implemented to cope with the recession. To return to a sustainable growth path, countries must be able to manage their external debt while continuing to provide adequate support to workers and businesses.

There is great potential for the region to diversify its export destinations by harnessing integration efforts to enter the European market. While the US has been the primary source of foreign direct investment inflows to the region, other partners, such as South Korea, are increasing their attention on Central America with various infrastructure projects underway. The region is unlocking its potential for sustainable growth and presents opportunities for environmentally-friendly investments, particularly in green transport and energy infrastructure.

The Covid-19 crisis has hampered education, increased unemployment, pushed more people into poverty and escalated social unrest. Holistic integration projects such as those in Central America will prove crucial. Unified efforts that go beyond economic integration towards institutional strengthening, social integration, sustainability and security enhance the region’s ability to overcome this crisis.