

## Central America

### El Salvador

#### Political

Political stability is gradually returning since the civil war ended in El Salvador in the early 1990s. However, the political environment remains polarized between the ruling right-wing National Republican Alliance (ARENA) and the former-guerrilla group left-wing, Farabundo Marti National Liberation Front (FMLN).

Presidential elections occurred in March 2004; ARENA secured its fourth consecutive term and pro-US President Antonio Saca is in office. Since 2004, legislative elections have produced a Congress with no working majority. In order to pass legislation, Saca has to engage in one-on-one negotiations. In the March 2006 legislative and municipal elections, ARENA strengthened its position by achieving 34 of Congress' 84 seats – it had won 27 in 2003 legislative race. However, ARENA's performance was nearly matched by the FMLN opposition party which took 32 seats in Congress and the important capital San Salvador. Opposition parties have been extremely critical of the Saca administration even though Saca has invited the opposition to hold a dialogue with the government.

Under Saca, the administration's focus is on consolidating democratic politics, controlling inflation, implementing market reforms and reaching consensus in Congress. However, significant security risks and a damaged infrastructure currently detract from the investment environment. Gang-related violence is the priority of a government crackdown called "Master Security Plan" in order to combat crime and violence in the country. The government has also joined regional initiatives to counter gang and drug-related violence. Social unrest is a concern, stemming from high levels of poverty and the increase in violent crime.

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#### Economic

In 2005 El Salvador's GDP grew by a relatively solid 2.9%, the highest result in over five years, supported by gains in agriculture and services. GDP in 2006 is anticipated to reach 2.5%, while growth in 2007 is expected to be slightly stronger at 2.6%. On March 1, 2006 El Salvador was the first country to implement CAFTA. This agreement will have a positive effect on the country, in particular for exports, investment and GDP. El Salvador adopted dollarization in 2001, meaning it has no direct monetary tools thus placing enhanced importance on fiscal spending as the prime policymaking instrument. Fortunately, the fiscal deficit remains manageable; 1.1% of GDP in 2005. The current account widened to 4.6% of GDP in 2005 as import spending continued due to sustained high global oil prices. In 2006 imports will continue to accelerate faster than exports, thereby widening the trade deficit and current account. The country's external balances are underpinned by very strong remittances from Salvadorians working in the US. Remittances in 2005 were equal to US\$2.8 billion, up over 11% y/y, and accounted for a large 16.5% of GDP.

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### Panama

#### Political

The Panamanian political scene has been relatively stable over the last decade. Martin Torrijos of the Democratic Revolutionary Party (PRD) won the May 2004 elections. He has a majority in Congress and, as the son of former military leader he was perceived as a strong leader. Early in his mandate he was able to pass constitutional reforms that increased transparency in government and strengthened democracy. However, he has struggled to reverse entrenched corruption and in early 2006 began a 2-month period of emergency rule by decree to pass several pieces of legislation without Congressional debate or voting.

The handover of the Panama Canal by the US at the end of 1999 marked a watershed for Panama and most observers note that the country has managed the transition fairly well. The canal needs to be expanded to handle an increase in traffic and larger vessels, so attracting investment is a major economic and political priority for the government. The constitution requires that both citizens at large and the legislature approve of the expansion. A referendum will be held on 22 October 2006, and opinion polls as of May 2006

#### Economic

The strong performance of Panama's economy seen in 2004 continued into 2005 with GDP growth clocking in at 5.0% y/y. Growth for 2006 and 2007 is forecast at 4.1% and 4.0% respectively. Annual inflation, which averaged 2.9% in 2005, has been impacted by high global oil prices. The measures the government has taken to reduce the impact of oil prices, such as lower import taxes on fuel, did not have the impact authorities were hoping for as 2005's inflation was the highest result since 1982. Going forward inflation is anticipated to decelerate slightly and average 2.5% for 2006 and 2% in 2007. Government authorities introduced a fiscal package in 2005, and the second stage of the reform is set to be introduced in 2006. The packaged entailed increasing revenue and spending restraints, and in 2005 the fiscal deficit fell to 3.6%, and is anticipated to fall further over the forecast period to reach 3% in 2006 and 2.4% in 2007. A referendum on the expansion of the Panama Canal was expected in 2005, but is now scheduled for some time in 2006. In the meantime, the government has increased the canal tolls in

show that over two-thirds of Panamanians support the project. Farming groups and their supporters will demonstrate vociferously to call attention to their concerns regarding issues of land loss and water supply reductions associated with the project. There is some apprehension that Panama is ill-equipped to defend the canal from potential hostilities or terrorist attacks. Panama has also suffered from escalating violence and crime that is mostly related to drug trafficking. Corruption and links between public authorities and organized crime are ongoing, worrisome subjects.  
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order to help finance the estimated US\$5 billion expansion costs. This should double the canal's capacity – a vital measure to ensure the economy's future as it allows the canal to cope with increased ship size and global shipping activity. Revenues from the canal accounted for approximately 3.1% of GDP in 2005, and with the expansion this value would increase substantially.  
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