CABEI
Central American Bank for Economic Integration

JUNE 2023

MONTHLY ECONOMIC
SITUATION REPORT

Office of the Chief Economist

The monthly economic situation report presents an ad hoc analysis of the macroeconomic performance of the world in general and of Central America in particular, with information available as of July 10, 2023. The preparation of the document was led by Armando E. Navarrete, Chief Economist. The review was conducted by Pablo Flores, Principal Economist. The research and writing was carried out by Miguel Medina (Economist), Leily Mendoza (Economist), Fanny Vargas (Country Economist), Rodrigo Méndez (Country Economist), Jilber Urbina (Country Economist) and Clara Rivera (Junior Economist).

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PUBLIC

OPINION

In a more favorable global environment compared to previous years, economies are actively striving to normalize economic growth and foster job creation. Nevertheless, these endeavors encounter the challenge of taming inflation, which remains the primary objective amidst the gradual tightening of monetary policies.

In the context of these challenges, Central American economies have coincided to global trends by keeping policy rates relatively high, aiming to assess the progression of inflation. Favored by the slowdown in the international behavior of prices, the countries have managed to control inflation, which is why some have even begun to gradually relax their financial conditions.

On the real economic front, there has been noticeable progress in employment recovery, although economic growth has moderated somehow, remaining consistently positive. However, the impact of global conditions is starting to impact international trade performance, leading to a deceleration process.

It is important that governments continue their proactive role in consolidating macroeconomic stability through responsible, maneuverable, and flexible conduct of both monetary and fiscal policy. It is important to design macroprudential mechanisms to mitigate the negative effects derived from increases in international interest rates. Finally, the countries must continue their efforts to promote an adequate business climate to strengthen foreign investment flows, allowing the consolidation of economic growth and the creation of jobs.

Armando E. Navarrete
Chief Economist

MONTHLY ECONOMIC SITUATION REPORT

I. US and Eurozone economy slows, and headline inflation continues to decline

1. The economic indicators in the United States have shown a mixed performance. The most recent estimates for second-quarter GDP indicate slower growth than expected in the previous month, while the total unemployment rate has decreased. The Fed holds policy rate unchanged at latest meeting. The combination of restrictive financial conditions and reduced pressure from international commodity prices, has reinforced the downward trajectory of inflation.

i. Real gross domestic product increased 2.0% in the first quarter of 2023 (1.3% in the second estimate issued in May). The updated estimates mainly reflect upward revisions to exports and consumer spending, partly offset by downward revisions to nonresidential fixed investment and federal government spending. Imports, which are a subtraction in the GDP calculation, were revised downward.[1]

ii. Weekly economic index[2] grew 1.3% in the week ending July 1 (1.5% as of December 31, 2022) and the 13-week moving average increased 1.0%[3] for the eighth week in a row.

iii. GDPNow model estimated an increase in real GDP of 2.1% for the second quarter of 2023 (as of July 6), which, although it was higher than the average growth for the month of June (2.0%), shows a slowdown compared to the average of the estimates of May (2.5%). The rebound observed, compared to the estimate of 1.6% of June 28, was due to the publication of GDP statistics for the first quarter, personal consumption expenditures, the tables of the national income and product accounts, international trade, ISM index, among others.[4,5]

iv. Total unemployment rate decreased slightly to 3.6% in June 2023 (3.7% previous month).[6,7] Unemployment among Latinos increased to 4.3% (4.0% in May). Meanwhile, total nonfarm employment generated 209,000 jobs (306,000 the previous month); while the average wage per hour increased 4.4% in the last 12 months.

v. Initial claims for unemployment benefits reached 248,000 in the week ending July 1, higher by 12,000 from the previous week.[8] The average number of requests for the last moving month increased by 6.6% compared to the previous month and was higher by 26.9% compared to January 2023.

2. Headline inflation in the US reached its lowest level in more than two years. This behavior was influenced by the drop in fuel prices and the deceleration in the prices of food and transportation services.

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[1] Bureau of Economic Analysis. Gross Domestic Product (Third Estimate), Corporate Profits (Revised Estimate), and GDP by Industry, First Quarter 2023. June 29, 2023.
[2] The Weekly Economic Index (WEI) is constructed using data available on a daily or weekly basis for 10 indicators of real economic activity related to the consumer, labor market, and production.
[3] Federal Reserve Bank of New York. Weekly Economic Index (WEI). July 6, 2023.
[4] GDPNow is not an official Atlanta Fed forecast. It is an estimate of seasonally adjusted real GDP growth based on the economic data available for the current quarter (nowcast).
[5] Federal Reserve Bank of Atlanta. GDP Now. Estimate for 2023: Q2. July 6, 2023.
[6] United States Bureau of Labor Statistics. Employment situation summary. July 7, 2023.
[7] It has remained in a tight range between 3.4%-3.7% since March 2022.
[8] United States Department of Labor. Unemployment insurance weekly claims, Seasonally Adjusted Data. July 6, 2023.

i. Year-over-year inflation was 3.0% in June 2023 (4.0% the previous month), the lowest rate since March 2021 (2.6%). The groups that registered the highest year-over-year increases were transportation services (8.2%), shelter (7.8%), food (5.7%) and electricity (5.4%), while fuels fell -26.8%. The total index minus food and energy grew 4.8% (5.3% in the previous month), the lowest rate since October 2021.[9]

ii. The Fed decided to maintain the target range of the monetary policy rate between 5.00%-5.25% in June. This decision considered that inflation is still high, that the growth of economic activity remained moderate, that the increase in employment has been solid in recent months and the unemployment rate has remained low. The Committee also reported that the US banking system is solid and resilient, and that the tightening of credit conditions for households and businesses could affect economic activity, hiring and inflation. They will continue to reduce its holdings of Treasury securities and agency debt and mortgage-backed securities (quantitative tightening). Finally, reaffirmed its commitment to return inflation to its long-term target of 2.0%.[10]

3. Economic activity slowed in the Euro Zone while unemployment remained stable. GDP decreased -0.1% in the first quarter of 2023 compared to the previous quarter and increased 1.0% compared to the same quarter of 2022.[11] Industrial production increased 1.0% in April compared to the previous month[12] and production in construction decreased -0.4% in the same period.[13] The European Central Bank slightly lowered its growth forecasts, expecting the economy to grow 0.9% in 2023, 1.5% in 2024 and 1.6% in 2025.[14] The unemployment rate was 6.5% in May, same as April, being the lowest rate recorded in the history of the economic block[15]; in addition, the job vacancy rate[16] was 3.0% in the first quarter of 2023, below the 3.1% registered in both the previous quarter and the first quarter of 2022.[17]

4. Consumer prices in the Euro Zone continue to slow down. Inflation year-over-year rate for June was estimated at 5.5%, lower than May (6.1%) and June 2022 (8.6%). Percent change in the total price index that excludes energy, food, alcohol, and tobacco is estimated at 5.4% in June, after reaching a record high of 5.7% in March and slowing down to 5.3% in May. The prices of food, alcohol and tobacco presented the highest year-over-year rate with 11.7% (12.5% in May), non-energy industrial goods increased 5.5% (5.8% in May) and services 5.4% (5.0% in May). Energy prices decreased -5.6% (-1.8% in May), after experiencing a rate of 42.0% in June of last year.[18] The latest projections from the European Central Bank estimate a downward trend in inflation with 5.4% in 2023, 3.0% in 2024 and 2.2% in 2025.[19]

5. European Central Bank continues to promote a restrictive monetary policy. The Board continues to pursue a restrictive monetary policy in its efforts to bring inflation back to its target of 2.0%. To achieve this, the ECB's Board has decided to increase the interest rates of the main

[9] US Bureau of Labor Statistics. Economic news release: Consumer Price Index Summary. July 12, 2023.
[10] Board of Governors of the Federal Reserve System. Federal Reserve issues FOMC statement. June 14, 2023.
[11] Eurostat. GDP down by 0.1% and employment up by 0.6% in the euro area. June 8, 2023
[12] Eurostat. April 2023 compared with March 2023. Industrial production up by 1.0% in the euro area and by 0.7% in the EU. June 14, 2023.
[13] Eurostat. April 2023 compared with March 2023. Production in construction down by 0.4% both in the euro area and in the EU. June 20, 2023.
[14] European Central Bank. Press Release Monetary Policy Decisions. June 15, 2023.
[15] Eurostat. May 2023. Euro area unemployment at 6.5%. June 30, 2023.
[16] Job vacancy rate = (number of vacant jobs) / (number of filled positions + number of vacant jobs)
[17] Eurostat. First quarter of 2023. Euro area job vacancy rate at 3.0%. June 15, 2023.
[18] Eurostat. Flash estimate - June 2023. Euro area annual inflation down to 5.5%. June 30, 2023.
[19] European Central Bank. Press Release Monetary Policy Decisions. June 15, 2023.

financing operations, the marginal credit facility, and the deposit facility by 25 basis points to 4.00%, 4.25% and 3.50%, respectively, effective from June 21.[20]

6. Most of CABEI's non-regional member countries present a slowdown in inflation levels. Mexico, the Republic of Korea, Spain, and the Republic of China (Taiwan) reduced their annual inflation in June compared to the previous month, reaching rates of 5.06%, 2.70%, 1.90% y 1.75%, respectively. The most significant decrease was presented by Spain with -1.30 pp. Furthermore, the monetary policy rates remained unchanged in June, except for the increase applied by the European Central Bank.

7. Industrial production indices reported mixed results for CABEI's non-regional member countries, while unemployment rates increased slightly. The production index declined in the Republic of China (Taiwan) and in the Republic of Korea in May, as well as in Colombia in April, with the former showing the largest decrease with -16.4%. On the contrary, the index increased in Argentina and in Spain in May, as well as in Mexico in April. On the other hand, the greatest variation in the unemployment rate in May was registered by Colombia, with a monthly decrease of -0.2 pp to reach 10.5%.

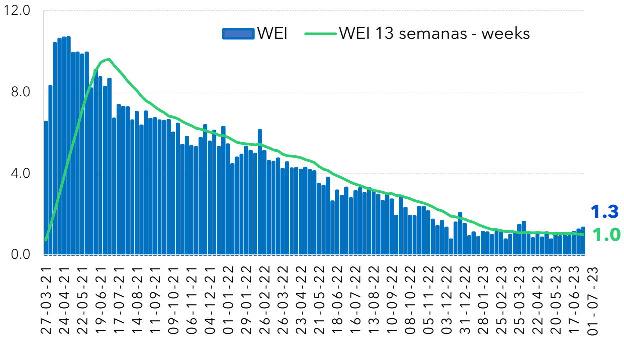
8. The FAO Food Price Index continue its downward trend. The index fell -1.4% compared to May and -23.4% compared to the all-time high of March 2022. The month-over-month decline in June was due to falls in the price indices of sugar (-3.2%), vegetable oils (-2.4%), cereals (-2.1%) and dairy products (-0.8%), while beef index did not have any significant variation. The sugar index experienced the first decrease after fourth consecutive monthly increase, mainly due to the good forecast of the 2023/24 sugarcane harvest in Brazil and the lower global demand for sugar imports; however, concerns remain about the possible effect of the El Niño phenomenon on crops in the 2023/24 cycle. [21]

9. Most of the main commodities prices in the Central American region registered a monthly decrease. The products that showed reductions in June were palm oil (-12.5%), beef (-6.4%), arabica coffee (-5.4%), shrimps (-5.1%), sugar (-3.1%), gold (-2.5%), WTI oil (-1.9%) and bananas (-1.2%). Likewise, palm oil (-45.6%) and WTI oil (-38.7%) registered the most significant price decreases compared to the same month of the previous year, while sugar (14.7%) and bananas (10.7%) the largest year-over-year increases.[22]

[20] *European Central Bank. Press Release Monetary Policy Decisions. June 15, 2023.*
[21] Food and Agriculture Organization of the United Nations. FAO Food Price Index. July 7, 2023.
[22] *The World Bank. Commodity Price Data. Updated July 06, 2023.*

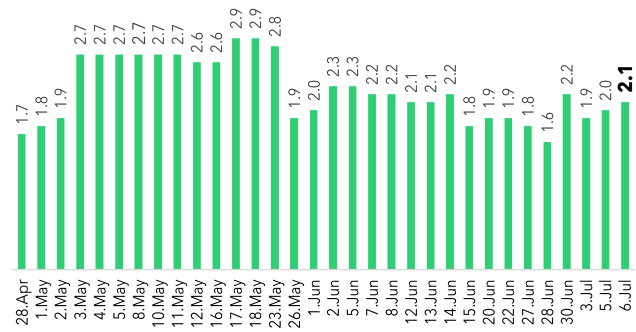
Panel 1 Selected US Macroeconomic Indicators

Graph 1. Weekly economic activity
(year-over-year percent change)



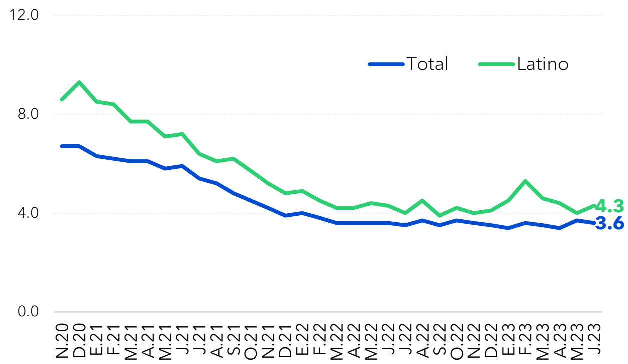
It grew 1.0% average in June (0.9% in May)

Graph 2. Second quarter 2023 real GDP estimate
(seasonally adjusted annualized rate, percent)



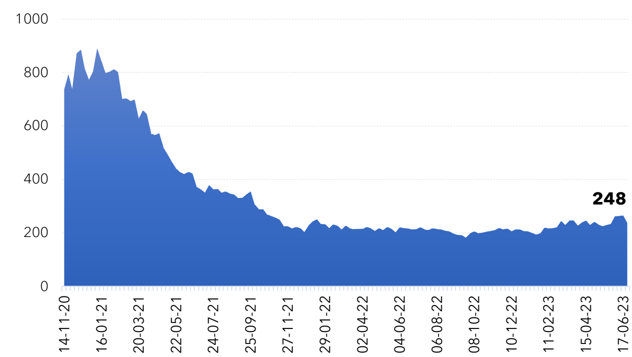
It grew 2.0% average in June (2.5% in May)

Graph 3. Unemployment rate (percent)



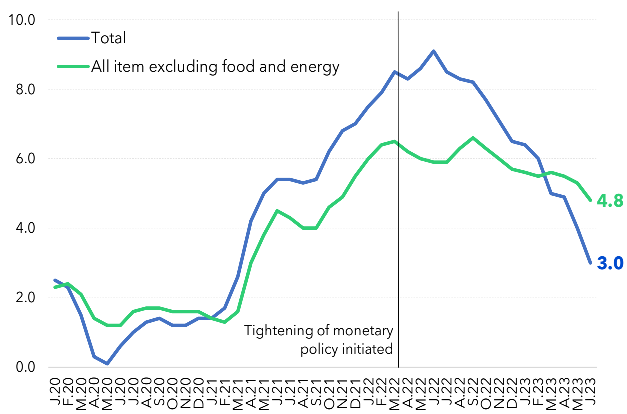
Total unemployment fell, Latino unemployment increased

Graph 4. Initial subsidy claims (thousands)



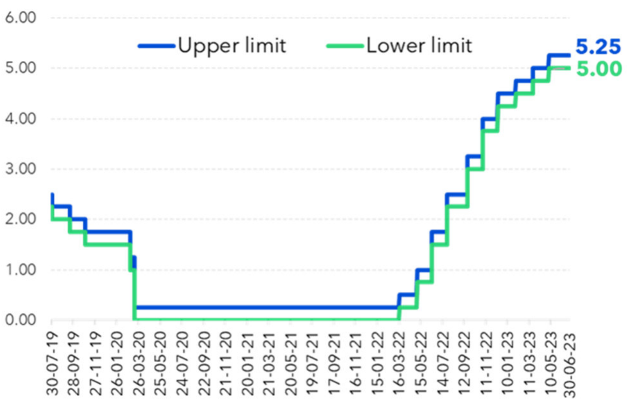
Applications increased in the last month

Graph 5. Inflation (year-over-year percent change)



Lowest total inflation since March 2021

Graph 6. Federal funds interest (percent)

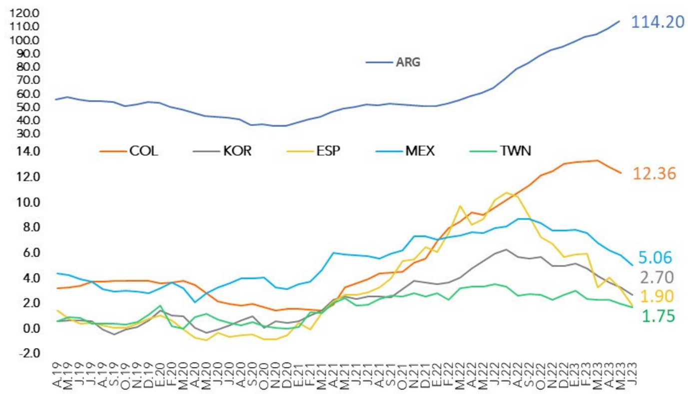


FED kept the rate unchanged in June 2023

Source: Office of the Chief Economist with information from the Federal Reserve Bank of New York. Federal Reserve Bank of Atlanta. Federal Reserve Bank of St.Louis. Bureau of Labor Statistics. Board of Governors of the Federal Reserve System. United States Department of Labor.

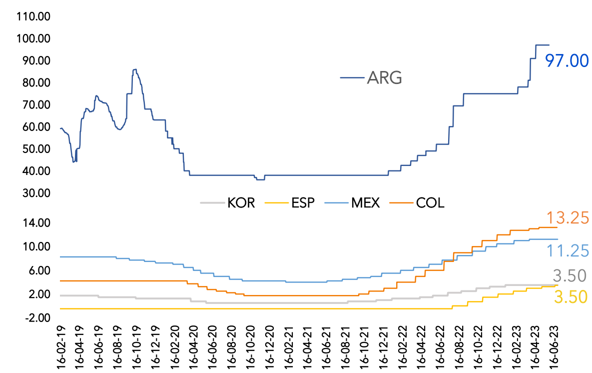
Panel 2 Selected macroeconomic indicators of non-regional CABEI member countries and commodity prices

Graph 7. Inflation (year-on-year change, percent)



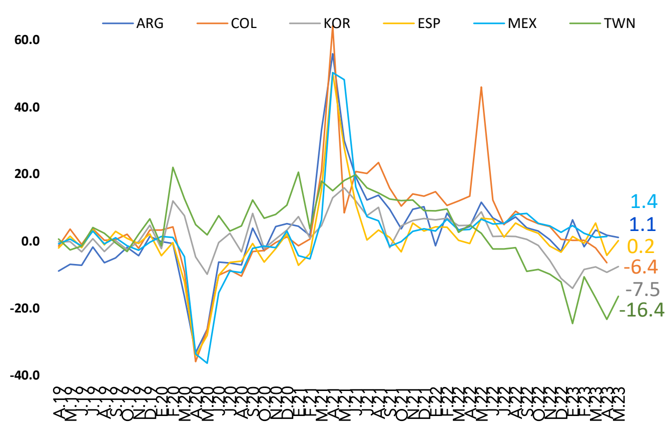
Inflationary pressures are reduced in most countries

Graph 8. Monetary Policy Rate (percent)



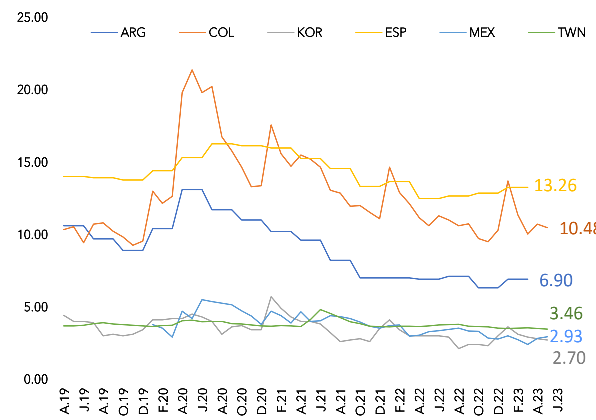
Restrictive monetary policy efforts continue

Graph 9. Industrial production index (year- over-year percent change)



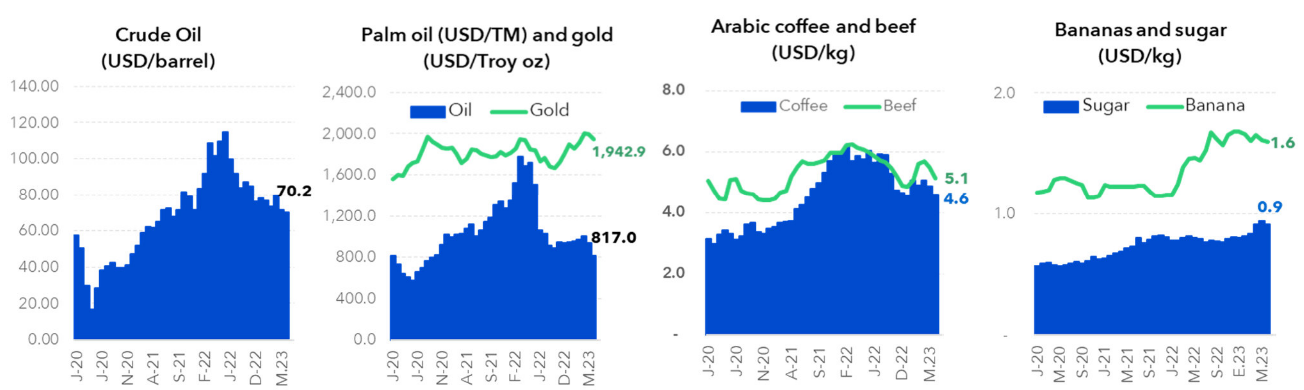
Industrial production with mixed performance

Graph 10. Unemployment rate (percent)



Unemployment with slight variations

Graph 11. International prices of main commodities in the Central American region as of Jun 2023



MoM price reduction in most commodities

Source: Office of the Chief Economist with information from the statistics institutes, central banks of the extra-regional partner countries and the World Bank.

Box 1. Summary of the recent evolution of the external sector in LAC and Central America

The commercial impact of the reversal in the international prices of the main commodities is heterogeneous among the LAC subregions. In the first quarter of 2023, exports grew 2.9% year-on-year, with around half of the increase driven by prices. However, by 2023 it is estimated that the price effect represents an average loss of -0.2% of GDP for LAC, with differentiated impacts between regions: for the economies of Central America, the Caribbean and Mexico, the fall in the prices of food, minerals and especially fossil fuels generates a positive net trade balance; on the other hand, for the MERCOSUR and Andean countries it is driving higher trade deficits (see Chart 1).

The world growth slowdown is reflected in the weakening of external demand in the countries of the region. Although the global context is generally affecting the entire region, it will be more relevant for Mexico and the countries of Central America and the Caribbean, which have strong ties to the North American market. For the economies of South America, which have an export profile more linked to East Asia, a slightly more favorable external scenario is expected (see Chart 2).

Chart 1. Effect of commodity price changes on the trade balance (% GDP)

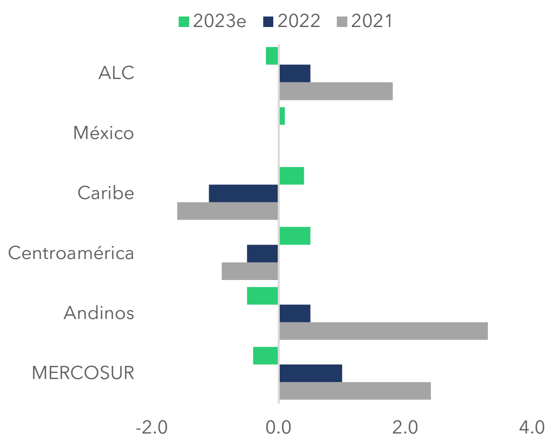
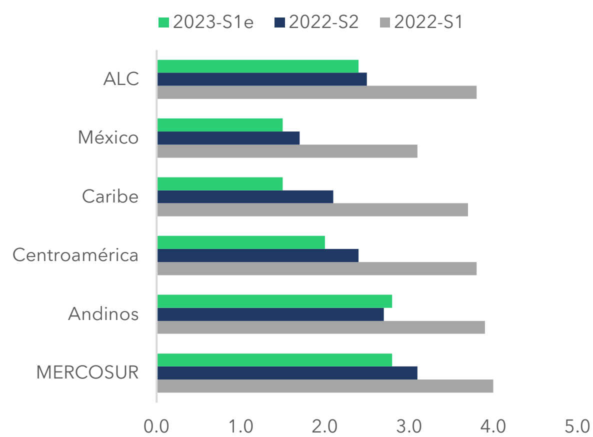


Chart 2. Export demand index (year-on-year growth of trading partners)



Note: S = semester; e = estimate. **Source:** Office of the Chief Economist with information from IDB INTAL

Proposals for environmental regulations in the EU present new challenges for LAC exports. The recent proposal to ban access to the common European market for products that come from deforested lands* would have a significant potential impact on the region's exports. The share of LAC exports to the EU of the total included in that regulation is equivalent to 2.0% of total exports to the world. At the Central American level, the figures of the exposure indicator are highlighted for Honduras (21.0% of total exports), Guatemala (5.0%) and Nicaragua (3.0%), especially due to palm oil and coffee exports.

** The standard was adopted by the European Parliament on April 19, 2023 and must be ratified by the European Council. It includes a list of raw materials closely linked to the expansion of the agricultural frontier worldwide, such as beef, wood, palm oil, soybeans, coffee, rubber and cocoa, and some other derived products.*

Source: Office of the Chief Economist with information from *Connexa No.18. (Junio 2023). Síntesis trimestral de información y datos sobre integración y comercio. IDB-INTAL*

II.The Central American region grows at a slower rate

10. Stable economic activity. After the economic recovery, the region has grown steadily around 4.0% from the last quarter of 2022 to February 2023. Regional growth reached 4.0% in February, exceeding that of the same month of 2019 (2.8%). Production was driven by an increase in more than half of the activities, with transportation, commerce, and accommodation and food service activities standing out.

11. The labor market continues performing robustly. The level of formal employment increased in all countries for which information is available.[23] The interannual variation was 4.9% in the Dominican Republic and 0.4% in Nicaragua in May; 5.4% in Guatemala in April and 2.6% in El Salvador in March. Guatemala and the Dominican Republic grew the most compared to their level in February 2020 with 18.0% and 12.3%, respectively.

12. Inflation registers a downward trend in all countries. The combined effects of more restrictive monetary policies, the slowdown in international prices and the decrease in other inflationary pressures have caused inflation to begin to moderate in all countries.

13. The region continues implementing a restrictive monetary policy. The Banco de Guatemala increased its policy rate by 25 basis points to 5.0% in April. The Central Bank of Nicaragua has maintained its rate at 7.00% since December 2022, while for Honduras it has remained constant since November 2020 at 3.0%. Meanwhile, the Central Bank of Costa Rica lowered its rate in June by 50 basis points to 7.0%, and the Central Bank of the Dominican Republic also made the decision to lower the rate to 7.75% in July, 25 basis points less than its previous level. Despite the mixed dynamics of the behavior in rates, the region still maintains rigid financial conditions.

14. The accumulated financial balance of the central government presented mixed results. Most countries recorded positive variations in public revenue. The Dominican Republic accumulated growth of 11.0%, Guatemala 9.3%, and Costa Rica 4.6% in April, while revenue contractions were observed for El Salvador in April (-3.7%) and Panama in March (-15.6 %). However, spending grew in Guatemala (20.3%) and the Dominican Republic (20.2%) in April, in Panama in March (21.5%), as well as in Costa Rica (2.5%) and Nicaragua (9.8%). Thus, the fiscal position deteriorated in relation to the previous month and year for Guatemala, the Dominican Republic and Panamá, and improved in El Salvador and Honduras.

15. Foreign trade slowed down compared to the previous year. The interannual variation of cumulative growth in exports ranged from -7.4% in El Salvador to 51.2% in Panama.[24] Likewise, imports' variation ranged from -9.1% in El Salvador to 27.3% in the Dominican Republic. In recent months there has been a change in the trend, where imports have slowed down faster than exports, which has led to an improvement in the trade deficit of most countries in the region.

16. Cumulative family remittances grew at a slower rate. All the countries exhibited positive interannual variations in the accumulated balances, but except for Nicaragua, the magnitude of growth has tended to decrease. Revenues for this concept in April amounted to USD 5,984.8

[23] Measured by the number of contributors to social security.
[24]To follow up the situation of exports and imports, the variations of the nominal values are estimated, since the values at constant prices are only calculated to compile the Gross Domestic Product (GDP) in the national accounts.

million in Guatemala, USD 3,292.4 million in the Dominican Republic, USD 2,811.8 million in Honduras, USD 2,378.3 million in El Salvador and USD 1,394.6 million in Nicaragua.

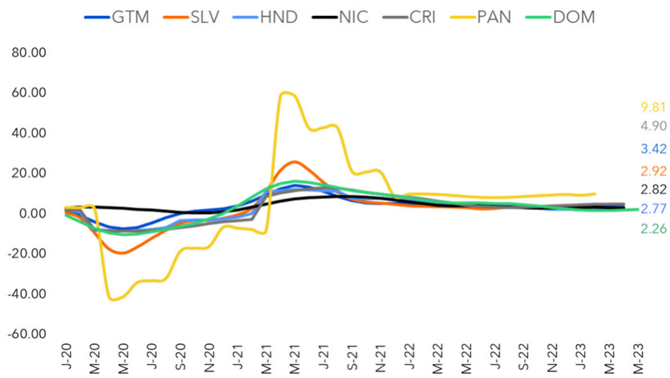
17. The exchange rate registered a higher level in most of the countries. The year-over-year variation showed an appreciation for Costa Rica (-19.6%) and the Dominican Republic (-1.2%) in May, while the rest of the currencies exhibited a slight depreciation. The month-on-month variation registered a slight appreciation in the Dominican Republic (-0.3%) and a slight depreciation in Costa Rica (0.5%) and Nicaragua (0.1%). The interest rate differential resulting from increases in the US monetary policy rate may explain part of the dynamics of this variable. The effect in Costa Rica and the Dominican Republic has been less influenced by the important increases in their monetary policy rates. Additionally, the flow of remittances can be a factor that decreases the variability in the exchange rate in countries like Guatemala and Honduras.

18. Net international reserves (NIR) contracted. The slowdown in remittances, and the decrease capital inflows due to the interest rate differential with the US, may be influencing the year-on-year contraction of NIRs observed in most countries, except for the Dominican Republic in May (13.6%), and in Costa Rica (59.9%) and Nicaragua (15.0%) in April. Likewise, the increase in the FED rate increases the probability of capital outflows or a reduction in inflows to the region, which could be affecting their accumulation. Most of the countries have enough reserves to cover at least three months of their imports, in line with the minimum threshold defined by the IMF[25].

[25] Panama and El Salvador are excepted from this limit with 2.9 and 2.1 months, respectively.

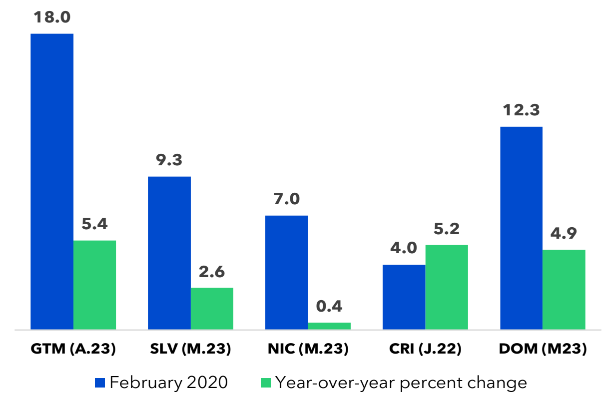
Panel 3 Central America: Selected macroeconomic indicators

Graph 12. IMAE (year-over-year percent change)



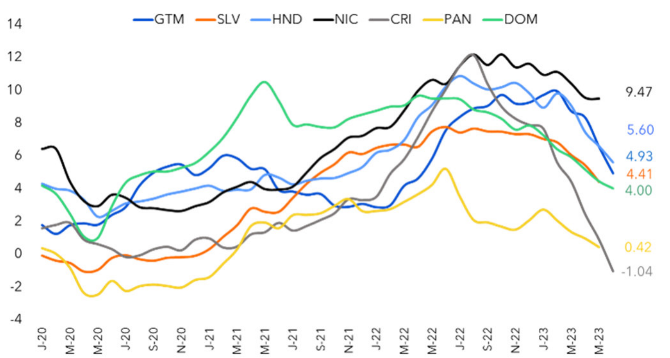
Activity converges to pre-pandemic rates

Graph 13. Formal employment (variation, percentage)



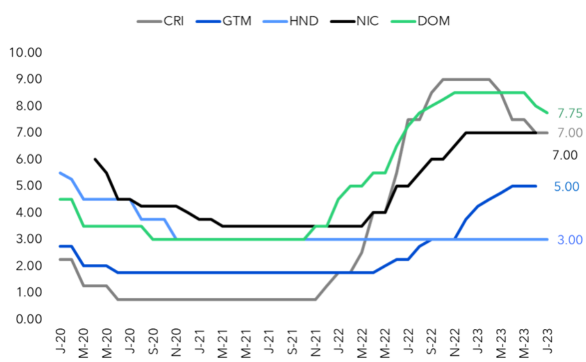
Economic dynamics have led to job growth

Graph 14. Inflation (year-over-year percent change)



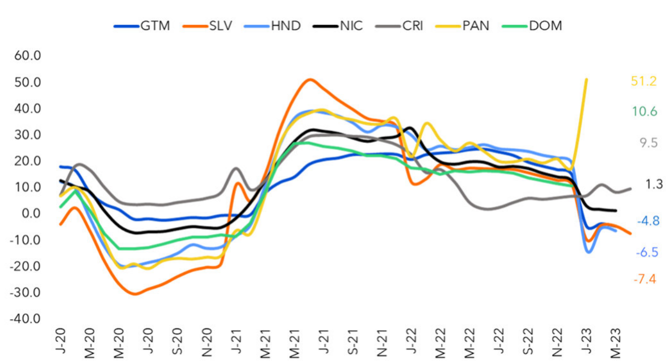
External pressures continue to affect inflation, but it starts to slow down

Graph 15. Monetary Policy Rate (percent)



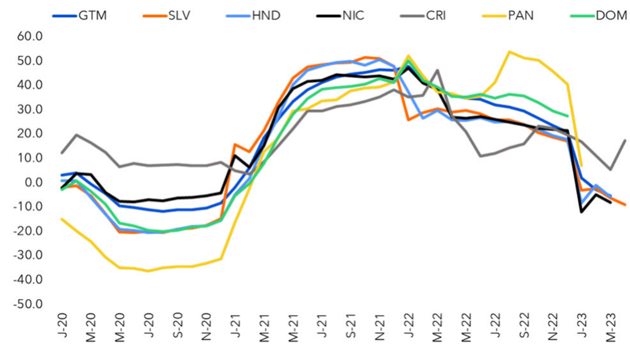
Restrictive policy to counter inflation

Graph 16. Accumulated exports
(year-over-year percent change)



Exports show signs of slowdown and in some cases drop compared to the previous year

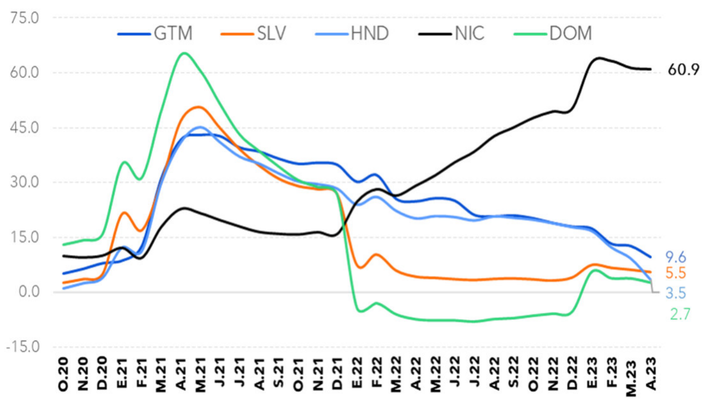
Graph 17. Accumulated imports
(year-over-year percent change)



Imports show a downward trend and in some cases drop compared to the previous year

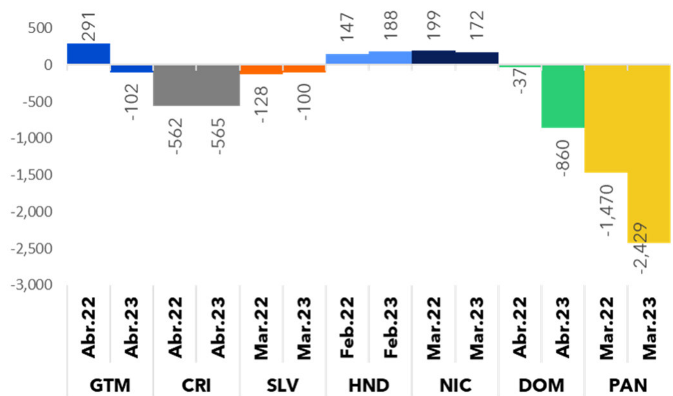
Source:Office of the Chief Economist with information from the SECMCA as of July 10.

Graph 18. Accumulated remittances received
(year-over-year percent change)



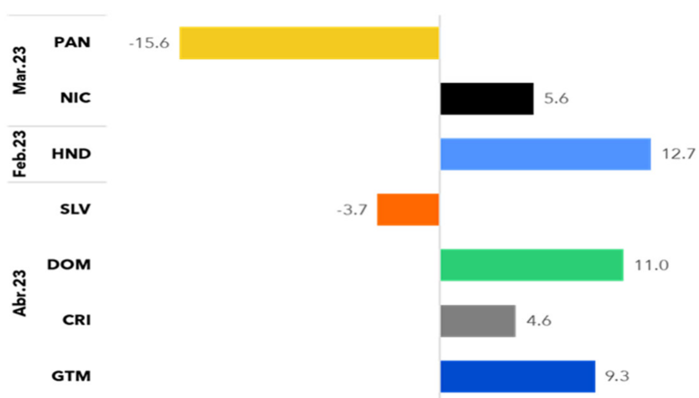
Accumulated family remittances continue growing at more moderate rates

Graph 19. Central government: accumulated financial balance (USD millions)

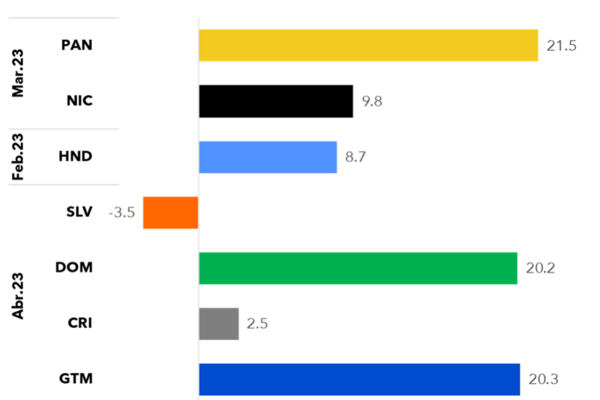


Mixed performance on the fiscal balance

Graph 20. Central government: total accumulated revenue *(year-over-year percent change)*

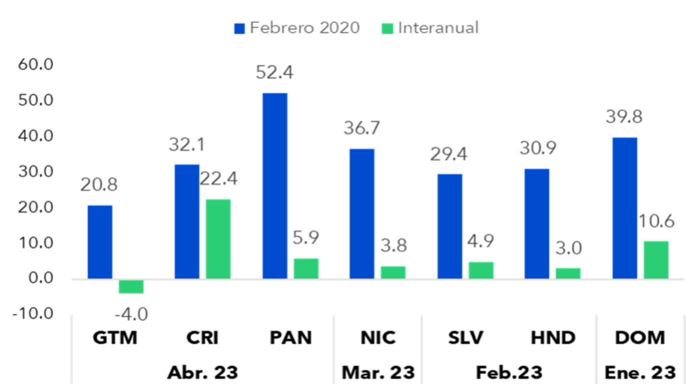


Graph 21. Central government: total accumulated expenditures (*year-over-year percent change*)



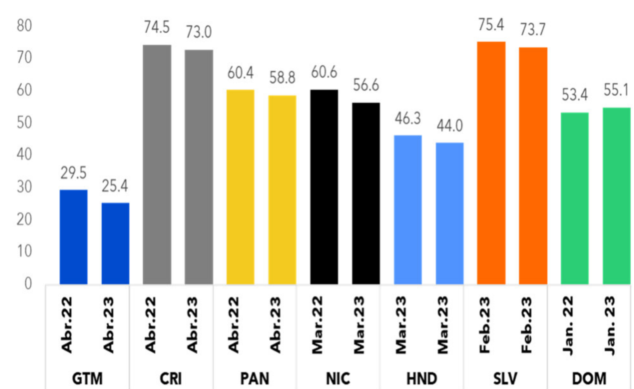
Expenditure growth outpaces revenue growth in most countries

Graph 22. Central government: total debt (*year-over-year percent change*)



Public debt growth continues to moderate

Graph 23. Total public debt
(as a percentage of GDP)



Decreased due to lower deficits and GDP growth

Source: Office of the Chief Economist with information from the SECMCA as of July 10.

Annex 1. Long-term sovereign debt rating in foreign currency

Moody's Countries	Rating as of March 2020		Previous rating		Rating as of June 30, 2023	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Belize	Caa2	Stable	Caa3	Stable	Caa2	Stable
Guatemala	Ba1	Stable	Ba1	Stable	Ba1	Stable
El Salvador	B3	Stable	Caa3	Negative	Caa3	Stable
Honduras	B1	Stable	---	---	B1	Stable
Nicaragua	B3	Stable	---	---	B3	Stable
Costa Rica	B2	Stable	B2	Negative	B2	Stable
Panama	Baa1	Stable	Baa2	Stable	Baa2	Negative
Dominican Republic	Ba3	Stable	---	---	Ba3	Stable
Colombia	Baa2	Stable	Baa2	Negative	Baa2	Stable
Republic of China (Taiwan)	Aa3	Stable	Aa3	Positive	Aa3	Stable
Argentina	Caa2	En revisión	Ca	Negative	Ca	Stable
Mexico	A3	Negative	Baa1	Negative	Baa2	Stable

Standard & Poor's Countries	Rating as of March 2020		Previous rating		Rating as of June 30, 2023	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Belize	B-	Stable	SD	n.a.	B-	Stable
Guatemala	BB-	Stable	BB-	Positive	BB	Stable
El Salvador	B-	Stable	CCC+	Negative	CCC+	Stable
Honduras	BB-	Stable	---	---	BB-	Negative
Nicaragua	B-	Stable	B-	Stable	B	Stable
Costa Rica	B+	Negative	B	Stable	B+	Stable
Panama	BBB+	Stable	BBB	Stable	BBB	Negative
Dominican Republic	BB-	Stable	BB-	Stable	BB	Stable
Colombia	BBB-	Stable	BBB-	Negative	BB+	Stable
Republic of China (Taiwan)	AA-	Stable	AAu	Positive	AA+u	Stable
Argentina	CCC-	Negative	CCC+	Negative	CCC-	Negative
Mexico	BBB+	Negative	BBB	Negative	BBB	Stable

Fitch Ratings Countries	Rating as of March 2020		Previous rating		Rating as of June 30, 2023	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Belize	---	---	---	---	---	---
Guatemala	BB	Negative	BB-	Positive	BB	Stable
El Salvador	B-	Stable	CC	---	CCC+	---
Honduras	---	---	---	---	---	---
Nicaragua	B-	Stable	B-	Stable	B-	Positive
Costa Rica	B+	Negative	B	Stable	BB-	Stable
Panama	BBB	Negative	BBB-	Negative	BBB-	Stable
Dominican Republic	BB-	Stable	BB-	Stable	BB-	Stable
Colombia	BBB	Negative	BB+	Stable	BB+	Stable
Republic of China (Taiwan)	AA-	Stable	AA	Stable	AAu	Stable
Argentina	CC	n.a.	CCC-	n.a.	C	n.a.
Mexico	BBB	Stable	BBB	Stable	BBB-	Stable

Source: Office of the Chief Economist with information from Bloomberg.

CABEI

Central American Bank for Economic Integration