

# Fifth Annual Regional Conference on Central America, Panama, and the Dominican Republic

Central American Monetary Council, Ministers of Finance and International Monetary Fund  
Hosted by the Central Bank of the Dominican Republic,  
Punta Cana, Dominican Republic  
June 29–30, 2006

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# The Global Context for the Central American Region

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Punta Cana

June 29–30, 2006

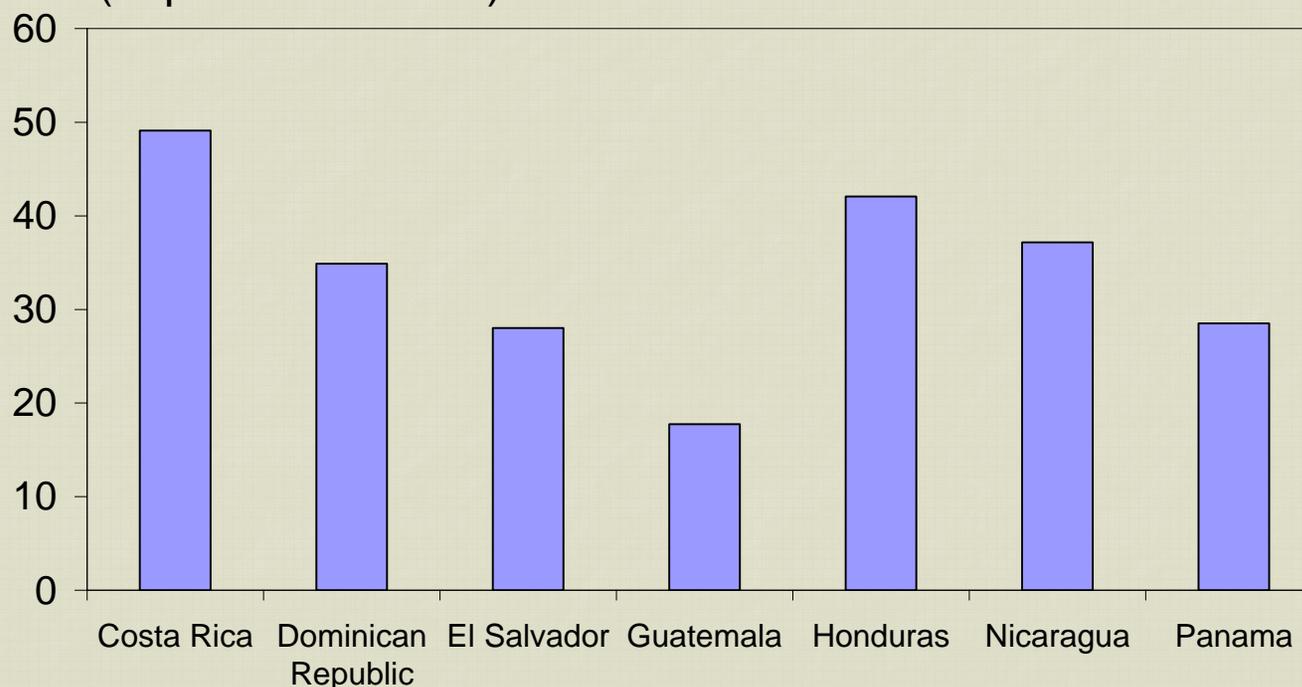
# Contents

- **Global Context**
- **World Outlook**
- **Global Risks**
- **Outlook for the United States**

# The region is sensitive to fluctuations in global demand...

## Exports of Goods and Services, 2005

(In percent of GDP)

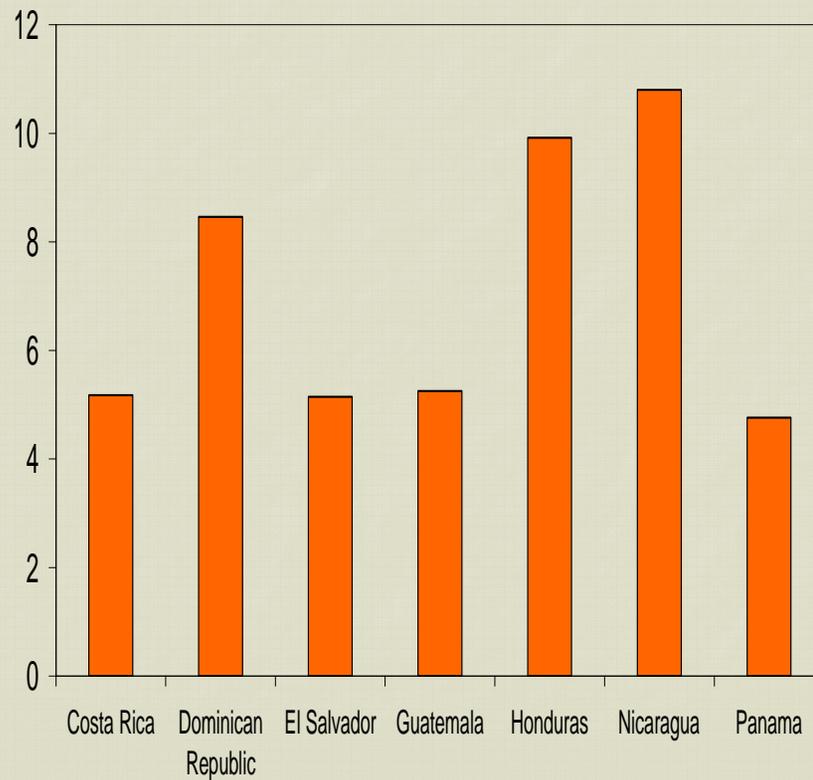


Sources: National authorities; and Fund staff calculations.

# ... and swings in the prices of oil and other commodities in world markets.

### Oil Imports, 2005

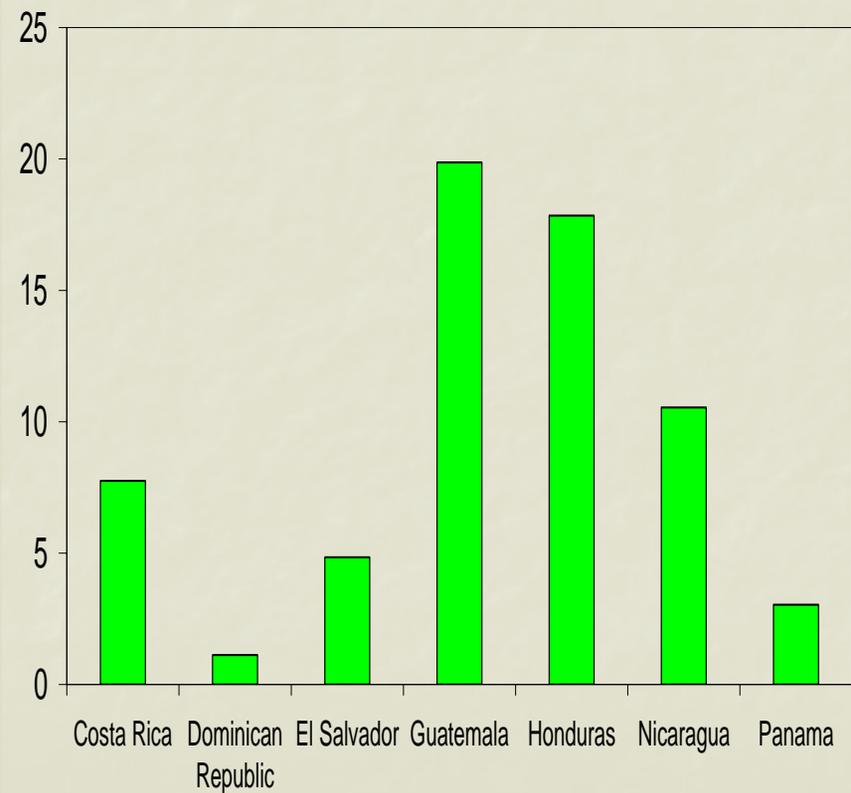
(In percent of GDP)



Sources: National authorities; and Fund staff calculations.

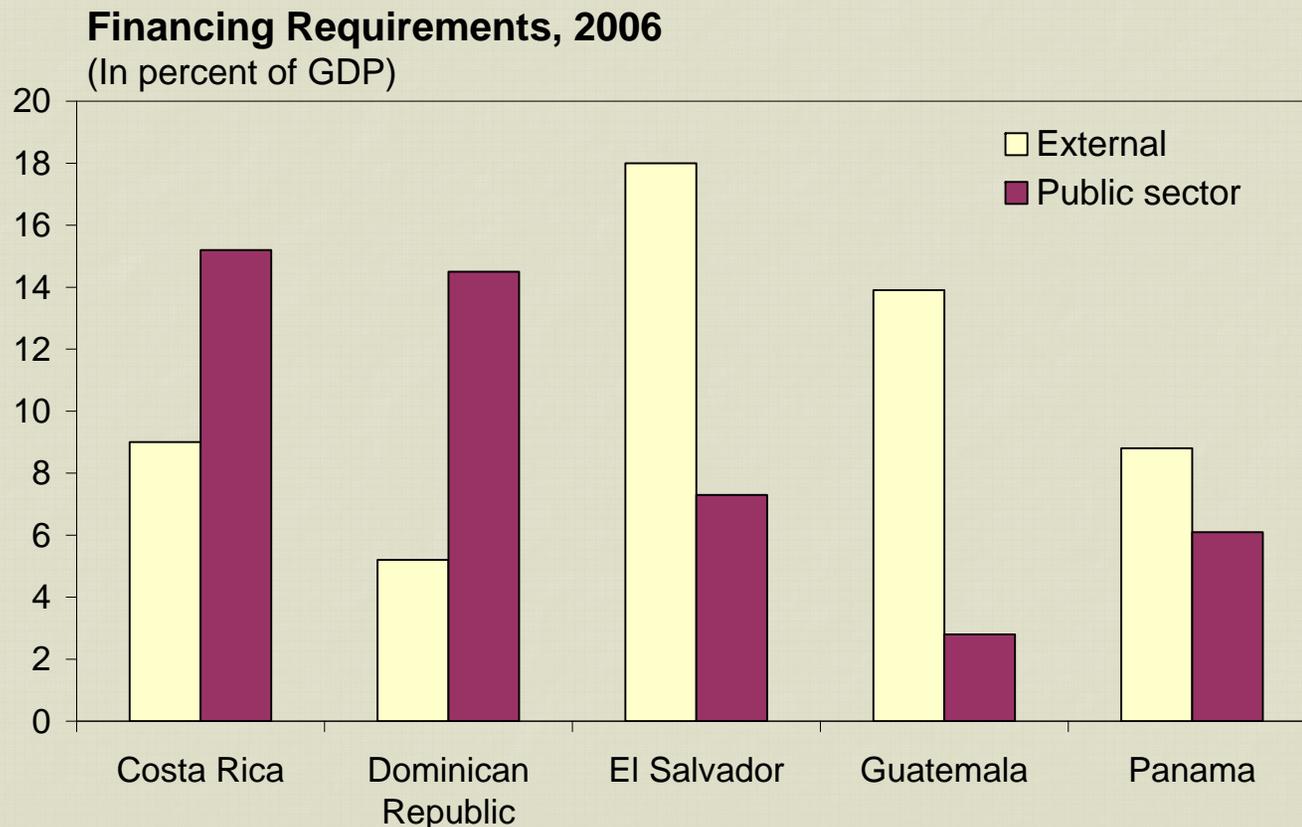
### Principal Agriculture Exports, 2005

(In percent of total exports of goods and services)



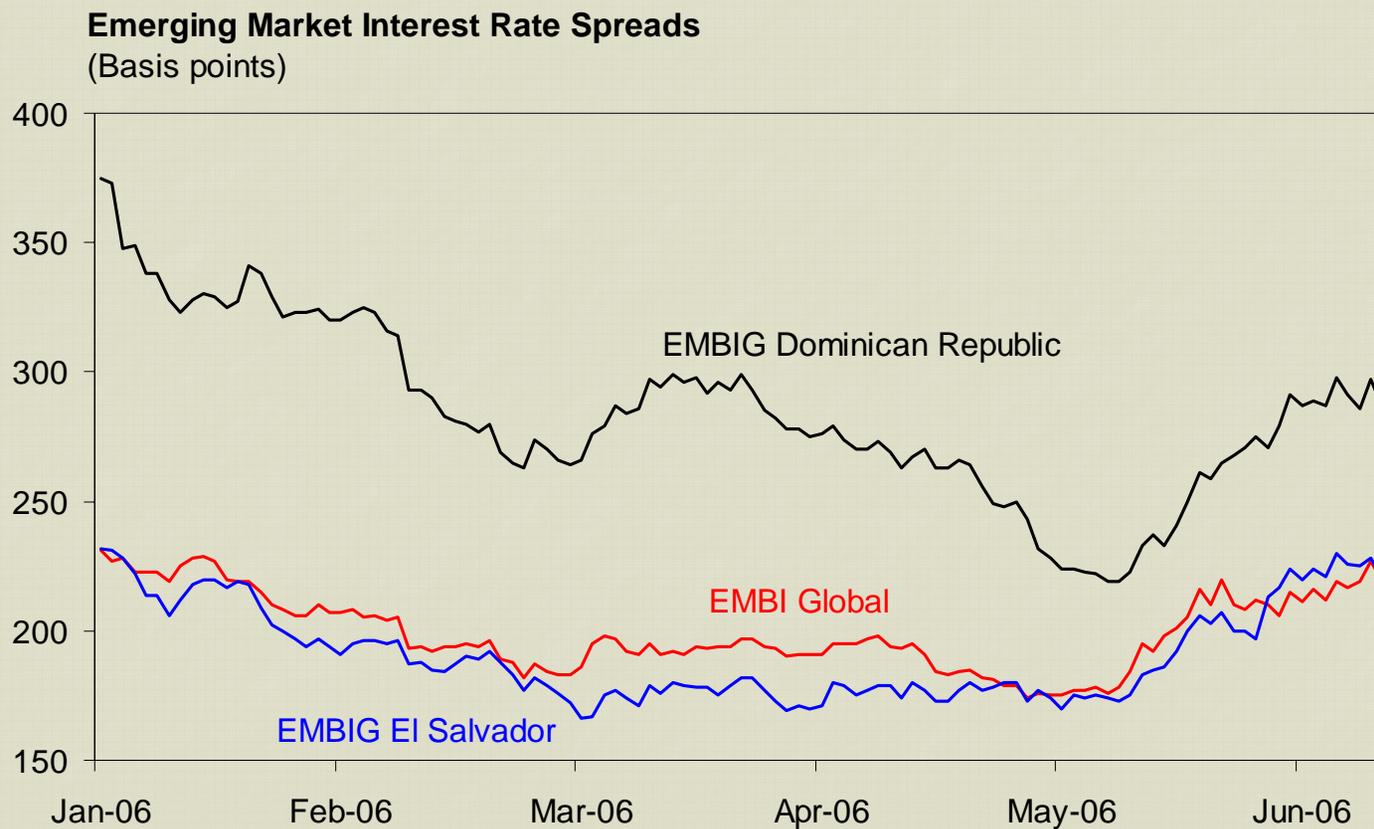
Sources: National authorities; and Fund staff calculations.

# The region needs access to foreign private capital, given large financing requirements...



Sources: National authorities; and Funds staff calculations.

... and face lending rates influenced by global financial conditions.

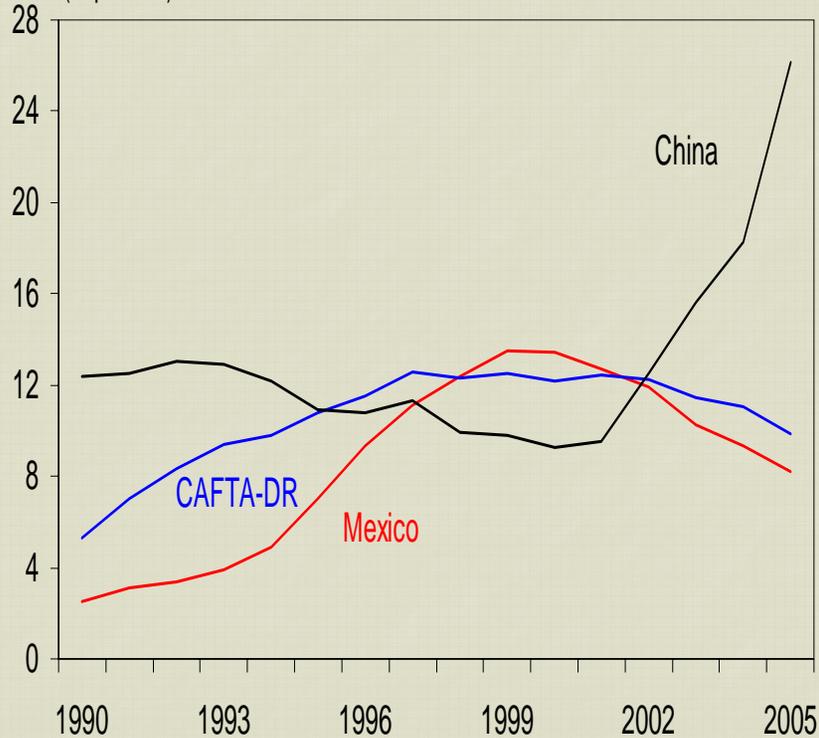


Source: JP Morgan

# China is a competitor for the region and a growing destination for its exports.

### Share in U.S. Textile Imports

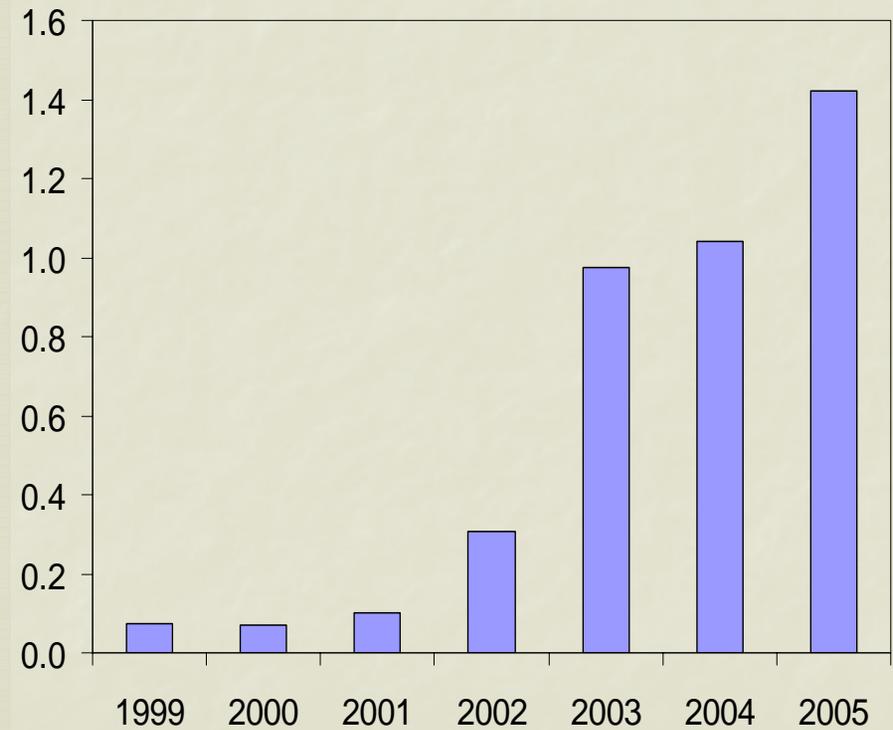
(In percent)



Source: US Department of Commerce, Office of Textiles and Apparel.

### Imports of China from Central America

(In billions of U.S.\$)

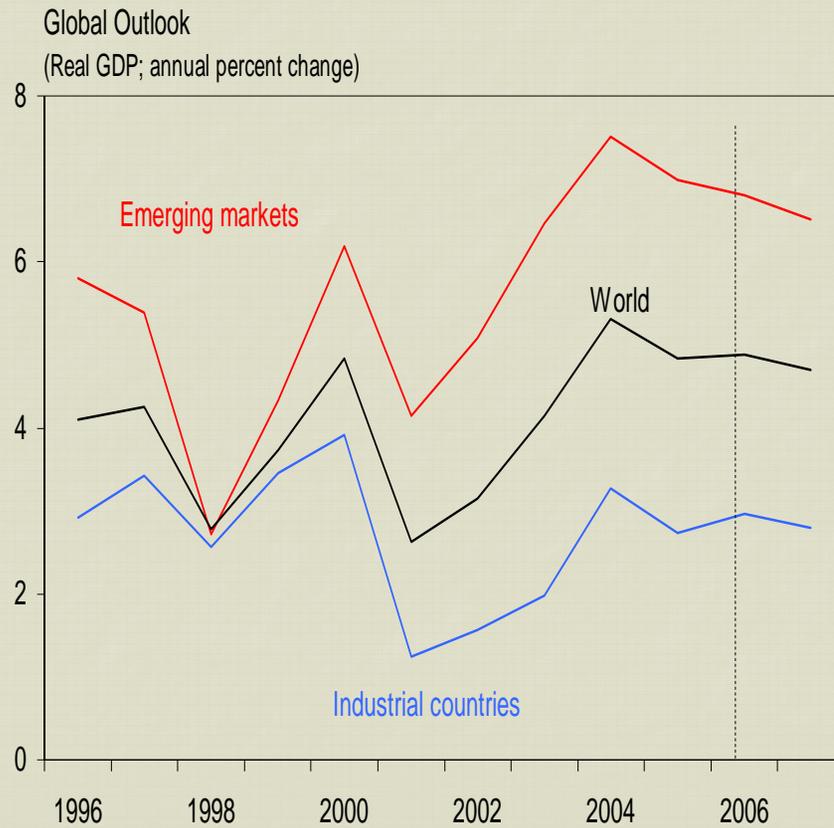


Source: IMF, Direction of Trade Statistics.

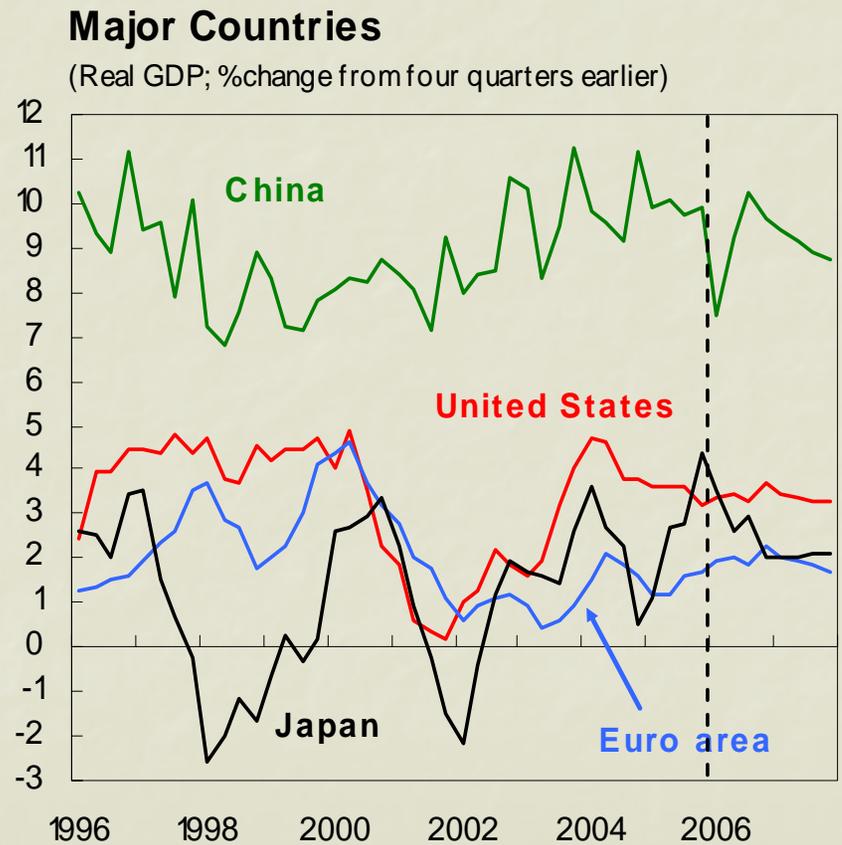
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# The global outlook is favorable, as the US and China remain key engines of growth.

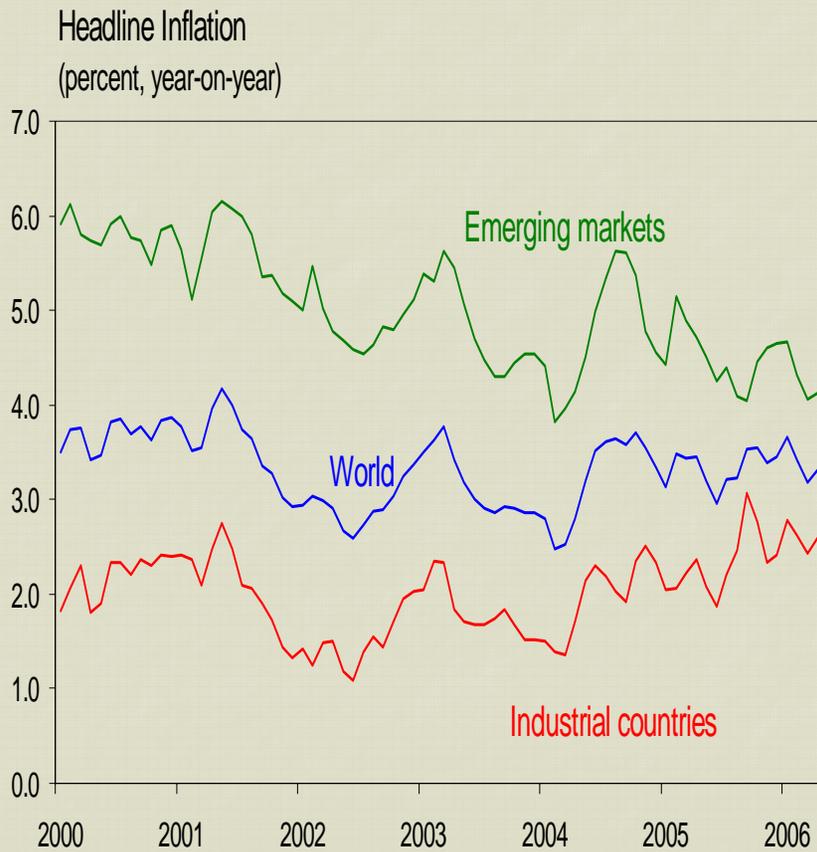


Source: IMF, World Economic Outlook.

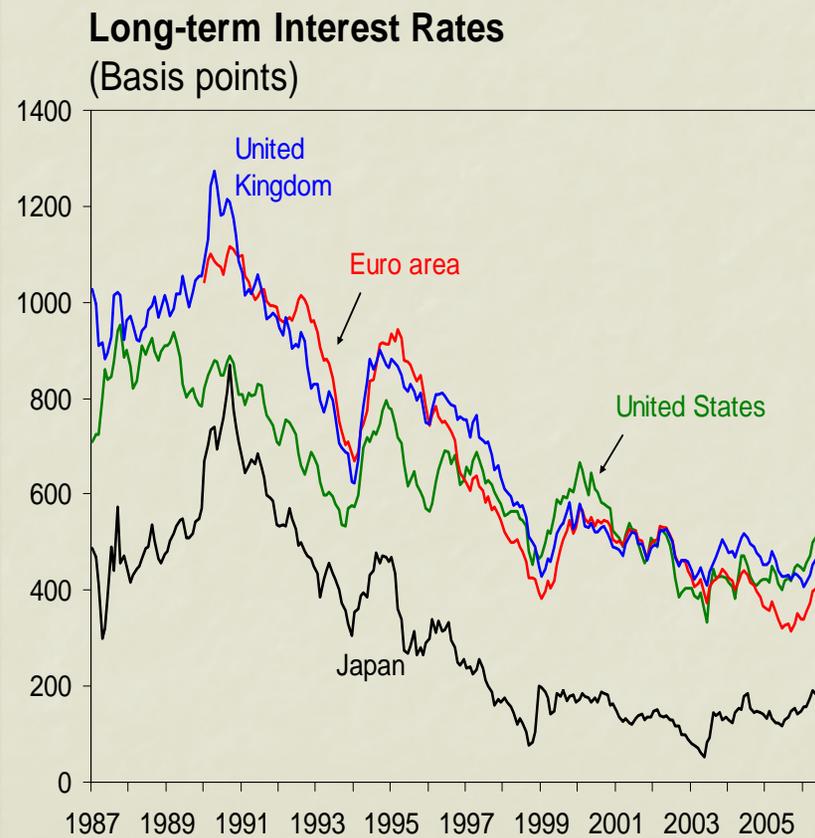


Source: WEO.

# Growth is anchored by contained inflation and low long-term interest rates.



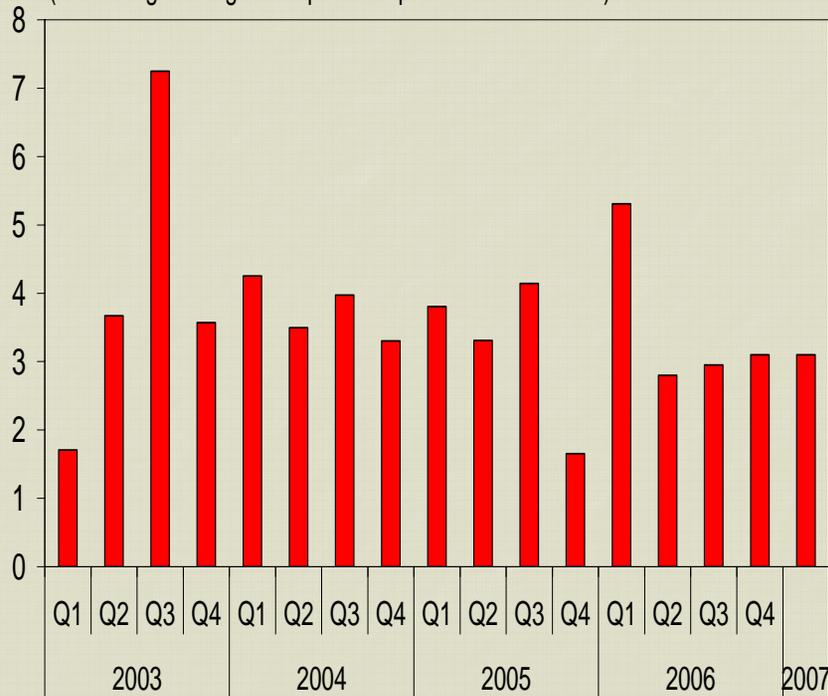
Source: IMF, Global Data Source.



Source: Haver Analytics.

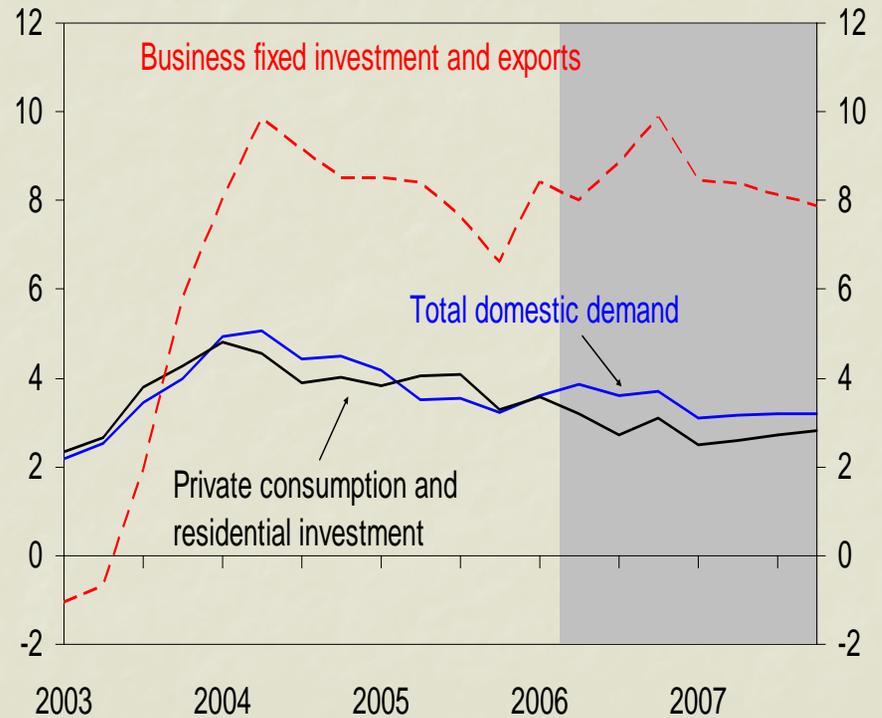
# U.S. growth is easing to potential, with slower consumption but faster investment.

Real GDP Growth  
(Percentage change from previous period at annual rate)



Source: Haver Analytics; and Fund staff projections.

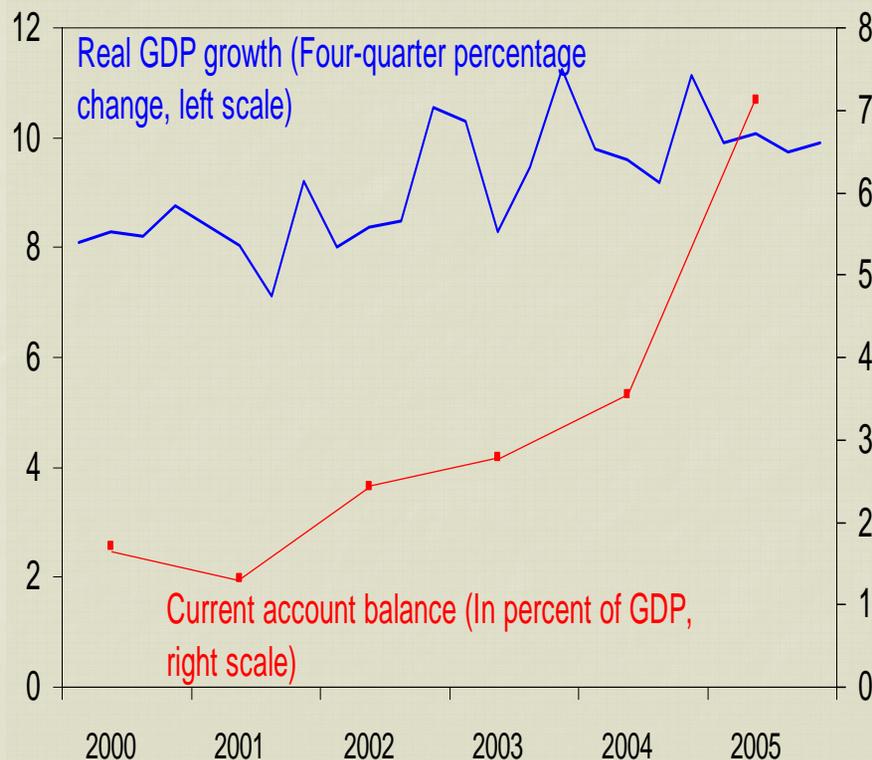
Composition of Growth  
(Year on year percent change)



Source: Haver Analytics; and Fund staff estimates.

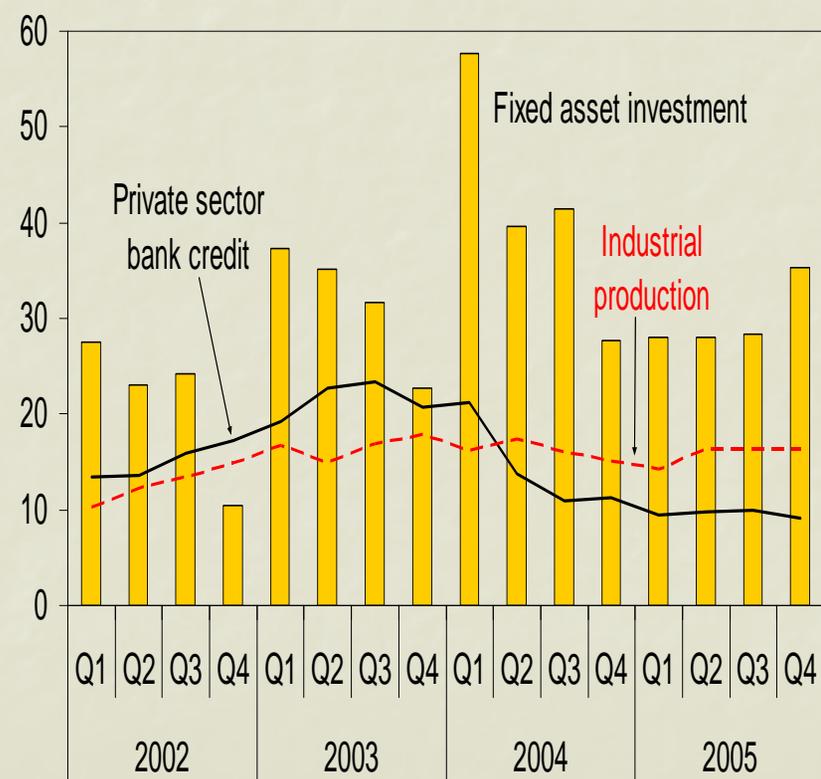
# China is growing briskly, spurred by investment and exports.

Growth and Current Account



Source: IMF, World Economic Outlook.

Investment and Industrial Production  
(Four-quarter percentage change)

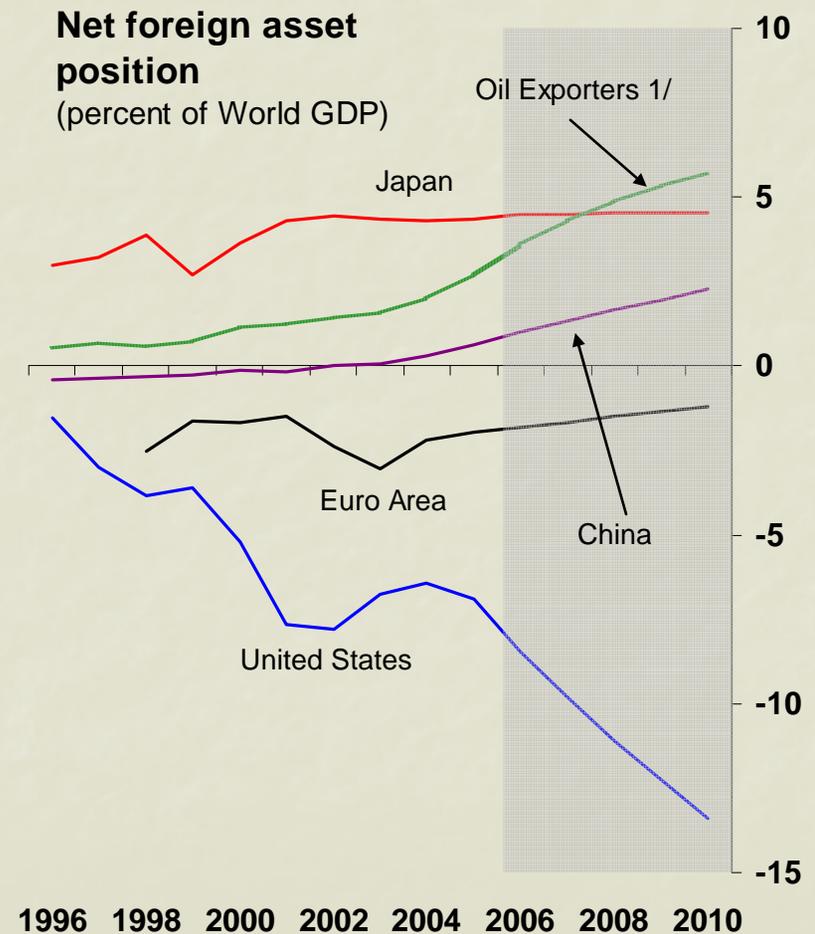
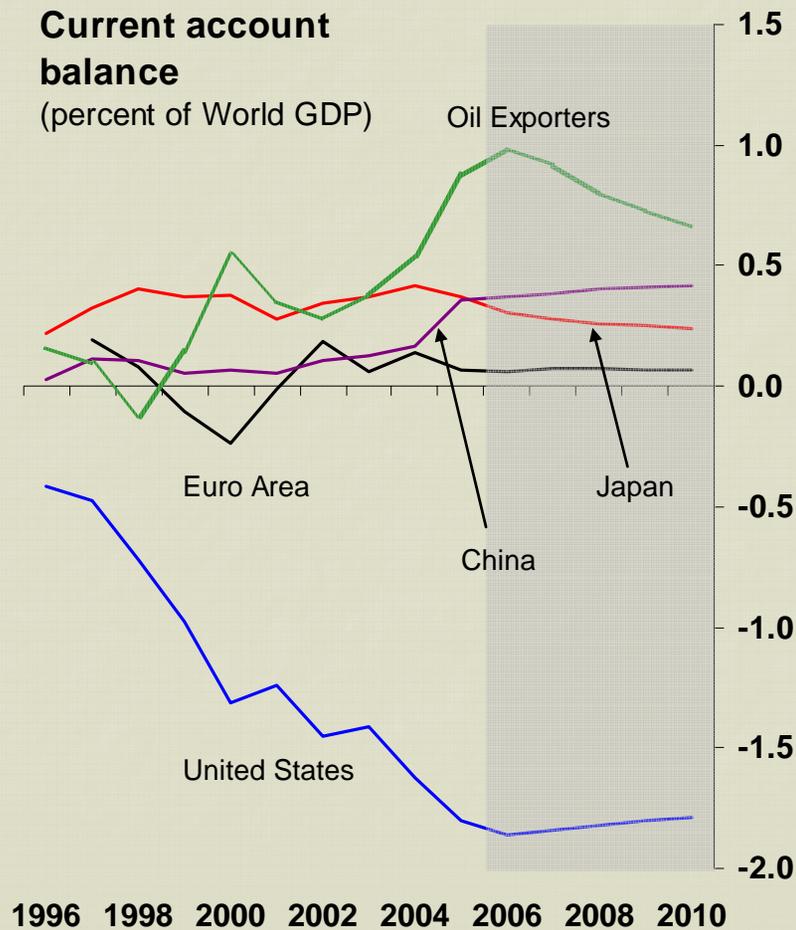


Sources: Haver Analytics; and IMF, World Economic Outlook.

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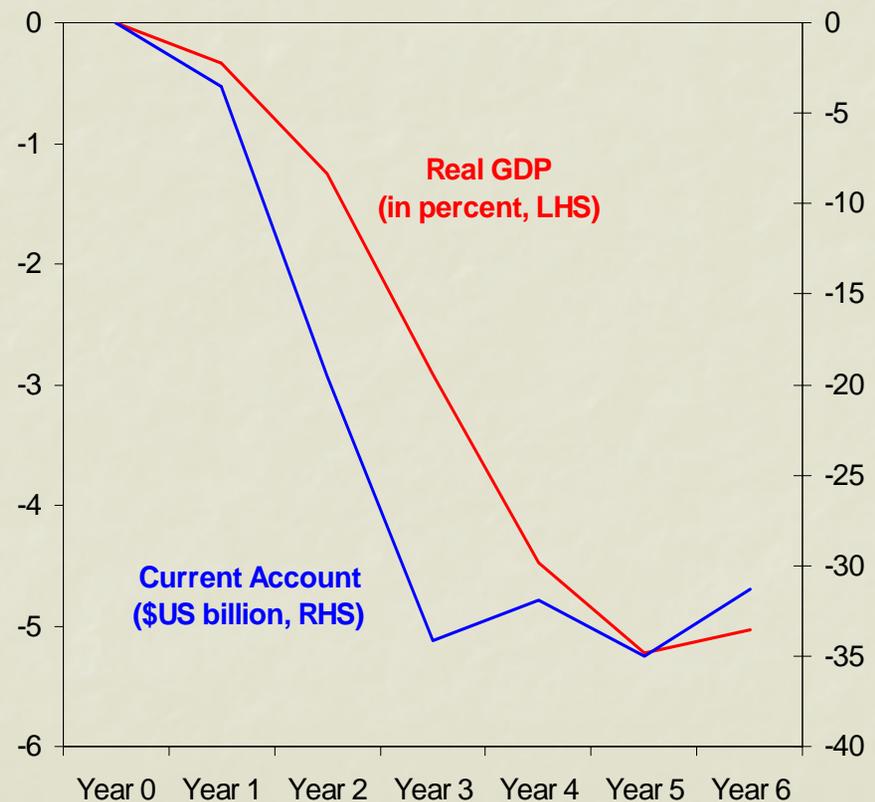
# Risks are to the downside. Global imbalances continued to widen ...



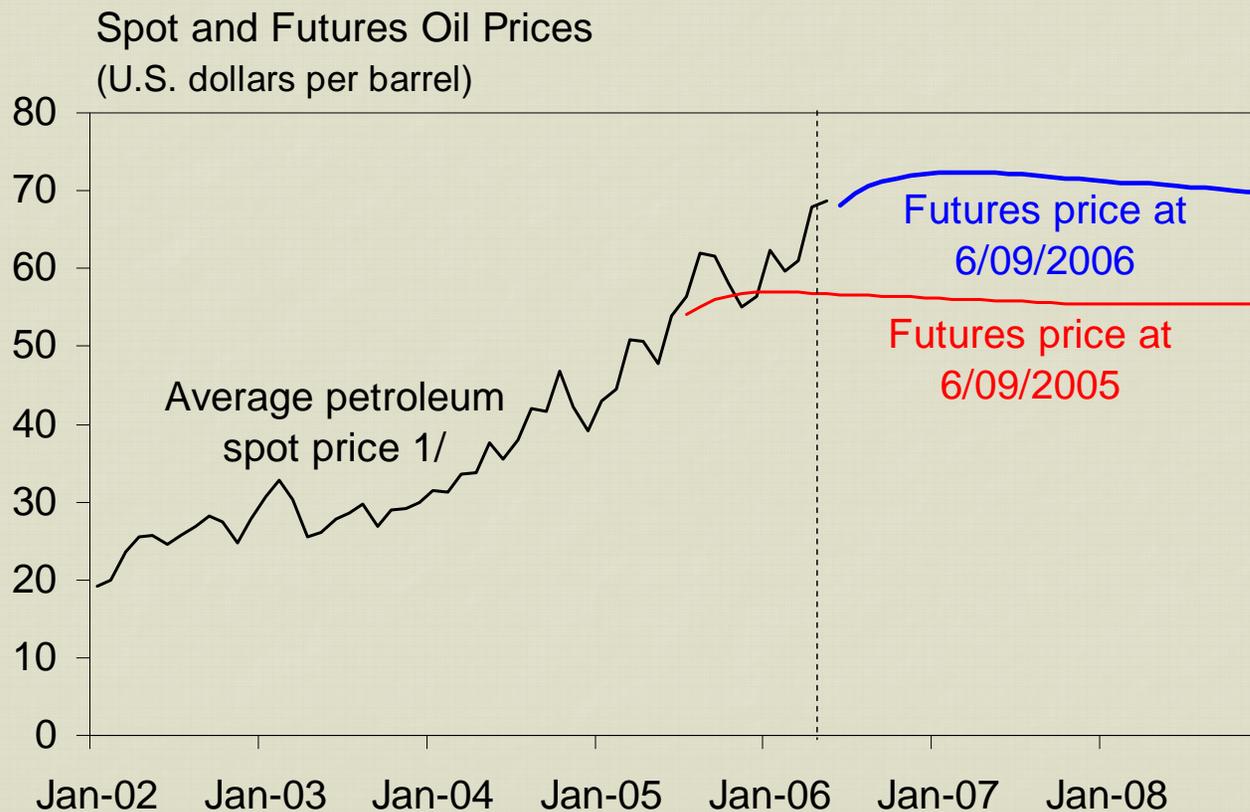
...making disorderly adjustment a key risk for the medium term.

- Sudden decline in demand for U.S. assets
- Sharp contraction in U.S. economic activity
- Increasing interest rate spreads for emerging markets
- Temporary rise in protectionist pressures

Impact of combined shock on LA region



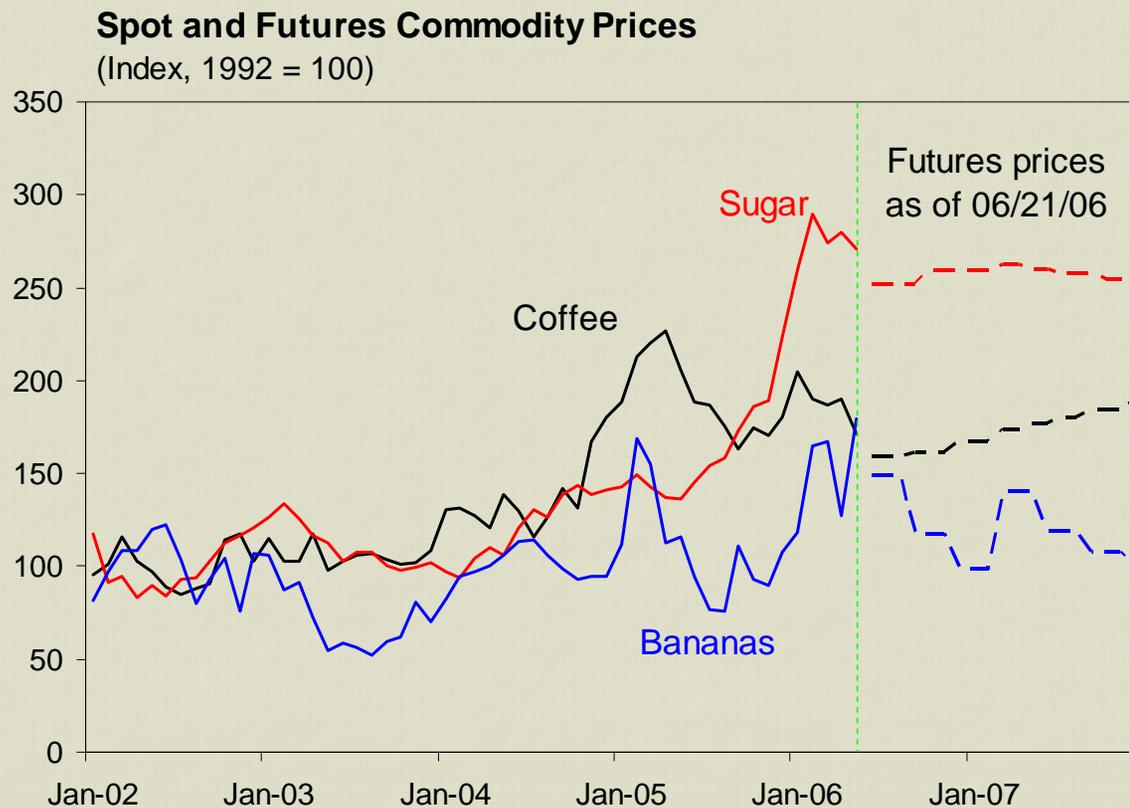
# Further turbulence in oil markets is another important risk ...



Source: Bloomberg Financial Markets.

1/ Average petroleum spot price of West Texas Intermediate, U.K. Brent and Dubai Fateh Crude.

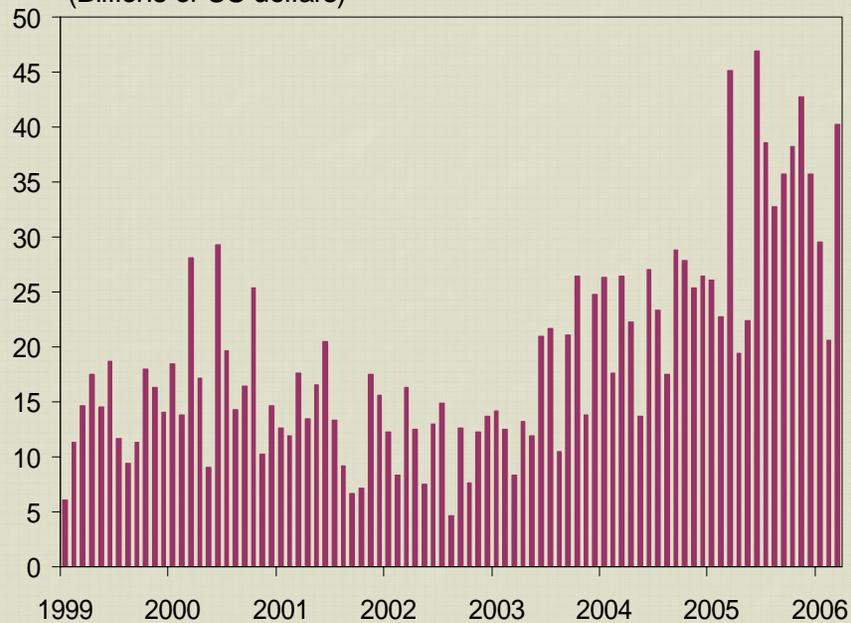
... while world prices of the region's traditional exports remain fairly high.



Sources: Bloomberg Financial Markets; and IMF, Commodity Price System.

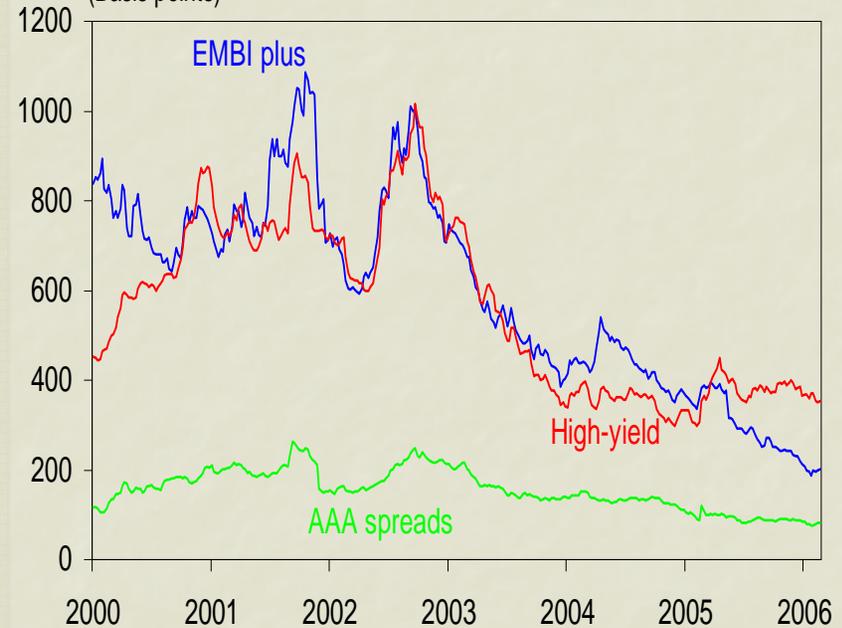
# Capital flows to EM are strong and bond spreads remain close to historical lows...

Emerging Market Financing  
(Billions of US dollars)



Source: IMF, World Economic Outlook

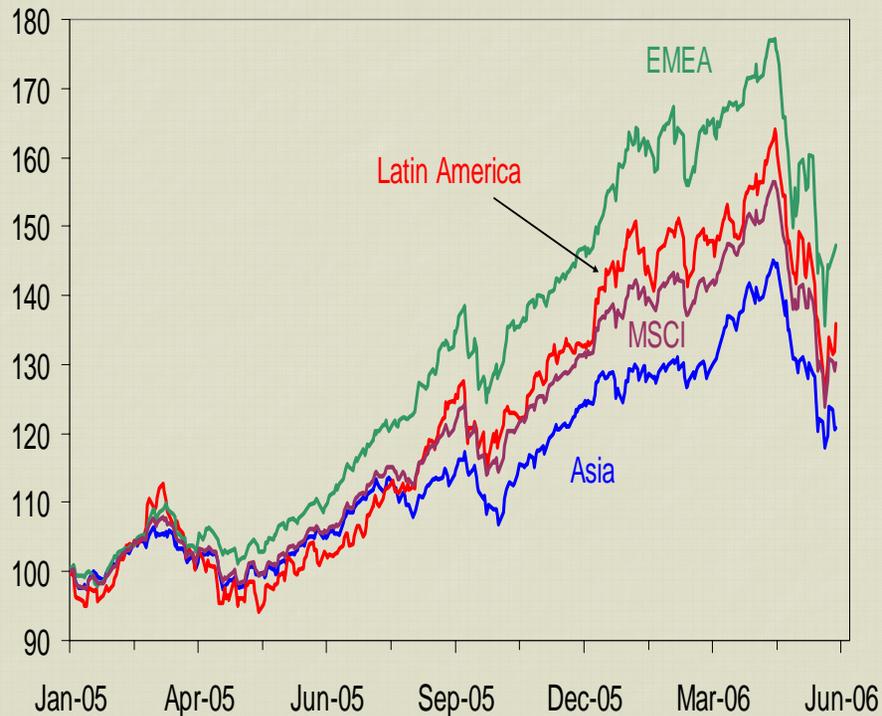
Emerging Market Interest Rate Spreads  
(Basis points)



Source: Bloomberg Financial Markets.

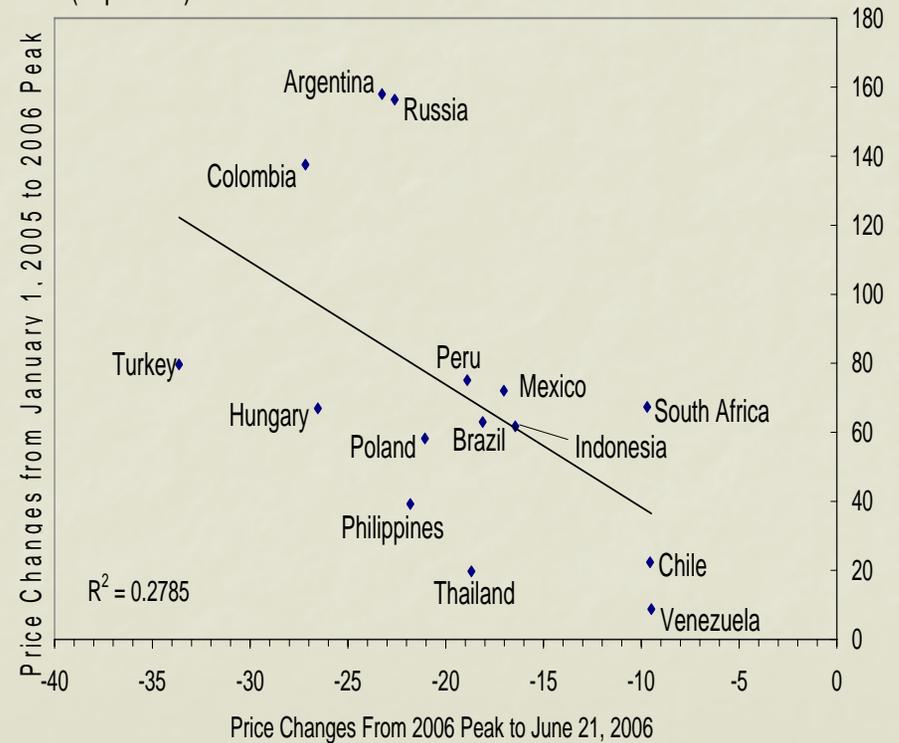
...but recent market developments highlight the risk of sudden shifts in market sentiment.

**Equity Market Developments Jan. 1, 2005–June 21, 2006**  
(December 31, 2004 = 100, local currency performance)



Source: Bloomberg Financial Markets.

**Emerging Markets: Relative Equity Price Changes**  
(In percent)

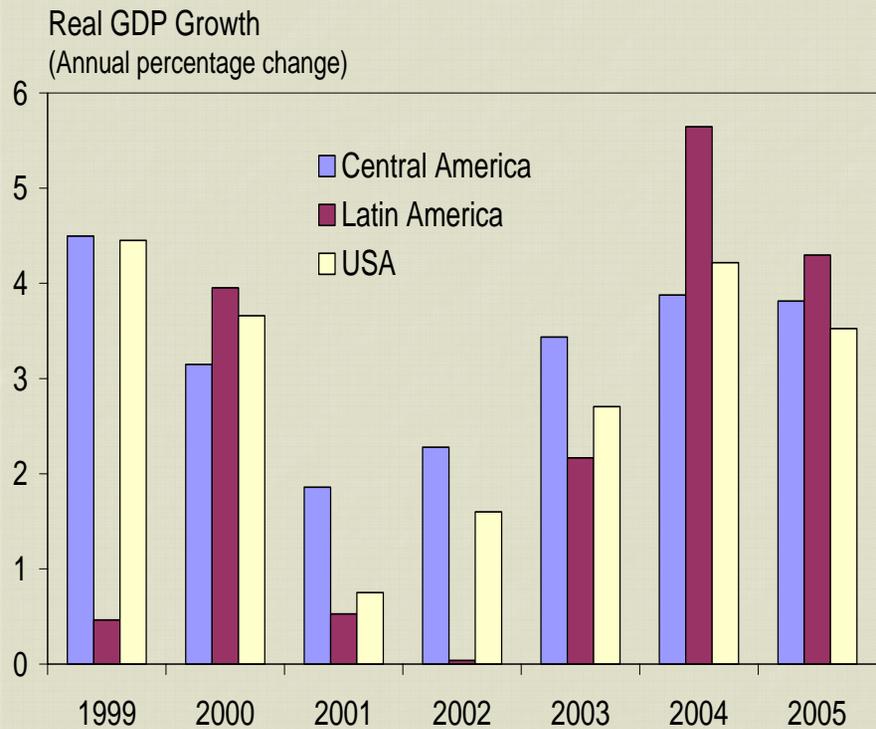


Sources: Bloomberg Financial Markets; and Fund staff calculations.

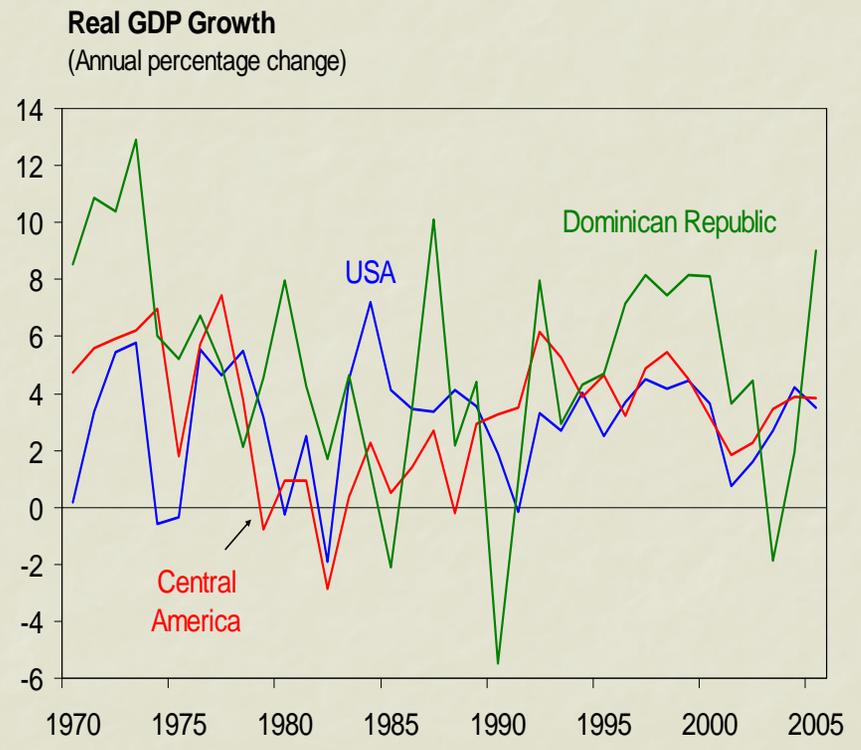
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# U.S. Outlook: U.S. economic developments have much influence on the region...

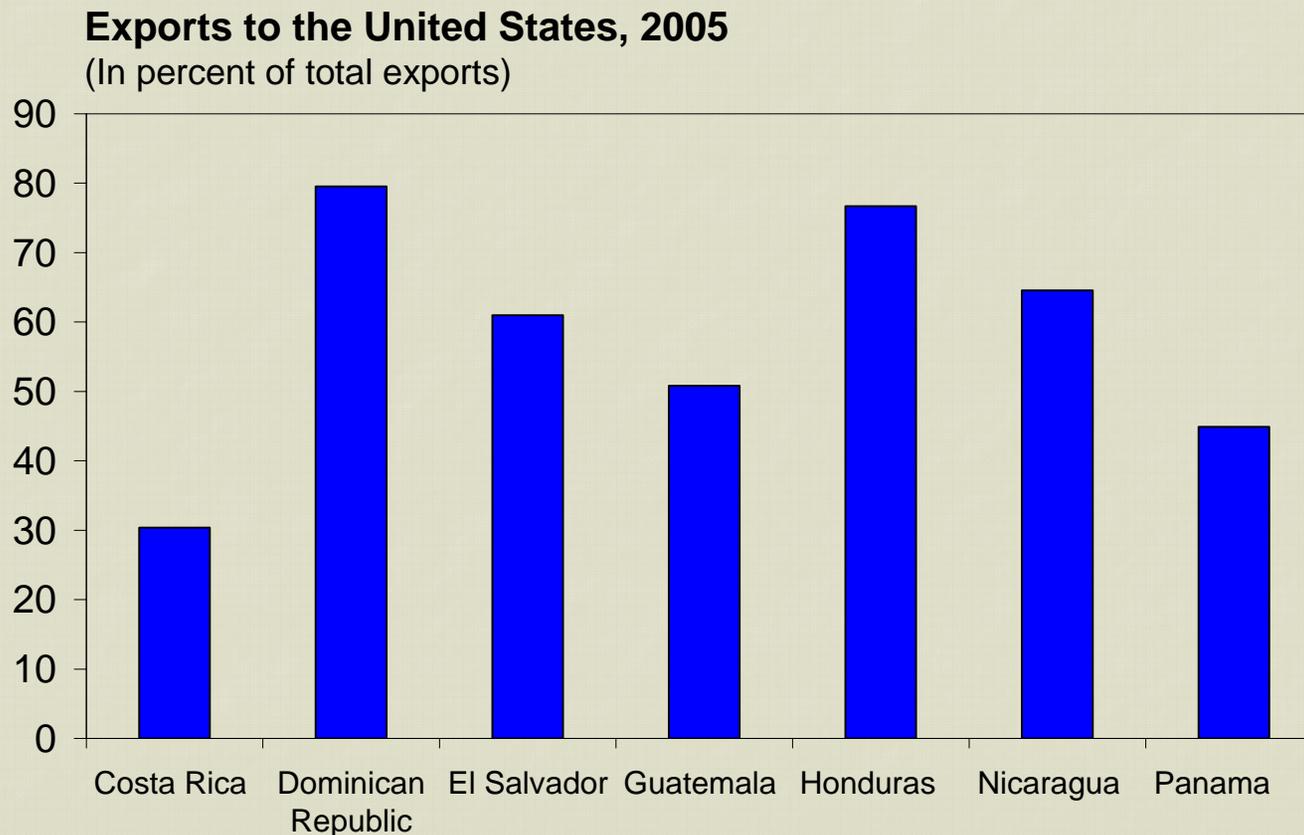


Source: IMF, World Economic Outlook.



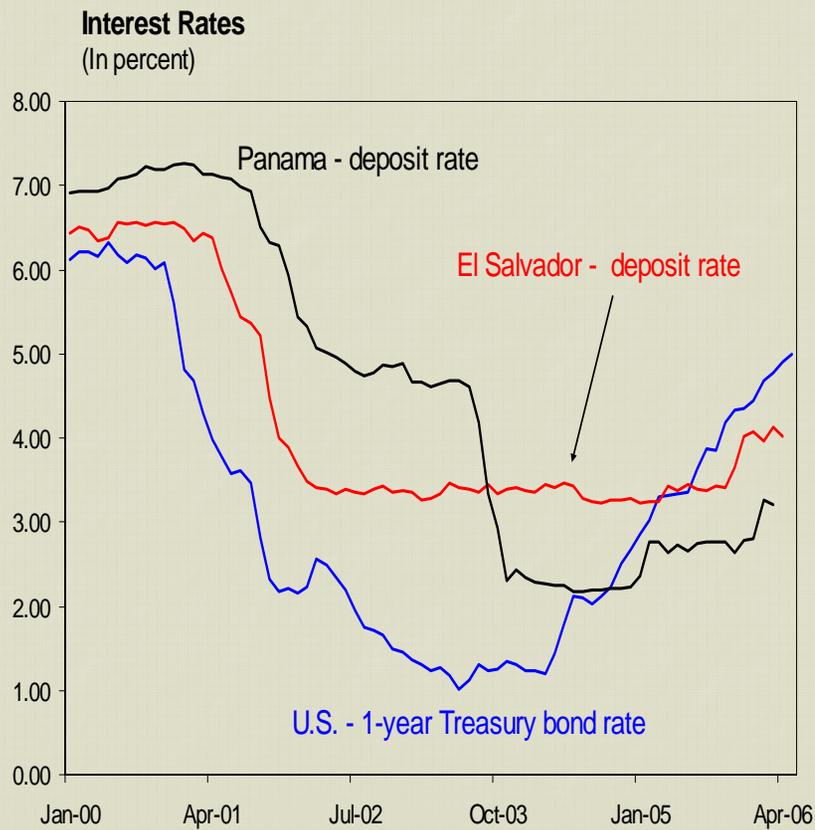
Source: IMF, World Economic Outlook.

...as the United States is the dominant trade partner...

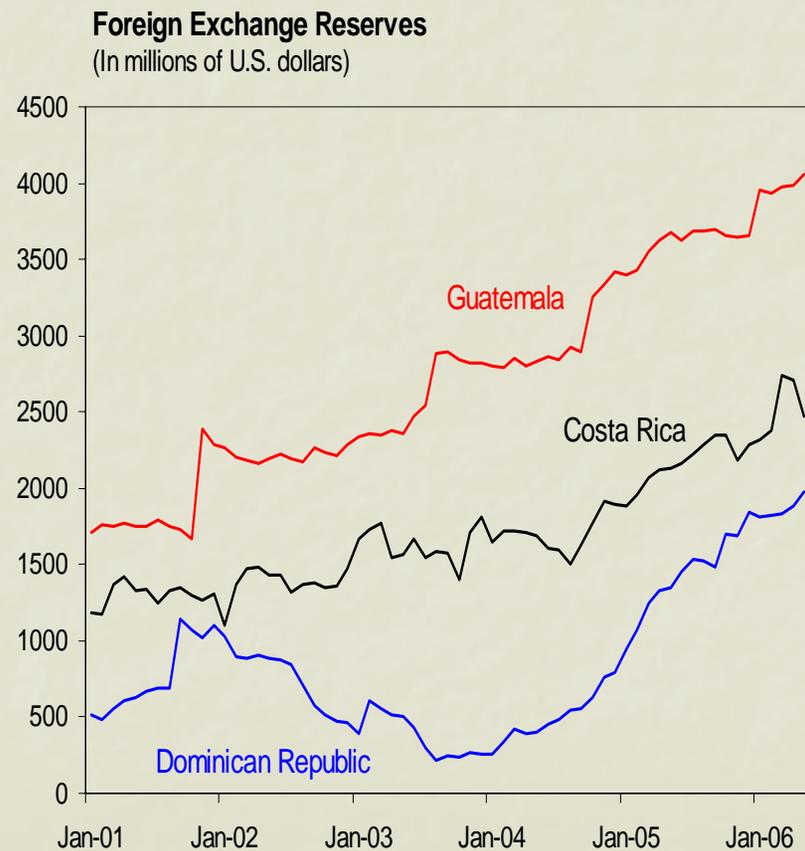


Source: IMF, Direction of Trade Statistics.

... changes in U.S. financial conditions are transmitted to the region...

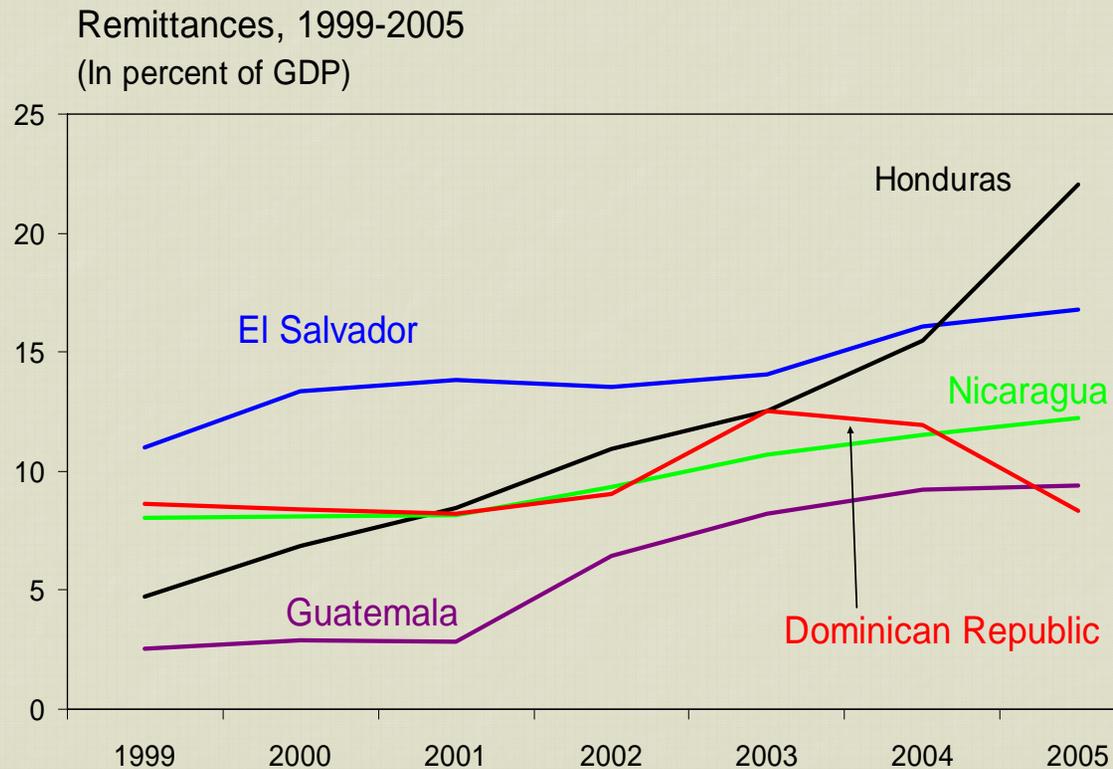


Source: IMF, International Financial Statistics.



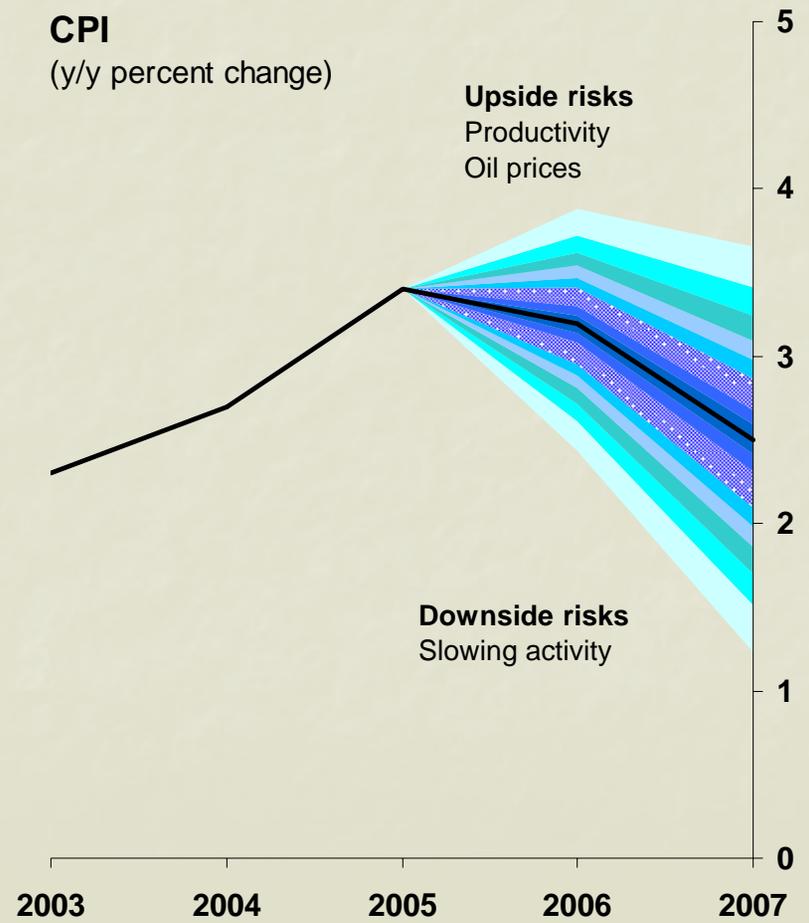
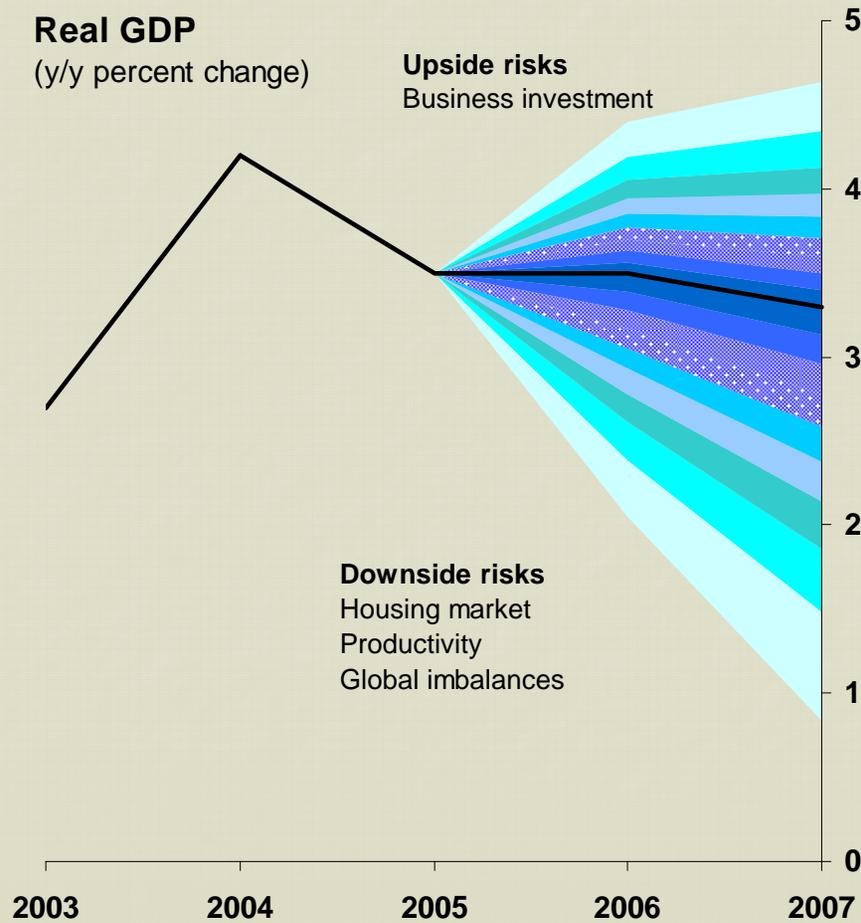
Source: IMF, International Financial Statistics.

... and the bulk of remittances flowing to the region come from the United States.

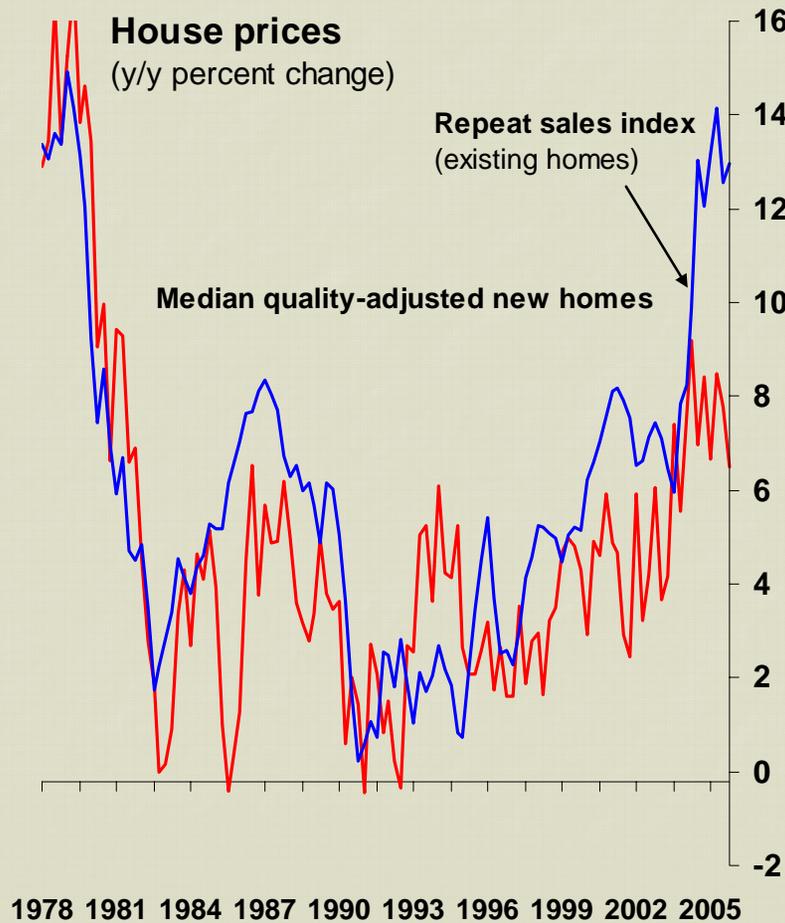


Source: National statistical authorities; and IMF staff

# U.S. economic outlook: Growth should remain robust, but risks are to the downside.



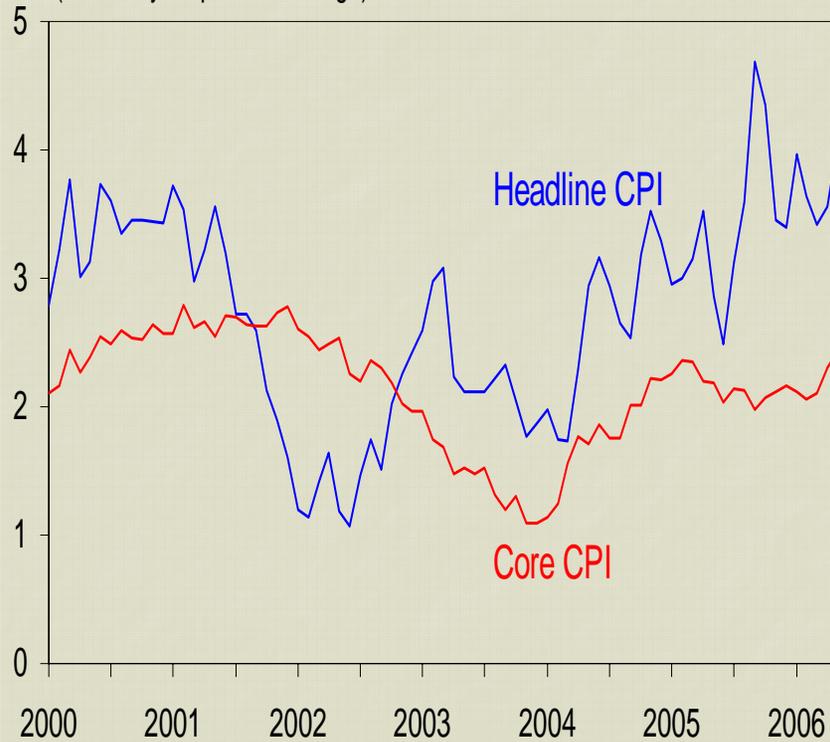
# Housing market developments remain the key macroeconomic risk.



# Recent inflation data surprised on the upside...

## Inflation

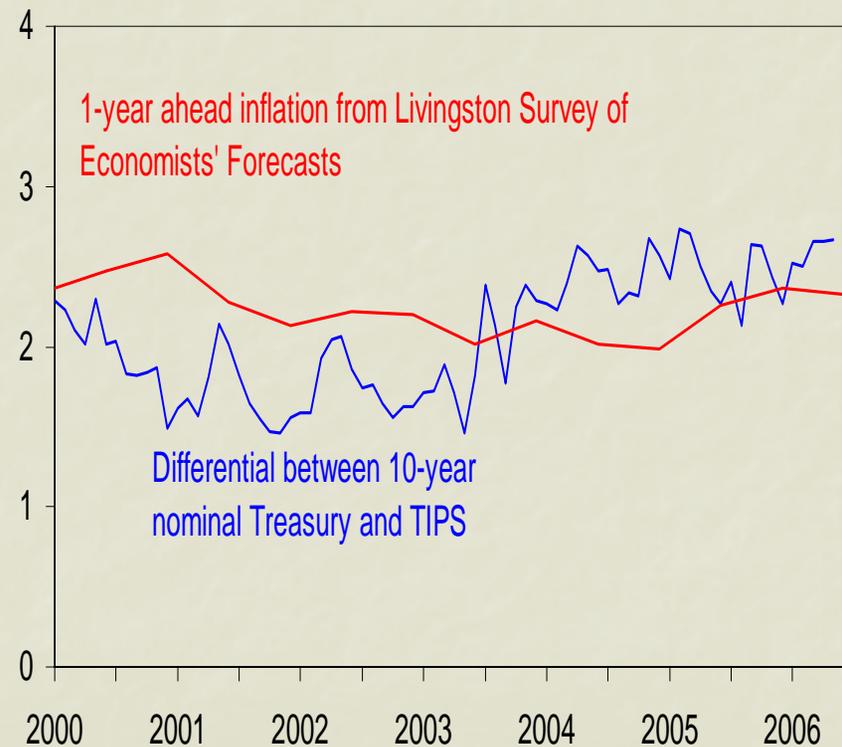
(Year on year percent change)



Sources: Haver Analytics; and Fund staff calculations.

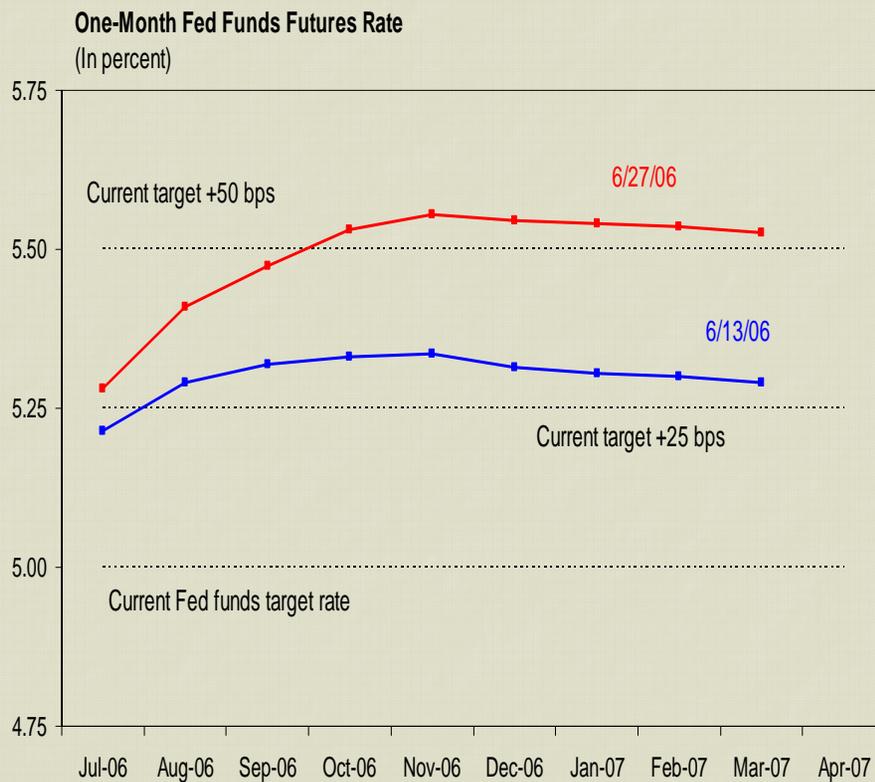
## Inflation Expectations

(In percent)

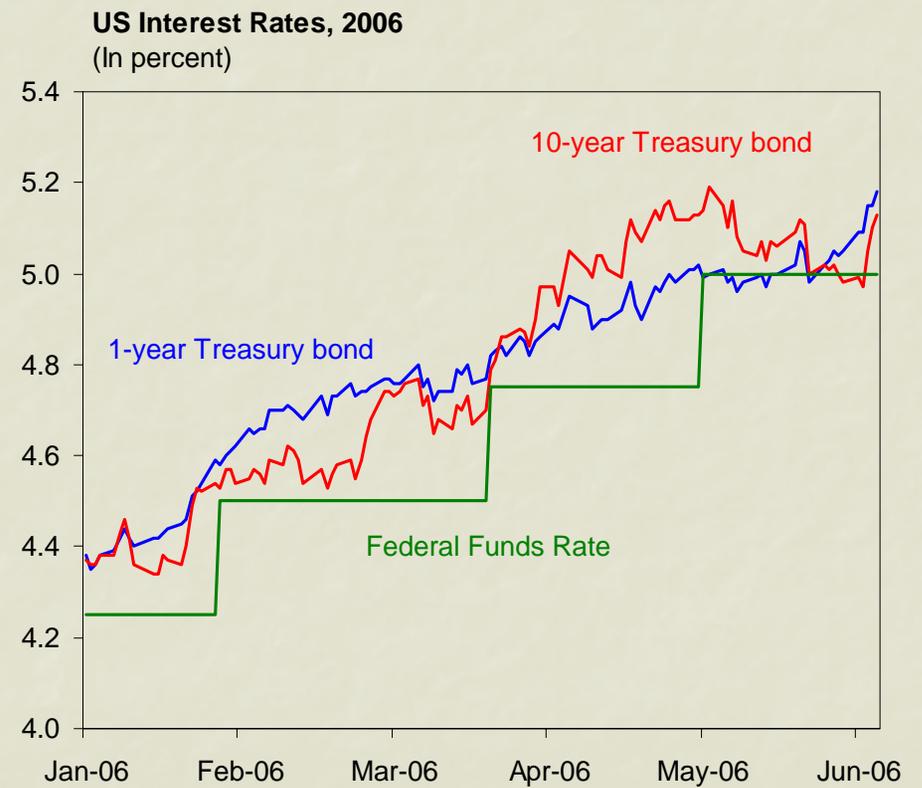


Source: Haver analytics; and Livingston Survey.

... prompting market observers to raise expectations of a rise in the fed funds rate.

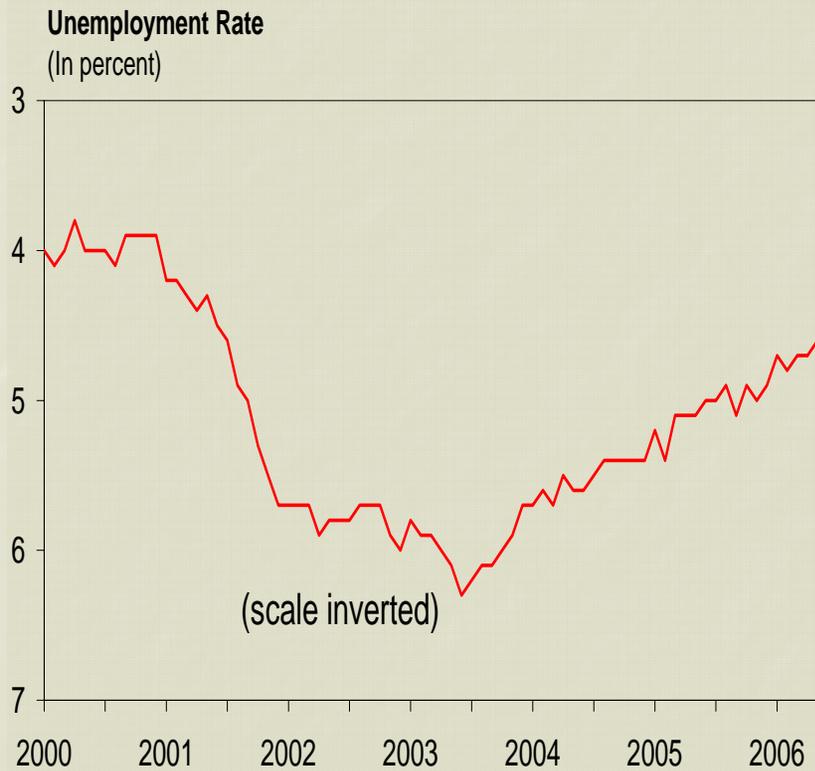


Sources: Global Markets Monitor; and Bloomberg Financial Markets.

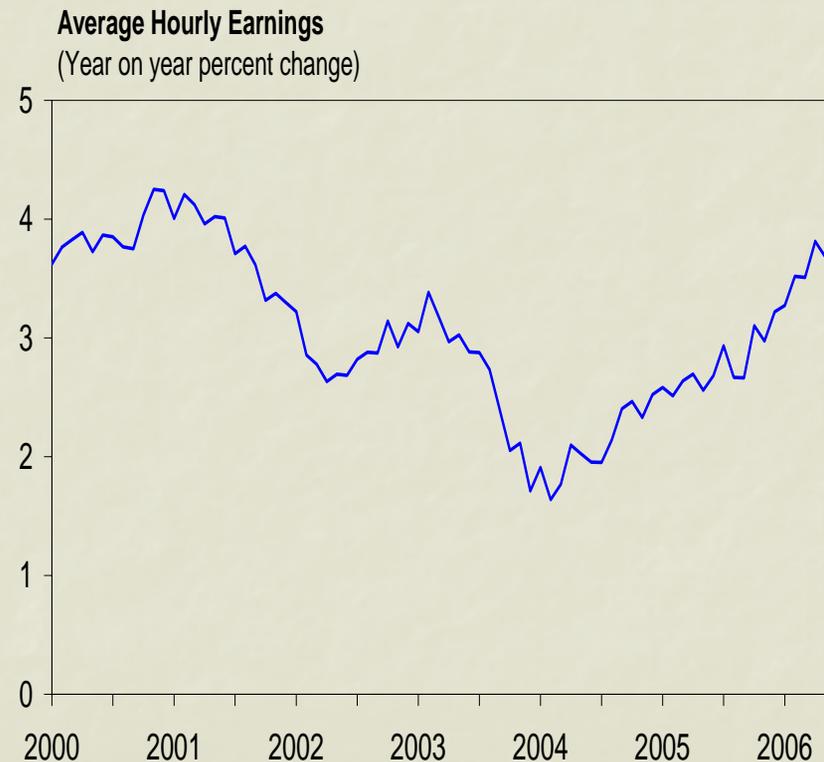


Source: U.S. Department of the Treasury.

# Meanwhile, the U.S. labor market has continued to tighten.

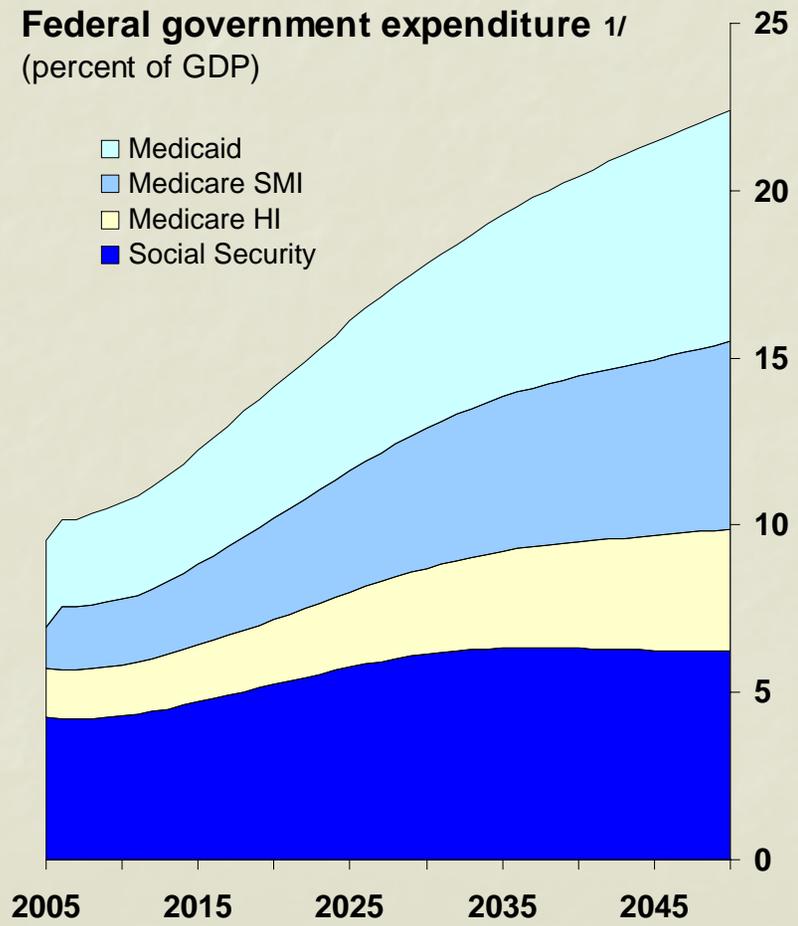
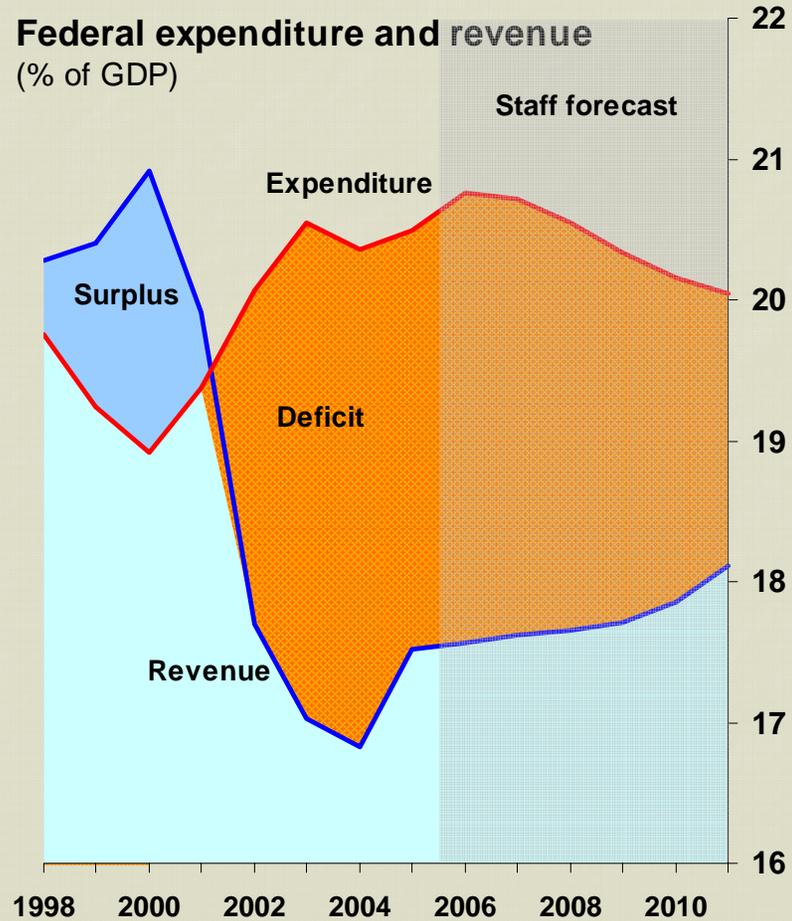


Source: Haver Analytics.



Source: Haver Analytics.

# Fiscal consolidation and entitlement reform are key for long-term sustainability



1/ Medicare SMI=Supplemental Medical Insurance for seniors (includes the new prescription drug component of Medicare). Medicare HI=Hospitalization Insurance for seniors.

# Conclusions

- The outlook for the world economy and the United States is favorable.
- But downside external risks have increased.
- Key risks for the region are:
  - a disorderly unwinding of global imbalances;
  - additional commodity price shocks;
  - a further rise in interest rates in the G-3; and
  - a fall in financial markets' appetite for risk.
- This is an opportune time to strengthen domestic policies to increase resilience to external shocks.