BMI Research
A FitchGroup Company

Central America

Country Risk Report

Includes 10-year forecasts to 2026

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BMI Indices – Brief Methodology

Composite Score

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

Political Risk Index

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

Economic Risk Index

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

Operational Risk Index

BMI's Operational Risk Index provides a comprehensive overview of potential risks facing investors operating in a country, as well as a cross-country regional evaluation of threats and advantages. The Operational Risk service evaluates Logistics Risk, Trade and Investment Risk, Labour Market Risk and Crime and Security Risk.

Costa Rica

The **BMI** Risk Indices can be used to rank emerging markets in terms of political risk, the economy and the operational risk environment. There are four indices: a composite score, political index, economy index and operational risk index. These scores are reviewed every month and the results posted on **BMI**'s online service (www.bmiresearch.com). The political and economic scores have short- and long-term components. The long-term scores are designed to reflect more structural considerations and will not change greatly in the short term. The short-term scores will change frequently in response to more transient influences. All scores are expressed as a number between one and 100. A high score is an indicator of lower risk.

BMI Risk Index – Costa Rica

	Latest Rating*	Previous Rating**	Regional Avg	Global Mkts Avg
S-T Political	61.0	62.7	56.8	63.2
L-T Political	71.8	71.8	60.4	62.0
S-T Economy	58.8	59.4	55.9	52.6
L-T Economy	58.1	61.1	57.9	53.4
Operational Risk	53.1	54.9	46.2	50.0
Composite	59.3	60.8	53.9	55.2

POLITICAL RISK
Policymaking A Drag

■ Costa Rica's 'policymaking' sub-score, which is slightly below the Latin American and Caribbean average, weighs on Costa Rica's Short-Term Political Risk Index (STPRI) score of 61.0. A recent downgrade to the 'policymaking' component, reflects increased legislative gridlock as the government struggles to push through fiscal reforms. Costa Rica's strong security position and the high likelihood of policy continuity following February 2018's general elections bolster the country's overall STPRI score, ensuring that it remains above the Latin American and Caribbean average.

Costa Rica's Short-Term Political Risk Index score is 61.0.

ECONOMIC RISK
Fiscal Deterioration Weighs On Score

■ Costa Rica receives a score of 58.8 out of 100 in our Short-Term Economic Risk Index. Costa Rica's score is weighed down in part by a weak performance in the 'fiscal' sub-component of the index. Indeed, Costa Rica has run nominal budget deficits in excess of 4.0% of GDP since 2013, owing to elevated levels of government spending. We do not expect the government to pull back considerably in the years ahead, forecasting a fiscal shortfall of 5.2% in 2018 and 4.9% in 2018.

Costa Rica's Short-Term Economic Risk Index Score is 58.8.

El Salvador

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BMI Risk Index – El Salvador

	Latest Rating*	Previous Rating**	Regional Avg	Global Mkts Avg
S-T Political	48.5	48.5	56.8	63.2
L-T Political	60.4	60.4	60.4	62.0
S-T Economy	49.8	48.5	55.9	52.6
L-T Economy	54.0	53.6	57.9	53.4
Operational Risk	41.8	41.8	46.2	50.0
Composite	49.4	49.1	53.9	55.2

POLITICAL RISK
Greatest Risks Stem From Security Concerns

■ El Salvador scores 48.5 in our Short-Term Political Risk Index. The country's score is weakened by political gridlock which will prevent policy formation, particularly legislation necessary for fiscal sustainability. El Salvador also continues to perform poorly in the 'social stability' and 'security/external threats' categories, reflecting high rates of underemployment, a substantial impoverished population and high incidence of drug-trafficking and gang-related violence.

El Salvador's Short-Term Political Risk Index is 48.5.

ECONOMIC RISK
Public-Private Partnership Law Launched

■ El Salvador scores 49.8 in our Short-Term Economic Risk Index. The country is highly dependent on household consumption to drive economic growth, with worker remittances from the United States playing a crucial role. A continued economic recovery in the US, which will bolster remittances and export growth, will provide tailwinds to the economy. That said, structural weaknesses, including a lack of domestic productive capacity and ongoing investor concerns about the security environment, will hamper real GDP growth.

El Salvador's Short-Term Economic Risk Index is 49.8.

Guatemala

The **BMI** Risk Indices can be used to rank emerging markets in terms of political risk, the economy and the operational risk environment. There are four indices: a composite score, political index, economy index and operational risk index. These scores are reviewed every month and the results posted on **BMI**'s online service (www.bmiresearch.com). The political and economic scores have short- and long-term components. The long-term scores are designed to reflect more structural considerations and will not change greatly in the short term. The short-term scores will change frequently in response to more transient influences. All scores are expressed as a number between one and 100. A high score is an indicator of lower risk.

BMI Risk Index – Guatemala

	Latest Rating*	Previous Rating**	Regional Avg	Global Mkts Avg
S-T Political	40.8	44.2	56.8	63.2
L-T Political	48.9	48.9	60.4	62.0
S-T Economy	58.5	57.9	55.9	52.6
L-T Economy	56.7	54.2	57.9	53.4
Operational Risk	38.2	40.1	46.2	50.0
Composite	46.9	47.6	53.9	55.2

POLITICAL RISK
Gridlock Inhibits Policy Formation

■ We have reduced Guatemala's Short-Term Political Risk Index score to 40.8 from 44.2 previously due to ongoing political tensions as a result of corruption allegations surrounding President Jimmy Morales and the president's perceived efforts to circumvent them. Guatemala is considerably below the regional and emerging market averages. Each subcomponent is well below the emerging market average, though none more so than 'policymaking', due to the fractured nature of Guatemala's political system. Security also remains a significant concern in the country as cartels and gangs become more pervasive.

Guatemala's Short-Term Political Risk Index is 40.8.

ECONOMIC RISK
Goods Trade Deficit Widening

■ Guatemala's Short-Term Economic Risk Index score comes in at 58.5 out of 100. This is due, in part, to a high level of import cover and low level of external debt owed by the country. Furthermore, with GDP growth set to be relatively robust on the back of stronger US demand for manufactured goods and increased remittance inflows, the 'economic growth' component of the score is higher than the regional average. However, despite our expectation for an uptick in economic growth in the short term, the Guatemalan economy will continue to face long-term structural challenges, including a weak business environment, dependency on low-value manufactured exports and high vulnerability to swings in commodity prices.

Guatemala's Short-Term Economic Risk Index is 56.0.

Honduras

The **BMI** Risk Indices can be used to rank emerging markets in terms of political risk, the economy and the operational risk environment. There are four indices: a composite score, political index, economy index and operational risk index. These scores are reviewed every month and the results posted on **BMI**'s online service (www.bmiresearch.com). The political and economic scores have short- and long-term components. The long-term scores are designed to reflect more structural considerations and will not change greatly in the short term. The short-term scores will change frequently in response to more transient influences. All scores are expressed as a number between one and 100. A high score is an indicator of lower risk.

BMI Risk Index – Honduras

	Latest Rating*	Previous Rating**	Regional Avg	Global Mkts Avg
S-T Political	43.5	46.0	56.8	63.2
L-T Political	47.5	47.5	60.4	62.0
S-T Economy	56.0	53.3	55.9	52.6
L-T Economy	53.0	51.2	57.9	53.4
Operational Risk	37.6	40.2	46.2	50.0
Composite	46.3	46.4	53.9	55.2

POLITICAL RISK
Narcotrafficking Violence Pulling Down Security Component

■ We have reduced Honduras' Short-Term Political Risk Index score of to 43.5 from 46.0 due to the political unrest following a highly contentious election in November. This places Honduras third to last in Latin America and the Caribbean, with each sub-component falling below the regional average. Honduras receives its weakest scores for social stability and 'security/external threats', as narcotrafficking-related violence continues to be an issue in the country.

Honduras' Short-Term Political Risk Index is 43.5.

ECONOMIC RISK
Structural Issues Persist

■ Honduras' Short-Term Economic Growth Risk Index (STERI) score is 56.0. The country's score is bolstered by above-average economic growth; however the country's fiscal position remains weak, driven up by still relatively high debt servicing costs. Furthermore, weak access to financial markets weighs on the STERI as Honduras remains highly exposed to external shocks, and is particularly vulnerable to capital flight.

Honduras' Short-Term Economic Risk Index is 56.0.

Nicaragua

The **BMI** Risk Indices can be used to rank emerging markets in terms of political risk, the economy and the operational risk environment. There are four indices: a composite score, political index, economy index and operational risk index. These scores are reviewed every month and the results posted on **BMI**'s online service (www.bmiresearch.com). The political and economic scores have short- and long-term components. The long-term scores are designed to reflect more structural considerations and will not change greatly in the short term. The short-term scores will change frequently in response to more transient influences. All scores are expressed as a number between one and 100. A high score is an indicator of lower risk.

BMI Risk Index – Nicaragua

	Latest Rating*	Previous Rating**	Regional Avg	Global Mkts Avg
S-T Political	66.0	63.8	56.8	63.2
L-T Political	45.2	45.2	60.4	62.0
S-T Economy	43.1	43.1	55.9	52.6
L-T Economy	46.1	45.5	57.9	53.4
Operational Risk	41.9	41.6	46.2	50.0
Composite	47.4	46.8	53.9	55.2

POLITICAL RISK
Social Stability A Concern

■ Nicaragua receives a score of 66.0 out of 100 in our Short-Term Political Risk Index. Nicaragua benefits from a stronger security environment than many of its Central American peers, and its 'security/external threats' score is above the regional average at 66.7. However, a relatively weak reading in 'social stability' sub-component tempers Nicaragua's overall score given relatively high unemployment and growing anti-government protests in the last few years.

Nicaragua receives a score of 66.0 out of 100 in our Short-Term Political Risk Index.

ECONOMIC RISK
Weak External Position The Main Drag

■ Nicaragua receives a score of 43.1 out of 100 in our Short-Term Economic Risk Index, below the emerging market average of 52.6. The major factor underpinning Nicaragua's low score is its substantial external trade vulnerabilities. Indeed, the country's goods trade shortfalls will remain fairly sizeable in the coming years, contributing to continued large current account deficits. As such, although Nicaragua has run financial and capital account surpluses in recent years, we caution that a sudden drop in capital inflows would present significant risks to the country's balance of payments position.

Nicaragua receives a score of 42.3 out of 100 in our Short-Term Economic Risk Index.

BMI Index League Tables

	S-T Political	Trend	Regional Rank	Global Rank
Panama	71.5	=	1	62
Uruguay	71.5	=	1	62
Chile	70.6	=	3	68
Colombia	66.5	=	4	83
Nicaragua	**66.0**	**=**	**5**	**85**
Argentina	65.8	=	6	86
Costa Rica	**61.0**	**-**	**7**	**105**
Peru	59.6	=	8	115
Brazil	57.5	=	9	123
Mexico	56.9	=	10	129
Ecuador	52.5	=	11	143
Bolivia	51.5	=	12	147
El Salvador	**48.5**	**=**	**13**	**150**
Paraguay	48.1	=	14	153
Honduras	**46.0**	**=**	**15**	**161**
Guatemala	**40.8**	**=**	**16**	**170**
Venezuela	30.6	=	17	182

Regional ave 56.8 / Global ave 63.2 / Emerging Markets ave 59.3

	L-T Political	Trend	Regional Rank	Global Rank
Chile	83.2	=	1	21
Uruguay	75.3	=	2	40
Costa Rica	**71.8**	**=**	**3**	**51**
Panama	69.0	=	4	70
Brazil	68.9	=	5	72
Mexico	64.7	=	6	85
Peru	62.5	=	7	92
Colombia	62.4	=	8	93
Argentina	61.6	=	9	98
Paraguay	61.1	=	10	102
El Salvador	**60.4**	**=**	**11**	**103**
Ecuador	50.1	-	12	143
Bolivia	50.0	=	13	144
Guatemala	**48.9**	**=**	**14**	**148**
Honduras	**47.5**	**=**	**15**	**153**
Nicaragua	**45.2**	**=**	**16**	**158**
Venezuela	44.8	=	17	159

Regional ave 60.4 / Global ave 62.0 / Emerging Markets ave 57.1

	S-T Economic	Trend	Regional Rank	Global Rank
Chile	67.3	+	1	40
Peru	66.9	+	2	41
Mexico	66.7	+	3	43
Panama	62.7	=	4	54
Colombia	61.3	=	5	58
Costa Rica	**58.8**	**-**	**6**	**62**
Guatemala	**58.5**	**+**	**7**	**64**
Argentina	56.7	+	8	70
Uruguay	56.7	-	8	70
Bolivia	56.5	+	10	72
Honduras	**56.0**	**+**	**11**	**74**
Brazil	55.6	=	12	75
Ecuador	55.0	-	13	78
Paraguay	52.5	+	14	86
El Salvador	**49.8**	**+**	**15**	**97**
Nicaragua	**43.1**	**+**	**16**	**127**
Venezuela	26.9	+	17	182

Regional ave 55.9 / Global ave 52.6 / Emerging Markets ave 48.1

	L-T Economic	Trend	Regional Rank	Global Rank
Chile	67.2	=	1	37
Peru	66.8	=	2	39
Panama	66.3	=	3	40
Bolivia	64.7	=	4	46
Mexico	64.6	=	5	47
Colombia	63.9	+	6	49
Uruguay	62.6	=	7	52
Brazil	62.2	+	8	56
Costa Rica	**58.1**	**-**	**9**	**65**
Ecuador	57.7	-	10	69
Argentina	57.0	+	11	74
Guatemala	**56.7**	**+**	**12**	**76**
El Salvador	**54.0**	**+**	**13**	**79**
Honduras	**53.0**	**+**	**14**	**82**
Paraguay	50.7	-	15	95
Nicaragua	**46.1**	**=**	**16**	**127**
Venezuela	33.3	+	17	179

Regional ave 57.9 / Global ave 53.4 / Emerging Markets ave 49.2

Executive Summary

Core Views

- We have a mixed outlook on Central American growth over the coming years.

- Costa Rica will post among the strongest real GDP growth rates in Central America, underpinned by a strong expansion of public and private investment, as well as resilient private consumption.

- Guatemala, Honduras and El Salvador will benefit from somewhat stronger US demand for their manufactured goods and rising remittance inflows, but security risks and social unrest in the wake of corruption scandals and a contentious election in Honduras will temper foreign investment.

- Nicaragua's macroeconomic position is also especially vulnerable given its strong ties to Venezuela. The potential for a re-evaluation of trade and immigration policy in the US under President Donald Trump's administration could threaten exports and remittance moving forward.

Major Forecast Changes

- We now forecast a budget shortfall of 4.6% of GDP in 2017 and 4.5% in 2018, narrowing to 4.0% in 2019, after an expected opposition victory in the February 2018 elections helps to end the current political stalemate.

Key Risks

- Should US growth underperform our expectations, coming in below our 2.2% forecast for 2018, this would translate into relatively weaker US demand for Central American manufactured goods. In turn, this would dampen economic activity throughout the sub-region. Additionally, a more aggressive stance on trade by the Trump Administration could threaten regional access to US markets.

- A significant deterioration in the security environment of one of the countries, either due to rising social unrest following anti-corruption demonstrations or a spike in cartel- or gang-related violence, could temper investment into that economy, weighing on economic activity.

SWOT Analysis

Strengths

- Proximity to the US, and established trade relations, offers a competitive advantage to Central American exporters over their Asian counterparts.
- With Spanish as the native tongue and a relatively cheap labour force, there is potential for foreign multinationals to use Central America as a manufacturing hub to service other Latin American markets.

Weaknesses

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

Opportunities

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

Threats

- Remittances remain vital to the region, serving as a major driver of private consumption for many economies in Central America. Combining with the region's heavy reliance on the US as a major destination for exports, this indicates that the US' growth trajectory has an outsized role in Central America's economic outlook.
- The Administration of US President Donald Trump is taking a more hard line stance on issues of trade and immigration, which could negatively affect access to the US market and remittance flows.

SWOT Analysis

Strengths

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

Weaknesses

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

Opportunities

- Most countries in the region are on fairly good terms with regional neighbours, and the Central America Free Trade Agreement acts to ensure a degree of economic and political cooperation.
- A tide of anti-corruption protests suggests the population is no longer willing to accept high levels of corruption, and weak rule of law. The successful efforts of the UN-backed CICIG may offer a successful model in cracking down on impunity.

Threats

- Elevated levels of violent crime are a serious problem and a major concern for regional policymakers. The 'northern triangle' of Guatemala, El Salvador and Honduras has one of the highest non-political crime rates in the world, with high levels of poverty exacerbating the problem.
- The alleged erosion of democratic institutions, most notably in Nicaragua, Guatemala and Honduras, presents political risks in the years ahead.

Long-Term Political Outlook

Central America Facing Continued Challenges To Political Stability

BMI VIEW

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

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

Locked In The Middle
Map Of Central America

Source: BMI

Ultimately, we expect that a two-tiered political risk profile will remain in place, with substantial economic headwinds and limited fiscal resources constraining the ability of the Honduran, Guatemalan, Salvadoran and Nicaraguan governments to offset the effects of the violence and social unrest. Meanwhile, Panama and Costa Rica, benefiting from comparatively stronger economic outlooks, will retain far more stable political outlooks. This is reflected in our political and economic risk indices, with Panama and Costa Rica scoring well above other Central American countries in terms of political risk and business environment.

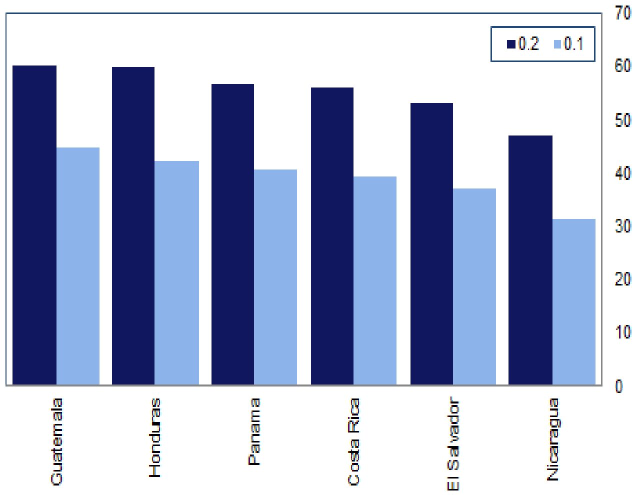
Meanwhile, the laggards – El Salvador, Honduras, Nicaragua and Guatemala – will continue to substantially underperform on both a regional and global basis.

Five Key Challenges

1. Elevated Violence Continuing

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

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



Source: World Bank

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

2. Inequality Driving Continued Social Unrest

Substantial income inequality will keep social tensions high in the coming quarters, implying potential for continued social unrest and sharp policy reversals. The most notable manifestation of the dangerous effects of socio-economic polarisation was the 2009 coup in Honduras, which was driven in large part by a wealthy elite attempting to protect its privileges. While the immediate catalyst for the coup was then-president Manuel Zelaya's attempts at constitutional reform, which had led many to believe he was attempting to revoke the single term limit on the presidency, the underlying cause was likely that Zelaya's increasingly left-leaning policies had earned him the enmity of traditional political elites. With Zelaya's successor, Juan Orlando Hernández set to win a second term in a highly contentious election in November 2017, there is an elevated risk of increased unrest. Elsewhere, deep divisions between a small wealthy elite and larger poor (and often indigenous) population have also encouraged large-scale protests in Panama, Guatemala and Nicaragua. Indeed, in Panama, widespread protests have forced the government to reverse course on everything from mining legislation to the sale of state assets in recent years.

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

3. Divisive Political Processes Prompting Policy Deadlock

Compounding the region's high incidents of violence and social unrest, many Central American countries are faced with a highly divisive political environment. In part, we see this as yet another legacy of the civil wars. The proxy warfare between the US and USSR, which fed the violence across the region, is over, but a sharp ideological polarisation between right- and left-leaning political parties remains in many countries, with potential to hinder the legislative policymaking process.

For example, after 36 years of civil war in Guatemala, the country's political institutions remain weak, with political parties struggling to organise on a national level, leading to the flourishing of a multiplicity of smaller parties and leaving no party with a clear majority. This has seen the legislature mired in policymaking deadlock, with agendas of recent administrations effectively held hostage by legislators willing to engage in obstructionist tactics.

4. Pervasive Corruption Eroding Trust In Government

Corruption is likely to remain pervasive in coming years given the weak institutional capacity and the increased presence of drug trafficking organisations. While the deep-rooted nature of corruption is at least partially due to the region's massive income inequality, which has engendered undemocratic practices and a broader culture of clientelism, we note that the drug trafficking organisations are likely to exacerbate the problem. Indeed, we have seen a number of countries in the region attempting to address the endemic corruption within law enforcement bodies in recent years with little success. Given limited resources and the cartels' substantial illicit revenue flows, we expect continued endemic corruption. This trend is reiterated by Transparency International's 2016 Corruption Perceptions Index, where, with the exception of Costa Rica, all Central American states score less than 40 out of 100; a lower score denotes greater corruption. While a spate of public outrage has begun to see some steps to address the pervasive culture of impunity in these countries – with Guatemala at the forefront of these efforts – the structural reforms necessary to lock in the recent gains will likely be slow.

5. Severe Climatic Conditions Slowing Development

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

Scenarios For The Next 10 Years

Mexican Cartels Settling Into Central America: Violence Continues To Moderate Slightly (60% Probability)

The most likely scenario over the next decade remains that the Mexican cartels, facing continued pressure at home, will maintain a high level of operations in Central America. We had seen violence spike in the region in recent years, with much of the bloodshed due to inter-cartel or cartel vs gang fighting, as the transnational groups moved into new territory. The risk of localised spikes in violence remains considerable due to the potential for alliances between various criminal groups to break down. This occurred in El Salvador in 2015, with a breakdown in the alliance between the MS-13 and Barrio 18 gangs driving that country's homicide rate to the highest in Central America. Meanwhile, with a continued strong presence by the cartels keeping sizeable illicit funds flowing through the region, this will make it harder to root out corruption.

Cartels Pushed Out Of, Or Leave Central America: Violence Drops Substantially (20 % Probability)

A relatively unlikely scenario is that the cartels are, to a large extent, forced to stop operations in the region, and violence and corruption decrease. This would require considerable regional coordination and substantially greater foreign assistance, which has become less likely as US foreign assistance to the region is likely to be curtailed by the Trump administration. Should we see a US-backed crackdown take hold, the cartels could be tempted to follow the path of least resistance and begin to move drugs through the Caribbean, which struggles with porous borders and weak institutions. However, as of now, we believe a robust Central America-wide crackdown is still some way off. Despite the formation of a number of region-wide cooperation initiatives, weak institutions in many of the countries will likely hinder progress.

Central American Gangs Usurp The Cartels: Violence Continues Rising (20 % Probability)

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

Chapter 1.1:
Economic Outlook – Costa Rica

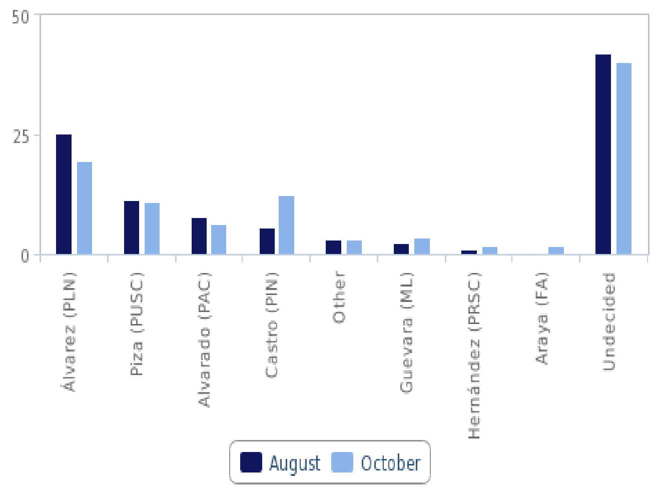
Fiscal Policy And Public Debt Outlook

Fiscal Outlook To Improve Post Election

BMI VIEW

Following significant spending growth in recent years, Costa Rica's fiscal deficit will remain wide in 2017 and 2018. Fiscal consolidation efforts beginning in 2018 will help to narrow the shortfall in subsequent years, but we cannot rule out funding difficulties in the interim.

Likely PLN Victory To Catalyse Deficit Narrowing
Voting Intentions For 2018 Presidential Election, %



Poll Question: 'If the election were held today, who would you vote for?'. Source: UCR-CIEP, BMI

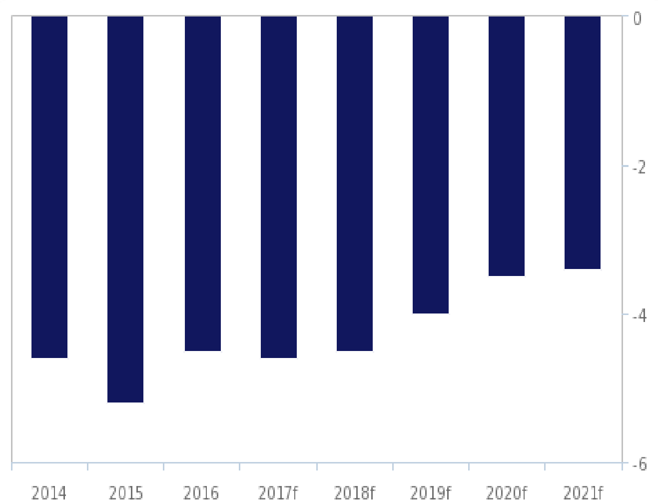
Costa Rica's fiscal deficit will remain wide in 2017 and 2018, as a political stalemate delays the passage of fiscal consolidation measures (*see 'Revenue Gains To Fade While Fiscal Reforms Stall', April 11*). We expect that a victory by the opposition Partido Liberación Nacional (PLN) in the February 2018 presidential election will help to break this stalemate, resulting in a narrowing of the non-financial public sector shortfall beginning in 2019 (*see 'PLN Favoured To Return To Power', September 1*). We forecast a budget shortfall of 4.6% of GDP in 2017 and 4.5% in 2018, narrowing to 4.0% in 2019.

In the interim though, there is a heightened risk that the Costa Rican government could face intermittent funding difficulties. This is due to the government's reliance on domestic funding sources, difficulties issuing debt in June and July, and increased spending requirements following tropical storm Nate, which made landfall in early October.

Reforms To Boost Revenues Beginning In 2019

Revenue growth will moderate in the next couple of years, as the impact of measures to increase the tax base, which were implemented in 2016, fades. Meanwhile, we expect real GDP growth to remain steady around 4.0%, suggesting no other major impetus for a spike in revenues. We forecast total revenue growth of 3.6% in 2017 and 4.3% in 2018, below the 6.0% growth recorded in 2016.

Fiscal Consolidation To Come
Non-Financial Public Sector Balance, % GDP



f = BMI forecast. Source: BMI, BCCR

Revenue growth will pick up more substantially in 2019 and beyond, as a new, PLN-led government is likely to implement additional revenue-raising measures. Measures supported by the IMF include a widening of the VAT base in order to capture a broader swathe of the service sector, gradual increases in the income tax and VAT rates and a simplification of the tax system in order to decrease tax evasion and avoidance.

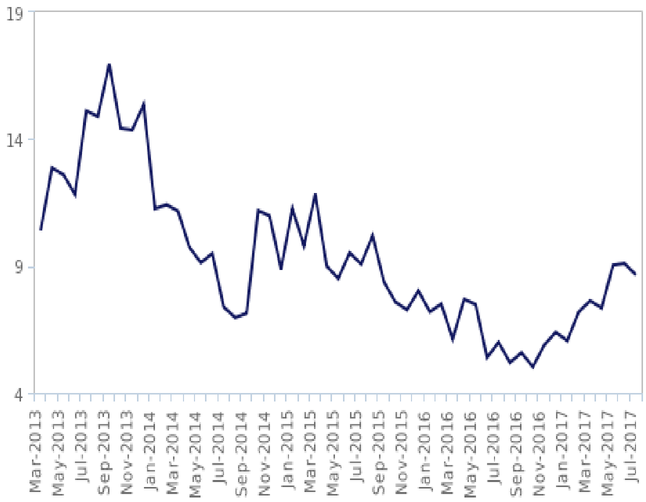
Spending Growth To Gradually Decelerate

Expenditure growth will tick up in 2017, bolstered in large part by spending in the lead-up to the 2018 election. Central government expenditures increased by 9.1% y-o-y during the first seven months of 2017, and we expect total spending growth will remain robust for the duration of the year.

With a PLN-led government likely to implement some spending cuts in 2018 in order to rein in the substantial growth in government expenditures over recent years, we expect a gradual deceleration in total expenditure growth beginning in 2018. That said, following substantial disagreement between political parties over whether to implement spending cuts in recent years, and reducing expenditures is likely to be a contentious process. This is particularly true as some of the ramp up in spending over recent years has taken place in sectors such as healthcare, education and housing.

Spending Slowdown To Come Post Election

Central Government Expenditure Growth, % y-o-y 6mma



Source: BCCR, BMI

Risks To Funding In The Short Term

Domestic financing will likely be sufficient to cover Costa Rica's shortfall in the coming year, but we cannot rule out funding difficulties. Lacking the legislature's authorisation to issue debt on international markets since 2015, the government continues to access local sources of funding at increasingly high interest rates. This may change under a PLN-led government, giving it slightly more flexibility. Moreover, the government declared a 'liquidity crisis' in August after unsuccessful attempts to garner domestic funding in June and July, reportedly due to the Treasury's unwillingness to offer debt at a higher interest rate. However, local press reports suggest that the government has had greater success in the last couple of months. General government debt rose to an estimated 48.8% of GDP in 2016, up from just 30.5% in 2011.

Still, with the government in need of funding rising expenditures following Hurricane Nate, which made landfall in the country in early October, there is a chance that it will face difficulty financing itself in the next few quarters. We expect these risks to abate by mid-2018 as a new PLN-led government, seated next May, will begin to put forward measures to rein in the deficit and stabilise the debt burden.

Chapter 1.2:
Poltical Outlook – Costa Rica

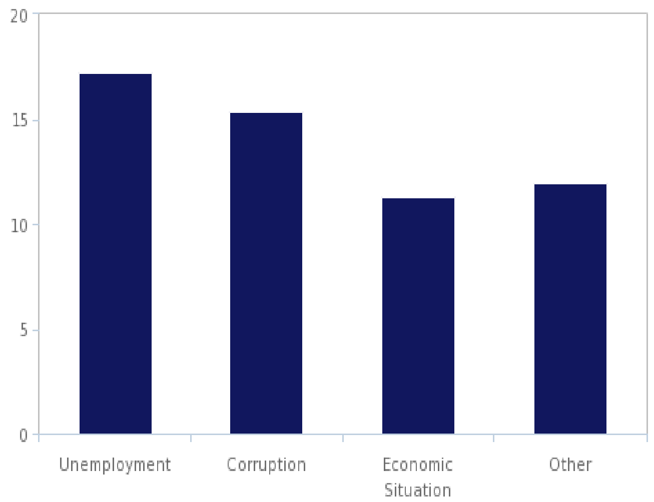
Domestic Politics

Cementazo's Impact On Presidential Race Muted For Now

BMI VIEW

The 'cementazo' scandal is likely to undermine public trust in Costa Rica's institutions, with members of all three branches of government being questioned or under investigation. However, the impact on the February 2018 election appears to be minimal for now, with the opposition PLN candidate still the most likely to win.

Corruption Near The Top Of The List
Principal Problems Facing The Country, %

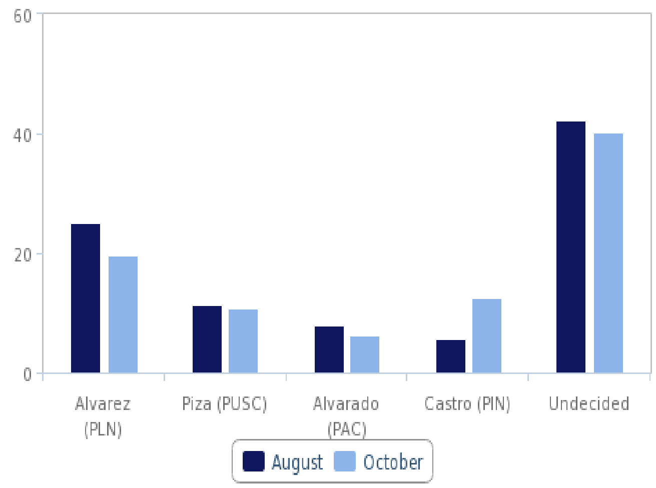


Note: Excludes problems receiving below 10% of responses. Source: UCR-CIEP, BMI

The centrist opposition Partido Liberación Nacional (PLN) candidate, Antonio Álvarez Desanti, remains the most likely victor of Costa Rica's 2018 presidential election, despite a recent drop in the polls (*see 'PLN Favoured To Return To Power', September 1*). This should spell broad policy continuity, with the exception of a tighter fiscal policy stance aimed at reining in the country's burgeoning fiscal deficit (*see 'Fiscal Outlook To Improve Post-Election', October 20*).

However, we will be watching the unfolding 'cementazo' scandal closely to assess its impact on the outcome of February's presidential and legislative elections. The scandal centres around alleged embezzlement and influence peddling related to the extension of a USD30mn loan to cement importer, Sinochem Costa Rica, which resulted in the suspensions of Attorney General Jorge Chavarría Guzmán and Supreme Court judge Celso Gamboa Sánchez in late October pending investigations in their potential roles in the case. Several directors of state-owned Banco de Costa Rica, which extended the disputed loan, and Sinochem Costa Rica director Juan Carlos Bolaños Morales have been arrested, while legislators from multiple parties have also been implicated.

PLN Likely To Remain Ahead
Voting Intentions For February 2018 Presidential Election, %



Note: Excludes candidates receiving below 5% of voting intentions. Source: UCR-CIEP, BMI

Trust In Institutions At Risk

Most significantly, the cementazo is likely to undermine public faith in the country's institutions. The latest polling data from UCR-CIEP shows that corruption is viewed as the second most significant problem in the country, behind unemployment. Moreover, members of all three governmental branches have been questioned or implicated, and the revelation of additional allegations seems likely. We have downgraded the 'policy enactment' subcomponent of our Short-Term Political Risk index to reflect the likelihood of persistent legislative gridlock as the government manages the fast-moving scandal and all parties gear up for the February elections. Concrete evidence of judicial corruption would prompt us to downgrade Costa Rica's score for 'characteristics of polity' in our Long-Term Political Risk index, which reflects our assessment of the judicial independence.

No Major Impact On Presidential Race Yet

The impact of the scandal on the outcome of the presidential election appears muted as of now, with latest polling data from UCR-CIEP showing no major change to the recent trends. The PLN's Álvarez remains in first place with 19.6% of voting intentions, although this is down from 25.2% in August. He is trailed by the Partido Unidad Social Cristiana (PUSC)'s Rodolfo Piza who is in second place, garnering 11.0% of voting intentions. This suggests a run-off between Álvarez and Piza as no candidate looks likely to surpass the 40% threshold to win outright. Given the PLN's traditionally larger base of support, we believe Álvarez is likely to come out on top.

Partido Acción Ciudadana (PAC) candidate, Carlos Alvarado Quesada, is polling in third place at just 6.3%. PAC, the party of President Luis Guillermo Solís, appears to be under the most pressure from the scandal, which will likely cap preferences for Alvarado. Solis appointed Gamboa had close ties to legislator Victor Morales Zapata who has also been implicated in the scandal. Still, with latest data showing that 40.3% of respondents are undecided, we will continue to monitor the scandal closely for signs that it is impacting the presidential candidates directly or bolstering the support of candidates from smaller parties perceived to be outside of the political mainstream.

Chapter 2.1:
Economic Outlook – El Salvador

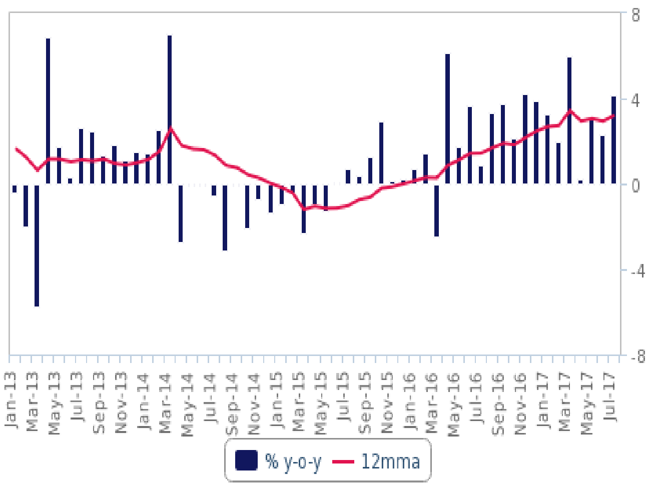
Economic Growth Outlook

Growth To Remain Solid, Despite Political Risks

BMI VIEW

Steady export growth and strong remittances will support El Salvador's economy in 2017 and 2018. That said, the country's willingness to meet its debt obligations will remain a persistent issue ahead of 2018's legislative elections.

Growth Holding Steady
IVAE Economic Activity Index



Source: BCRES, BMI

El Salvador will continue to post solid growth in the quarters ahead, on the back of steady agricultural and manufacturing activity as well as robust remittance inflows. After posting 2.3% y-o-y real growth in H117, we maintain our forecast for real GDP to rise 2.2% in 2017, from 2.4% in 2016. We expect growth will come in at 2.1% in 2018. We note risks stemming from the country's political willingness to pay its obligations, following a default on local debt in April.

Key Sectors To Post Solid Growth

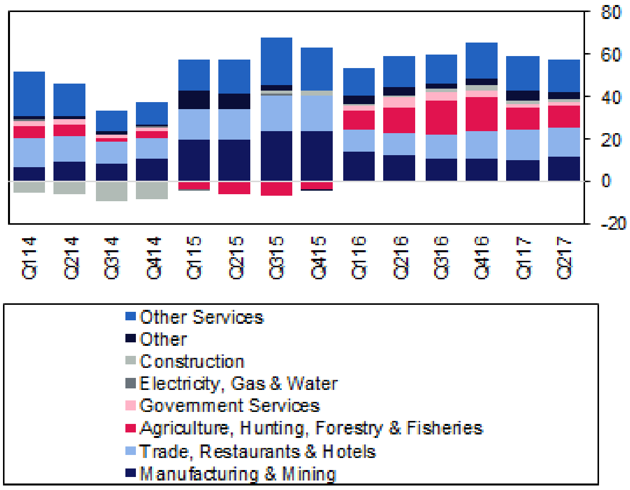
We expect to see solid, if unspectacular, growth to continue in key sectors over the quarters ahead:

- Activity in the agricultural sector has decelerated, averaging 2.4% y-o-y growth through July compared to an average of 5.9% in 2016 as the base effect of weak harvests in 2015 fades. The sector will remain a key pillar of the economy in the next two years, supporting modest growth.

- Manufacturing, which accounts for roughly one-quarter of real GDP, grew 1.8% y-o-y in real terms in H117. Growth in the sector in the months ahead will be driven by higher demand from the US, which is a major market for manufacturing as well as agricultural shipments.

- Private consumption will remain a source of strength for El Salvador, on the back of strong remittance inflows. Remittances in the 12 months to September reached a record USD4.9bn, which amounts to nearly 20.0% of nominal GDP, largely due to higher economic activity and employment in the US. Private consumption accounts for roughly 90% of GDP in El Salvador.

Most Important Sectors Growing In 2017
Change In Real Output, y-o-y, USDmn, By Sector



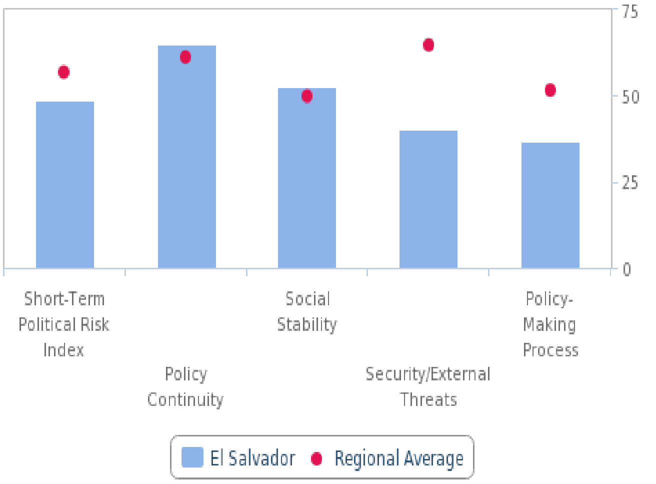
Source: BCRES, BMI

Persistent Risk Of Government Gridlock

Government finances will remain a persistent threat to growth in the years ahead. The largest opposition party, Alianza Republicana Nacionalista (ARENA), holds enough seats in the National Assembly to block the issuance of new government debt, which requires a two-thirds majority to pass (*see 'Legislative Gridlock Will Intensify Ahead Of 2018 Elections', July 21*). This led to a default on pension obligations in April, as ARENA refused to authorise the issuance of new debt without cuts to government spending (*see 'Further Defaults Will Be Avoided, Though Finances To Remain Weak', April 12*). This reduced domestic appetite for short-term debt and led to credit rating downgrades from all three major agencies. While economic activity has not yet shown a negative impact, and the two sides passed an important pension reform bill in September, the probability of additional defaults due to policy gridlock is high. Further defaults will make it extremely difficult for the country to borrow to finance its spending, and reduce investor interest given elevated political uncertainty.

Political Risks Will Remain Elevated

Latin America – Short-Term Political Risk Index



Note: Scores out of 100. Higher score = Lower risk. Source: BMI

In addition to risks from government gridlock, investment inflows will remain weak in the years ahead, due to El Salvador's poor operating environment. We attribute this primarily to high levels of violent crime, particularly a murder rate that is among the highest in the world. Extortion of Salvadoran businesses will also remain an issue, as payments to gangs will impact profitability.

Domestic Politics

Nueva Nación Could Shake Up Two Party Dominance

BMI VIEW

The traditional dominance of El Salvador's political system by ARENA and the FMLN could be challenged by the emergence of a new party led by the mayor of San Salvador, Nayib Bukele. Early polling suggests that Bukele is the favourite to win El Salvador's presidential election in March 2019, with unclear implications for policy direction in the country.

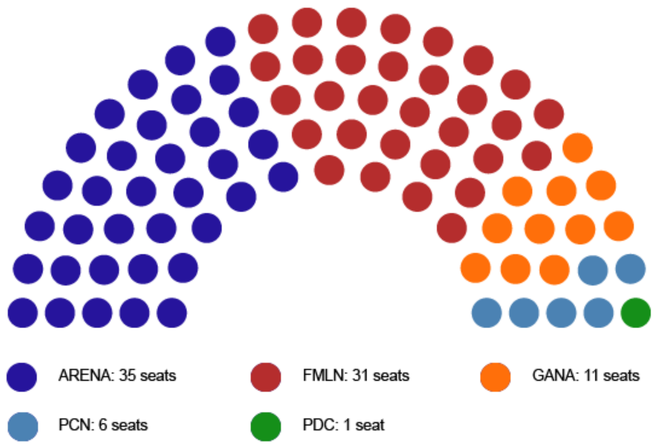
The potential emergence of a new party in El Salvador, led by the current mayor of San Salvador, Nayib Bukele, could shake up the political status quo. The political landscape has been dominated by the right-wing Alianza Republicana Nacionalista (ARENA) and the left-wing Frente Farabundo Martí para la Liberación Nacional (FMLN) since the end of the country's civil war in 1992. While we do not expect that this new party, which will reportedly be called Nueva Nación, will participate in March 2018's legislative elections, we expect that Bukele will run under the party's banner in March 2019's presidential vote, should criminal charges against him not bar him from running. While at this time we are not taking a view on who is likely to win, early polling pegs Bukele as a sizeable favourite.

Bukele, who is generally considered the most popular politician in the country, was a prominent member of the FMLN before being removed from the party on October 10 due to allegations that he verbally and physically assaulted a female party councillor in September. While the case against Bukele was thrown out by a judge on October 18, a higher court later ordered that Bukele be tried for the crime. While it is unclear whether he will ultimately be convicted of the charges, a split between Bukele and leading members of the FMLN, such as secretary general Medardo González, had been growing for some time before he was removed from the party. While Bukele has since referred to himself as an independent since being removed, local media reports suggest that he has begun proceedings to officially form Nueva Nación.

Nueva Nación Unlikely To Impact 2018 Legislative Vote

We do not expect Nueva Nación to participate in March 2018's legislative elections, as it will be too difficult to register a slate of candidates before the deadline on December 18. This implies that the legislature will, once again, be split between ARENA, who currently holds 35 out of 84 seats, and the FMLN, who holds 31. September polling by Mexican firm Consulta Mitofsky showed ARENA and FMLN in a virtual dead heat, well ahead of all other parties, suggesting that seats are likely to be evenly divided following March's election.

Fractured Legislature Likely To Persist
Distribution Of Seats In Legislative Assembly, Out Of 84



Source: Asamblea Legislativa, BMI

Should the March 2018 vote reflect current polling, we expect that political gridlock will persist in the quarters following the election. The two parties have shown an inability to compromise over recent months, which resulted in a default in April after ARENA would not authorise debt payments without cuts to government spending (*see 'Further Defaults Will Be Avoided, Though Finances To Remain Weak', April 12*). While we do not expect additional defaults, given that the country has the necessary liquidity to meet its debt obligations, political gridlock will likely pose a risk to the country's willingness to pay in the quarters ahead.

Bukele In Strong Position Ahead Of 2019 Elections

At this early stage, Bukele is the favourite to win El Salvador's presidency in March 2019, though we will not adopt an official view on the election at this point. Consulta Mitofsky pegged Bukele as having support from 47.6% of those polled, well ahead of the 20.6% recorded by his closest potential opponent, Carlos Calleja, who will compete in primaries for ARENA in 2018. The current president, Salvador Sánchez Cerén, of the FMLN, is constitutionally barred from seeking immediate re-election.

A victory for Bukele would be a substantial shift in the political environment in El Salvador, by breaking the two party dominance of ARENA and the FMLN. This result would likely be a large blow to the FMLN, in particular, as Bukele would siphon off left wing voters. While it is far too early to say with confidence what policies a Bukele presidency would pursue, his stint as mayor of San Salvador and his history of public comments suggest that he would emphasise poverty alleviation and anti-corruption efforts, while adopting a less aggressive security posture than his predecessors.

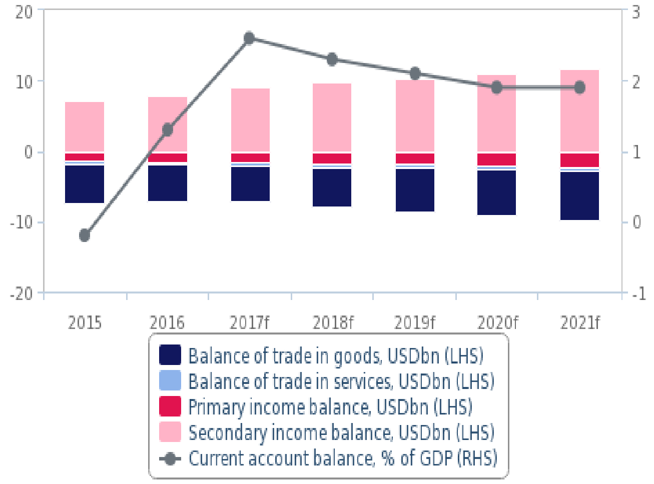
External Trade And Investment Outlook

External Accounts To Remain Stable

BMI VIEW

Guatemala's current account will remain in surplus in 2017 and 2018, on the back of robust exports and remittance inflows. Combined with a rapid increase in foreign reserves, we see little risk to the country's external account stability in the quarters ahead.

Surplus To Remain Wide In 2017 & 2018
Current Account



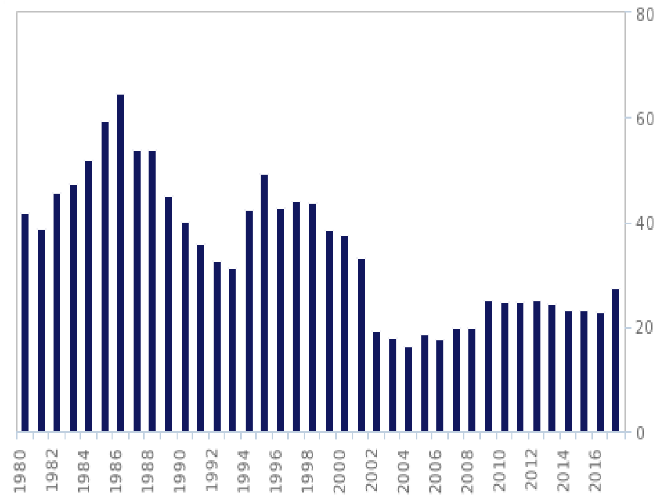
f = BMI forecast. Source: Banguat, BMI

Strong export growth and robust remittance inflows will see Guatemala's current account surplus widen in 2017. Persistent surpluses and a sharp increase in foreign reserves over recent quarters will support the country's external account stability in the years ahead, though we note risks from US immigration policy as well as domestic political turmoil. We forecast the surplus to widen to 2.6% of GDP in 2017, from 1.3% in 2016, and remain wide at 2.3% in 2018.

Goods Trade Deficit To Modestly Narrow

Goods export growth will contribute to a modest narrowing of Guatemala's goods trade deficit in 2017. While month-on-month data is not yet available, total exports through August are on pace to rise 8.2% y-o-y, largely driven by a 29.8% increase in key agricultural exports and modestly higher exports of manufactured goods, primarily to the US. We see less upside for two of these agricultural products – coffee and sugar – in 2018 due to our forecasts for only limited price gains, underpinning our view that export growth will decelerate next year. However, agricultural products have fallen as a share of total exports over recent decades, somewhat insulating Guatemala's balance of payments from commodity price swings.

Reduced Dependence On Agricultural Exports
Share of Coffee, Sugar, Bananas & Cardamom In Total Exports, %



*Note: * = through August. Source: Banguat, BMI*

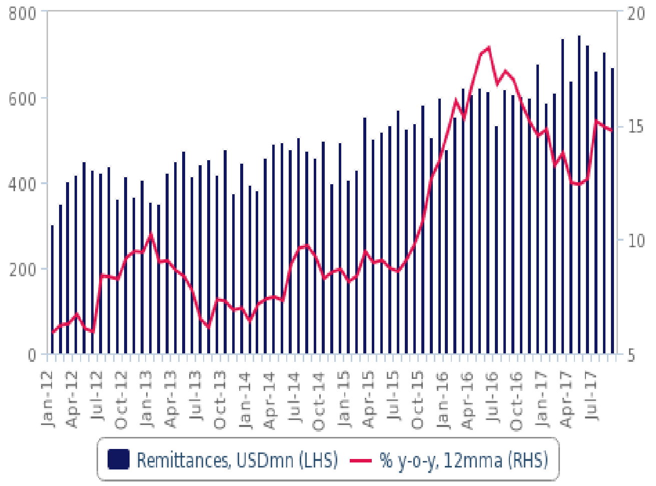
Similarly, total goods imports are heading higher thus far in 2017. Through August, imports are on pace to rise 5.1% y-o-y, marking the first year of import growth since 2014. This has been driven by an uptick in fuel imports as global prices rise, as well as modest growth in capital goods imports. While the total value of imports will remain larger than exports in 2017, relatively faster growth in exports will see the goods trade deficit narrow.

Remittance Inflows To Keep Current Account In Surplus

Remittances will continue to cover Guatemala's goods and services trade deficit. Remittances are up 15.6% y-o-y in the year through September, largely on the back of higher economic activity in the US (*see 'Remittances Will Keep Current Account In Surplus', May 25*). As a result, we forecast Guatemala's secondary income account surplus to increase by 14.0% in 2017, to USD9.1bn.

Remittances Inflows Reaching Record Levels

Remittances



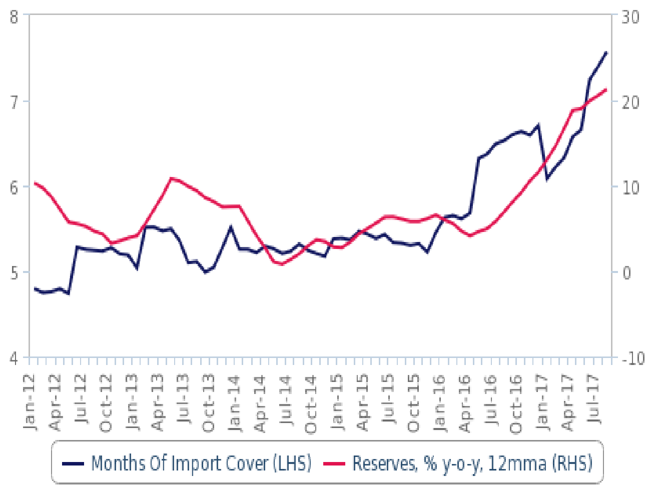
Source: Banguat, BMI

Surplus, Reserves To Support External Stability

We expect that Guatemala's current account surplus and strong growth in reserves will ensure that the country's external accounts remain stable in the quarters ahead. Foreign reserves have risen to USD11.3bn as of August, a 26.5% y-o-y increase, and equal to 7.6 months of import cover, up from 6.9 the year before. In addition to insulating the country from a balance of payments shock, increased foreign reserves allow the Banco de Guatemala (Banguat) to intervene to protect the Guatemalan quetzal as needed (*see 'GTQ: Remittances Will Drive Currency Strength', February 14*).

Increasing Reserves Ward Against External Shocks

Foreign Reserves



Source: Banguat, BMI

However, we do note several risks to our outlook. First, we expect that President Trump will struggle to pass his legislative agenda (*see 'Domestic Gridlock Portends More Assertive Foreign Policy In 2018', September 26*). This increases the risk that he uses his executive powers to crack down on immigration in an effort to shore up his domestic support, slowing the flow of remittances into Guatemala. Second, ongoing political turmoil in Guatemala threatens the flow of foreign investment into the country, which could create financing issues for the country in the event of a balance of payments shock (*see 'Quick View: Morales On Firmer Footing As Immunity Remains Intact', September 12*).

Domestic Politics

Political Crisis Will Bring Heightened Social Unrest

BMI VIEW

An ongoing political crisis in Guatemala will lead to increasing social unrest in the coming quarters, testing the country's fragile institutions. Corruption allegations are likely to consume the attention of the congress, slowing policy formation and presenting a headwind to growth.

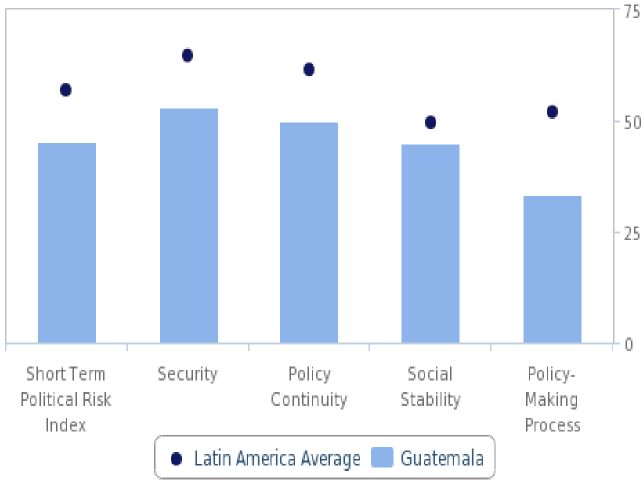
Political risks in Guatemala will remain elevated in the coming months as corruption allegations surrounding President Jimmy Morales and members of congress spur social unrest across the country. Public outrage has intensified following an attempt by Morales to expel Ivan Velasquez, the head of the UN-backed anti-corruption body Comisión Internacional contra la Impunidad en Guatmeala (CICIG), in August, after Velasquez and Attorney General Thelma Aldana called for Morales to be stripped of his presidential immunity (*see 'Political Crisis Will Test Guatemala's Fragile Institutions', August 28*). Since then, protests have continued to mount, calling for Morales and members of congress to resign. On November 7, the indigenous group Comité Desarrollo Campesino de Guatemala (Codeca) began to blockade many of the country's major highways, a protest which is ongoing as of the time of writing.

Trust In the Ruling Elite Nearing All-Time Lows

Recent allegations of corruption and perceived efforts to circumvent the rule of law by multiple branches of government have weighed on public support for Guatemala's institutions, and will drive social unrest in the coming quarters. Following the attempted ouster of the CICIG chief, Guatemala's congress maintained President Morales' immunity and then introduced legislation which would have weakened existing anti-corruption legislation. Congress eventually backtracked and repealed this endeavour. Further, on October 11, Guatemala's Supreme Justice Court (CSJ) decided against investigating Morales for allegedly receiving a payment from the defence ministry. The CSJ also ruled against investigating the 107 legislators for their participation in the attempted weakening of anti-corruption legislation. The allegations against Morales have proved particularly galling, as he ascended to the presidency on an anti-corruption ticket following the resignation of former President OPM in late 2015.

Heightened Political Risks Among Worst In Region

Latin America – Short-Term Political Risk Index



Note: Scores out of 100. Higher score = Lower risk. Source: BMI

President Morales Remains On The Ropes

Despite recent legislative and judicial victories, it remains likely that Morales will not see out his full term amid mounting unrest and international pressure. Should protests escalate in the coming months, Morales could be forced to resign, following in the footsteps of his predecessor Molina. Additionally, we note the potential for increasing international pressure in the coming months, following an open-letter signed by US Congressmen on October 16 calling for the Secretary of State to review US assistance to Guatemala and place VISA bans on Guatemalans facilitating acts of corruption. The US is a major provider of aid to Guatemala. However, Morales' position will continue to benefit from the support of the legislature and much of the judicial branch, possibly precluding his ouster.

Crisis Will Present Headwinds To Growth

In this environment we expect very little progress on Morales' pro-business reform agenda which has been largely stalled since

2016 (*see 'Morales' Coalition Unlikely To Last, Dampening Reform Efforts', October 18 2016*), as the legislature remains gridlocked and primarily focused on corruption allegations. Further, political instability will present major headwinds to growth as investors remain on the side-lines, and has caused S&P to downgrade Guatemala's credit rating to BB- from BB in October. As such, Guatemala falls below the regional average for all indicators on our Short-Term Political Risk Index, and receives its worst scores for the policy making process and social stability.

Chapter 4.1:
Economic Outlook – Honduras

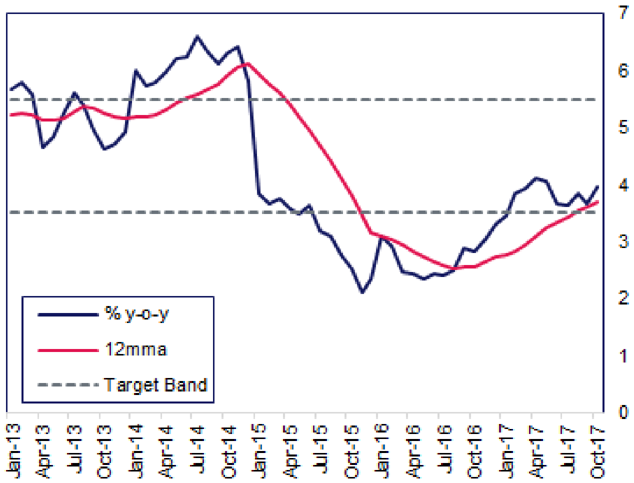
Monetary Policy

Hiking Cycle Likely For 2018

BMI VIEW

The Banco Central de Honduras will begin a hiking cycle in 2018. Rising oil prices and robust economic activity will push inflation near the bank's 4.5% y-o-y target, spurring 50 basis points in hikes to bring the benchmark rate to 6.00%.

Prices Growth Bouncing Back, But Below Target
Consumer Price Inflation

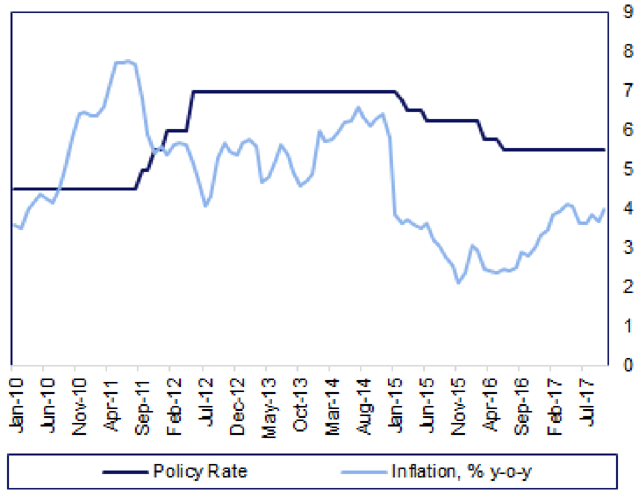


Source: BCH, BMI

The Banco Central de Honduras (BCH) will maintain its benchmark policy rate at 5.50% for the remainder of 2017, bolstering economic activity amid low inflation, before enacting 50 basis points (bps) of hikes in 2018 to bring the rate to 6.00%. Inflation has risen from an all-time low of 2.1% y-o-y in November 2015 to 4.0% as of October 2017, within the BCH's tolerance band of 3.5-5.5%. However, this remains below the bank's target of 4.5%, and price growth has largely stalled after accelerating over the early months of the year.

Despite below-target inflation, policymakers have held the country's policy rate at 5.50% since June 2016. The BCH has noted on several occasions that, due to Honduras' relatively shallow financial markets, interest rate transmission is relatively weak. However, the bank does not yet appear concerned about the gradual uptrend in prices over recent quarters, underpinning our view that the BCH will hold for the remainder of the year.

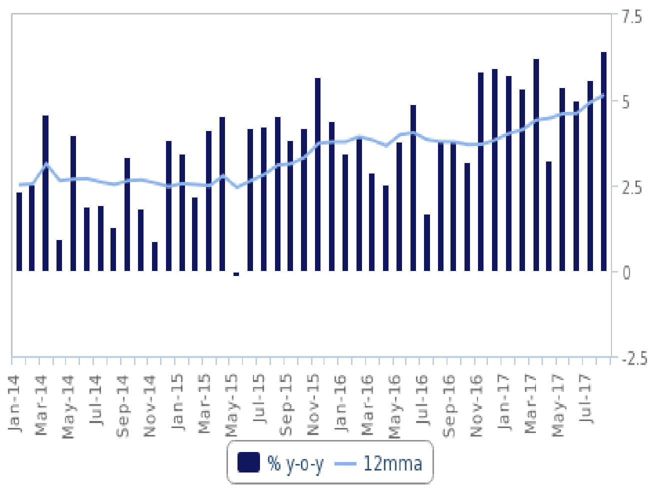
BCH Willing To Be Patient
Policy Rate, % & Inflation



Source: BCH, BMI

Heading into next year, robust growth in the Honduran economy will help drive rising price pressures. The IMAE economic activity index has averaged 5.4% y-o-y growth thus far in 2017, fuelled by rapid export growth, particularly in the agricultural sector, as well as remittance-fuelled private demand (*see 'Agriculture And Manufacturing Exports Will Underpin Growth', August 9*). We expect these dynamics to persist in the quarters ahead.

Economic Growth Picking Up Steam
IMAE Economic Activity Index

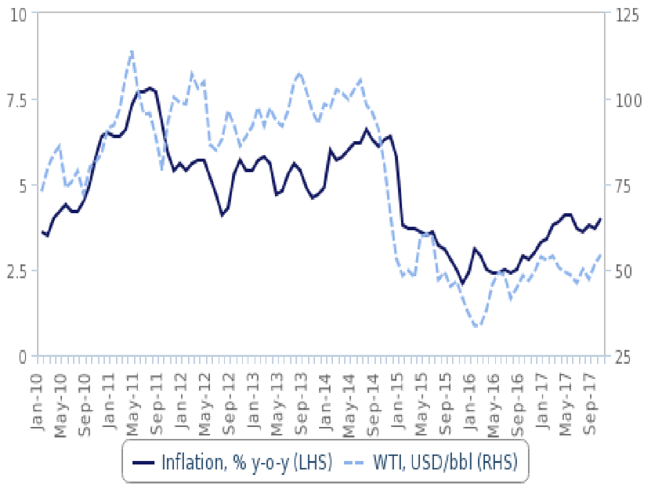


Source: BCH, BMI

The BCH will begin a hiking cycle in 2018 in response to rising inflation, in line with the broader trend in Central America (*see 'Rate Hikes Ahead As Inflation Accelerates In Central America', October 13*). We forecast inflation will average 4.2% in 2018, up from 3.8% in 2017, due to the demand-pull impact of rising economic activity and higher global crude prices. Our Oil & Gas team forecasts WTI to average USD54.0/bbl in 2018, up from USD50.0/bbl in 2017, and gradually trend higher in the years thereafter. Rising import prices will put upward pressure on inflation in the coming quarters.

Fuel Prices Will Push Inflation Higher

Consumer Price Inflation & West Texas Intermediate Crude



Source: BCH, Bloomberg, BMI

Domestic Politics

Hernández Faces Unrest Following Disputed Victory

BMI VIEW

Honduran President Hernández will likely serve his controversial second term with a much weaker mandate amid allegations of voter fraud. Furthermore, large-scale protests, social unrest and potential court battles will add to political instability in the coming months.

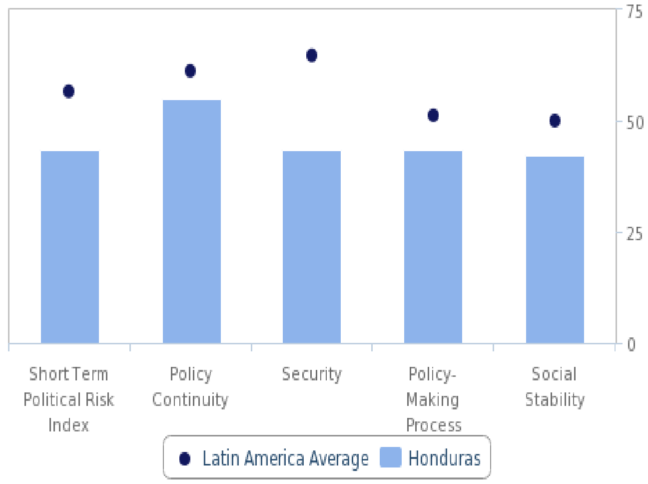
Heightened social unrest and large-scale protests are likely to weigh on political stability in Honduras over the coming months following the controversial re-election of President Juan Orlando Hernández over leftist opposition candidate Salvador Nasralla. Both Hernández and Nasralla claimed victory following elections held on November 26. The following day, preliminary results gave Nasralla a 5.0% lead. However, Hernández has since closed the gap. While the Supreme Electoral Tribunal (TSE) has yet to release the final result as of the time of writing, Hernández held a 0.5% lead with 94.3% counted and seemed very likely to be named the winner. While we expected a Hernández victory (*see 'Hernández Victory Likely Despite Controversy', November 22*), the vote was far closer than we anticipated.

Protests and legal battles are likely over the coming months. On November 29, Nasralla said he would not recognize the result of the election, reneging on an earlier pact he had signed brokered by the Organization of American States (OAS). Nasralla accused the Hernández government of voter fraud and urged his supporters to protest the results. At the time of writing, large-scale protests had erupted across the country and we expect that social unrest will remain heightened for some time.

A Hernández's second term was already set to be divisive, as he was only allowed to run after a controversial court ruling in 2015 lifted an 'ironclad' constitutional ban on presidential re-election. An attempt by leftist former president Manuel Zelaya, a Nasralla ally, to similarly amend the constitution led to his ousting in a military coup in 2009. Given the allegations of voter fraud, Hernández's second term will be even more contentious, leaving the president with a much weaker mandate. As a result, we have lowered Honduras's score in our Short-Term Political Risk Index to 43.5 out of 100, from 46.0 previously, reflecting heightened public unrest.

Elevated Political Risks Among Worst In Latin America

Latin America – Short-Term Political Risk Index



Note: Scores out of 100. Higher score = Lower risk. Source: BCH, BMI

Hernández Will Continue Pro-Business Policies

Despite heightened risks as result of the electoral controversy, we expect a Hernandez presidency will support policy continuity and the business environment. The government will continue to pursue policies aimed at promoting foreign investment and fiscal consolidation in an effort to reduce the country's debt burden and improve its sovereign credentials. The Hernández administration will also likely continue its militaristic security measures, which have led to reductions in crime in recent years. However, Hernández's weak mandate could limit his ability to pass legislation or fracture support from his Partido Nacional and other members of the political elite.

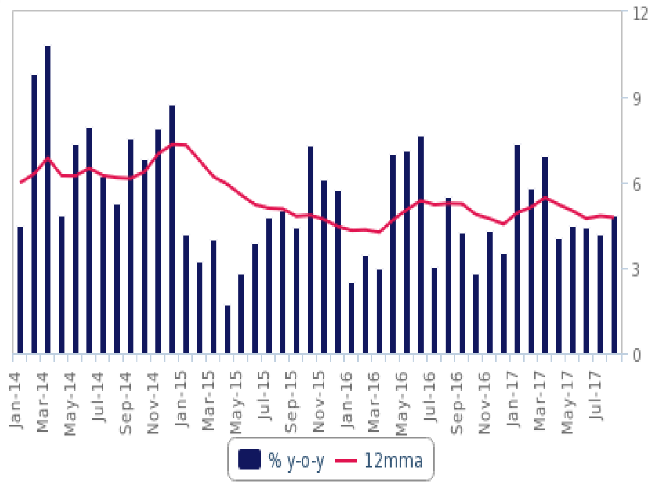
Economic Growth Outlook

Exports Drive Growth Outperformance

BMI VIEW

Nicaragua will continue to be a regional growth outperformer in the quarters ahead, on robust export growth and strong private consumption. However several potential headwinds, most notably the passage of the NICA Act in the US, will likely weigh on investment.

Growth Remains Robust
IMAE Economic Activity Index



Source: BCH, BMI

- We have modestly revised up our real GDP growth forecast for Nicaragua for 2017, due to stronger export and private consumption growth this year than we had anticipated.

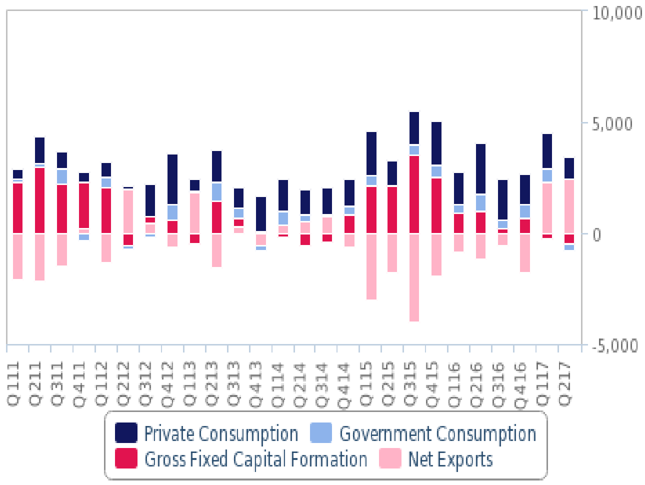
- We have also revised up our growth forecast for 2018, due to our expectation that these dynamics will persist in the coming months.

- We forecast real GDP growth of 4.5% in 2017 and 4.3% in 2018, from 4.3% and 4.1% (*see 'Growth To Be Robust, Though Risks Remain', May 19*). Full year data in 2016 showed 4.7% growth, above our estimate of 4.6%.

- The US is likely to pass the Nicaraguan Investment Conditionality Act (NICA), which will undermine financial support for Nicaragua from multilaterals, leading the government to cut capital expenditures in 2018.

- A likely victory for the ruling Frente Sandinista Liberación Nacional (FSLN) in November's municipal elections will ensure that political risks remain subdued.

Exports, Private Demand Drove H117 Growth
Real GDP By Expenditure, In 2006 NIOmn, y-o-y



Source: BCN, BMI

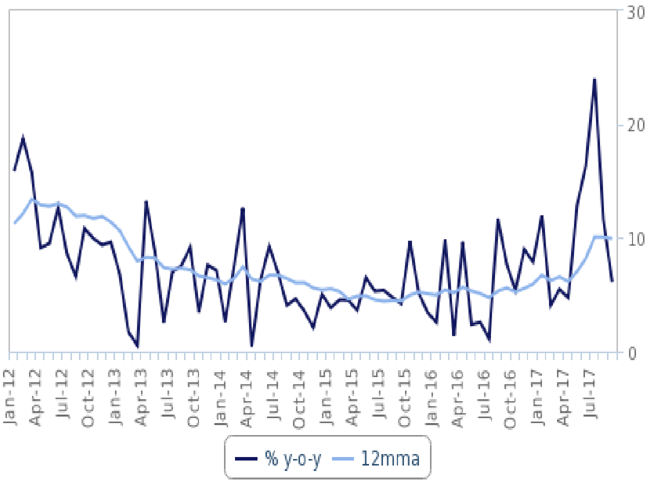
Robust H117 Performance Suggests Continued Strength

Nicaragua will continue to grow at a strong pace in the quarters ahead, following a robust economic expansion in H117. The economy expanded 5.4% y-o-y in real terms in the first half of the year, underpinned by export growth of 15.4%. Through August, exports of agricultural, fisheries and manufacturing goods have grown 23.5%, 9.1% and 17.4%, respectively, suggesting that strong export growth has carried into the second half of the year. While we expect export growth to modestly decelerate in Q417, as flooding caused by Tropical Storm Nate will cause crop loss, it will remain a source of strength given growth in major export markets such as the US.

Private consumption will be underpinned by robust remittance inflows, which have grown 4.0% y-o-y in H117. Remittances reached USD1.4bn in the 12 months to September, or 10.3% of 2016's nominal GDP. This is likely driven by stronger labour market conditions in the US, the largest source market for remittances to Nicaragua. Barring a more aggressive anti-immigrant policy in the US under President Donald Trump, which we expect is unlikely, we see remittance growth fuelling strong private consumption into 2018. An uptick in tourism inflows has also supported private consumption, reflected in the 7.7% y-o-y growth in the hotels and restaurants sector in H117.

Remittances Support Household Disposable Income

Family Remittances



Source: BCN, BMI

2018 Outlook Still Bright, Despite Risks

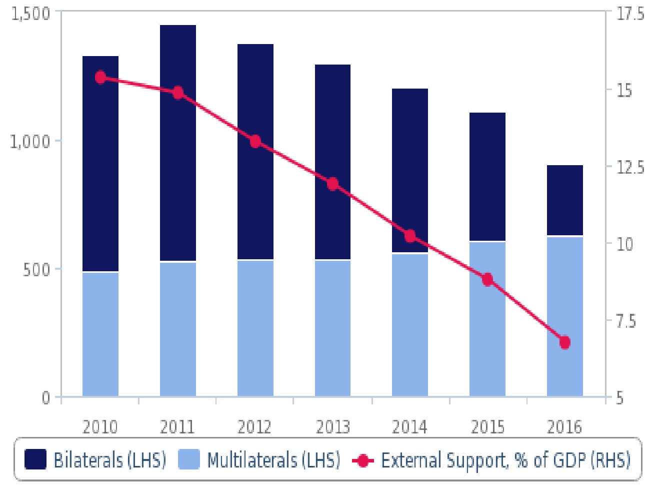
Exports and private consumption will continue to support activity into 2018. While growth will likely decelerate from the rates seen thus far in 2017, we expect that Nicaragua will remain among the fastest growing economies in Latin America. This positive trajectory will be supported by political stability. The FSLN posted a decisive victory in municipal elections on November 5 (*see 'Election Results Tighten FSLN's Grip On Power', November 6*). This will ensure that policy direction in the country remains unified in the quarters ahead, underpinning Nicaragua's score of 66.0 out of 100 in our Short-Term Political Risk Index, 5th out of 17 in Latin America.

However, we note several risks to Nicaragua's economic outlook. Most notably, the likely passage of the NICA Act in the US would require the US to veto any multilateral aid to Nicaragua. We estimate the Act could cost Nicaragua aid amounting to 3.0% of GDP. The country will most likely compensate for this loss of revenue by cutting capital expenditures, rather than popular social programmes (*see 'Growth To Be Robust, Though Risks Remain', May 19*). The NICA Act would also cut multilateral support for the private sector, and potentially discourage investors from opening operations in the country.

The loss of multilateral funding will also complicate Nicaragua's efforts to address funding shortfalls at its Social Security Institute (INSS). The INSS provides pensions, insurance and some health services to the general population, and the IMF reports that it will deplete its reserves by 2019. However, we believe that given unified FSLN control of all three branches of Nicaragua's government, and the party's recent moves to adjust its finances in order to compensate for declining aid from Venezuela, the government has the willingness and ability to intervene to shore up the INSS's finances. Various reforms have been discussed, including a gradual increase in the retirement age, reducing average benefits and requiring larger employer contributions.

Loss Of External Funding A Risk To Growth

Total External Support, USDmn



Source: BCN, BMI

Additionally, Nicaragua's poor operational environment will undermine investor interest in the country. Nicaragua scores only 41.9 out of 100 in our Operational Risk Index, placing it 11th in Latin America and 130th in the world. The country's score is held back by an elevated crime rate, poor infrastructure and a relatively low-skilled workforce. Despite robust growth rates in recent years and a stable political outlook, we believe that these are structural issues that will not be corrected in the short-term, and will continue to be a headwind to growth in the country for the foreseeable future.

Chapter 5.2:
Political Outlook – Nicaragua

Domestic Politics

Election Results Tighten FSLN's Grip On Power

BMI VIEW

Municipal elections on November 5 in Nicaragua saw the ruling FSLN win a decisive victory. However, concerns over the legitimacy of the election results will increase the chances that the US passes the NICA Act in the months ahead, reducing multilateral funding for the country.

As we expected, Nicaragua's ruling Frente Sandinista Liberación Nacional (FSLN), led by President Daniel Ortega, posted a decisive victory in municipal elections on November 5 (*see 'FSLN Set To Dominate Municipal Elections', May 19*). While full results have not yet been published, preliminary results from the national electoral board (CSE) suggest that the FSLN won 68.5% of the vote, likely capturing the majority of the 6,534 city council positions that were up for grabs and is leading in 148 of the 153 mayoral races. In second-place, was the Partido Liberal Constitucionalista (PLC) at only 16.2% of the vote.

However, turnout was relatively low by the CNE's estimation, at roughly 51.0% compared to 68.2% in 2016's general elections. However, electoral observers have indicated that the CSE's official figure likely overestimates the actual level of participation. The opposition coalition Frente Amplio por la Democracia (FAD) argues that turnout was as low as 20%, and other groups such as a mission from the Organisation of American States (OAS) and civil society group Panorama Electoral (PE) also reported that turnout was likely lower than the CSE's official number. Low participation likely reflects increasing disillusionment with the democratic process in the country after multiple disputed elections in recent years (*see 'Questions Over Election Legitimacy Will Bolster Opposition', November 7 2016*).

In addition to questioning the official participation figures, the opposition has alleged that the election was not free and fair, which will increase the likelihood that the US takes action against the Nicaraguan government. The opposition's criticisms are based on the following:

- The CSE is generally perceived to be controlled by the FSLN.
- The head of the OAS observation mission, Wilfredo Penco, is not seen by the opposition as a credible monitor, due to his endorsement of election results in 2008, 2011 and 2016 that the opposition criticised for lacking transparency.
- Several members of the opposition Partido Liberal Constitucionalista (PLC) were arrested the week before the elections, and numerous reports of voter intimidation on election day have emerged.
- Opposition mayoral candidates have resigned due to concerns about a lack of transparency in the process, and

TABLE: PRELIMINARY RESULTS OF MUNICIPAL ELECTIONS, BY PARTY

Party	Votes	% of total
FSLN	1,319,865	68.54
PLC	312,223	16.21
CxL	183,572	9.53
PC	25,635	1.33
PRD	23,365	1.21
YATAMA	21,645	1.12
ALN	21,042	1.09
PLI	14,530	0.75
APRE	3,909	0.20

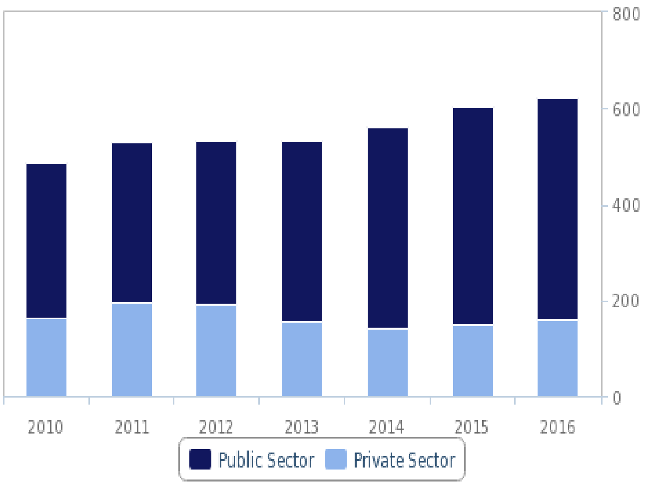
Source: CSE, BMI

one was murdered, though it is unclear if the incident was politically motivated.

- The FSLN-controlled national legislature altered the country's electoral law in order to make it easier to vote, which the opposition has argued will make it possible to vote twice.

Substantial Aid At Risk

Support From Multilaterals, USDmn



Source: BCN, BMI

Questions About Legitimacy Increase Likelihood NICA Act Passes

Given these concerns about the electoral process, we maintain our view that the US is likely to pass the Nicaraguan Investment Conditionality Act (NICA) into law in the months ahead, though we note there is currently no timetable for the bill's passage (*see 'Quick View: NICA Act Looks Increasingly Likely To Pass', October 5*). The law, which has already passed the US House of Representatives, requires the US to veto any multilateral aid to Nicaragua until the country makes democratic reforms. As we have previously argued, this will cost the public and private sector aid amounting to roughly 3.0% of GDP per year, while also creating uncertainty that will reduce the country's appeal to foreign investors (*see 'NICA Act To Widen Deficit From 2018', October 16*).

Domestically, we do not expect that the election results will have a substantial impact on the country's political trajectory. The FSLN already held the 134 of the country's mayoralties, and has a dominant position in all three branches of government, meaning that the municipal level victories will only marginally increase the party's power. Moreover, allegations that elections are not free and fair are not new, and in the past have not been enough to bolster the country's heavily divided opposition. We see no reason that the most recent vote will alter this trend. This stability underpins Nicaragua's relatively high score of 66.0 out of 100 in our Short-Term Political Risk Index, placing the country 5th of 17 in Latin America.

Chapter 6:
BMI Global Macro Outlook

Above-Trend Growth Spurs Central Banks To Act

- **BMI**'s global real GDP growth forecasts for 2017 and 2018 raised by 0.1pp in each year, to 3.2% and 3.1% respectively
- Growth forecast upgrades in November highlighted by improved outlook for world's four largest economies: US, China, Japan and the eurozone
- Monetary policy set to tighten against positive macro backdrop, with US leading the way and EM central banks having less room to ease
- Despite cyclical improvement, structural issues to weigh on growth in the long term

We have raised our growth forecasts for the world's four largest economies: the US, China, Japan and the eurozone, and in turn this has pushed up our global real GDP growth forecasts for 2017 and 2018 by 0.1 percentage points (pp) in each year, to 3.2% and 3.1% respectively. Both our emerging and developed markets aggregate growth forecasts have risen, with the increased pace of economic activity through the second half of 2017 thus far affirming our 'good as it gets' outlook for global growth and trade. We still see structural headwinds dragging down global growth as a whole over the longer run, with 3.1% annual expansion on average over 2017-2018 to fall slightly, to 3.0%, in the ensuing five-year period. Emerging markets excluding China will buck this trend, but in general, the current pace of global growth is likely to prove unsustainable.

TABLE: GLOBAL MACROECONOMIC FORECASTS

		2016	2017f	2018f	2019f	2020f	2021f
Real GDP Growth, % y-o-y							
	US	1.5	2.2	2.2	2.0	1.9	1.9
	Eurozone	1.8	2.2	1.8	1.6	1.5	1.5
	Japan	1.0	1.8	1.5	0.5	0.4	0.4
	China	6.7	6.8	6.5	6.2	5.8	5.4
	World	2.6	3.2	3.1	3.0	2.9	2.9
Consumer Inflation, % (ave)							
	US	1.8	2.0	2.0	2.1	2.1	2.1
	Eurozone	0.4	1.5	1.8	1.8	1.8	1.9
	Japan	-0.1	0.7	2.0	2.8	2.9	3.0
	China	1.8	1.6	1.8	2.2	2.3	2.4
	World	2.5	2.7	2.8	2.9	2.8	2.9
Interest Rates, % (eop)							
	Fed Funds Rate	0.5	1.3	1.8	2.3	2.3	2.3
	ECB Refinancing Rate	0.0	0.0	0.0	0.0	0.3	0.8
	Japan Overnight Call Rate	-0.1	-0.1	-0.1	0.0	0.3	0.5
Exchange Rates (ave)							
	USD/EUR	1.11	1.13	1.10	1.15	1.17	1.17
	JPY/USD	108.81	112.00	117.00	121.00	122.00	123.00
	CNY/USD	6.65	6.81	6.74	6.79	6.85	6.91
Oil Prices, USD/bbl (ave)							
	OPEC Basket	40.76	50.50	54.00	60.00	67.00	69.00
	Brent Crude	45.13	53.50	57.00	63.00	70.00	72.00

f = forecast. Source: BMI

Our expectations of monetary policy tightening have ratcheted up in November alongside these GDP revisions, with the low volatility, above-trend economic growth seen in most parts of the global economy providing opportunity to policymakers to normalise to varying degrees. In emerging markets, a combination of weaker exchange rates, rising commodity prices and firming economic growth will result in a modest uptick in inflation over the coming months, in our view. Accordingly, we believe that the interest rate cutting cycle has largely run its course in EMs. For instance, Brazil's central bank has cut interest rates by 625 basis points (bps) since the start of 2017, but we expect the bank to move to a neutral stance in 2018.

In the US, the announcement of Jerome Powell as the nominee to serve as the next chair of the US Federal Reserve, succeeding Janet Yellen, is unlikely to be a gamechanger for monetary policy in and of itself. Even so, clearer signs that core inflation will pick up over the coming quarters have led us to raise our end-2017 Fed funds rate forecast is up from 1.00-1.25% to 1.25-1.50%, while we still expect 50bps of hikes in each of 2018 and 2019. In total, this implies a 25bps increase to our end-2019 Fed funds rate forecast, from 2.00-2.25% to 2.25-2.50%. For 2018 and 2019, this keeps us above the futures markets but below the projections of the Fed policymakers themselves.

With the US central bank continuing on a hawkish path, it puts the contrast with the UK and eurozone in somewhat stark relief. Though the latter two have tightened policy in November, in line with the global theme, each did so in a 'dovish' way. The Bank of England (BoE), facing a weak growth outlook but an elevated inflation prognosis due to Brexit-related supply-side weakness, delivered a 'dovish hike' in the benchmark interest rate from 0.25% to 0.50% on November 2. However, we believe the BoE will keep its benchmark rate on hold throughout 2018, and

TABLE: DEVELOPED STATES – REAL GDP GROWTH, % y-o-y

	2016	2017f	2018f	2019f
Developed States Aggregate Growth	1.6	2.2	2.0	1.8
G7	1.4	2.1	1.9	1.7
Eurozone	1.8	2.2	1.8	1.6
EU-27	1.9	2.2	1.9	1.8
Selected Developed States				
Australia	2.5	2.1	1.8	2.2
Austria	1.5	2.3	1.8	1.8
Belgium	1.2	1.6	1.5	1.5
Canada	1.5	3.1	2.0	2.0
Czech Republic	2.4	4.3	3.3	2.4
Denmark	1.7	2.2	2.1	1.9
Finland	1.9	3.0	2.0	1.6
France	1.2	1.7	1.8	1.7
Germany	1.9	2.3	1.8	1.6
Hong Kong	2.0	3.5	3.0	2.5
Ireland	5.2	4.2	3.6	3.1
Italy	0.9	1.4	1.0	0.8
Japan	1.0	1.8	1.5	0.5
Netherlands	2.2	3.0	1.8	1.7
Norway	1.1	1.7	2.0	1.7
Portugal	1.4	2.5	1.9	1.3
Singapore	2.0	3.2	3.0	2.8
South Korea	2.8	3.2	3.0	3.2
Spain	3.2	2.9	2.2	2.2
Sweden	3.2	3.1	2.5	2.5
Switzerland	1.4	0.8	2.0	1.8
Taiwan	1.5	2.7	2.5	2.8
United Kingdom	1.8	1.5	1.2	1.5
United States of America	1.5	2.2	2.2	2.0

f = forecast. Source: BMI

for 2019 we have left our end-of-period rate forecast at 1.00%, contingent on our core view of a transition deal being agreed between the EU and UK, which facilitates a relatively benign Brexit outcome. The European Central Bank (ECB)'s tapering announcement in October points the way to a gradual exit from extraordinary accommodation, but its tone in delivering the news gave us no reason to change our mind that its policy will remain very easy for years. Our core view remains that the ECB will continue expanding its balance sheet into 2019 and keep its benchmark interest rates on hold until 2020, a policy mix that will keep the euro on the back foot against the US dollar.

Developed States

Developed States will expand by 2.2% on aggregate in 2017 and 2.0% in 2018, up from our previous forecasts of 2.1% and 1.8% in those years respectively, propelled by improved prospects for the Japanese, eurozone and US economies.

In Japan, the combination of surging equity prices and Prime Minister Shinzo Abe's re-election in October has given us cause to upwardly revise our real GDP growth forecast to 1.5% for 2018 from 0.5% previously (our 2017 estimate remains 1.8%). While the re-election of Abe's reform-minded government among other factors presents upside risks to long-term economic output, and we maintain our core view that Japan's real GDP growth will average just 0.4% between 2019 and 2026.

The eurozone expansion continues to hum along, and we have raised our real GDP growth forecast for 2017 to 2.2% from 2.1%. Real GDP growth in Q217 was revised up from 0.6% q-o-q to 0.7%, while the preliminary estimate of Q317 came in at 0.6% q-o-q and 2.5% y-o-y, the latter being the strongest since 2011. Subdued core inflation data, at the same time, supports the ECB's recent 'dovish taper' of asset purchases in 2018. Our 2018 real GDP forecast remains unchanged at 1.8%. The only

TABLE: EMERGING MARKETS – REAL GDP GROWTH, % y-o-y

	2016	2017f	2018f	2019f
Emerging Markets Aggregate Growth	**4.2**	**4.6**	**4.8**	**4.7**
Latin America	-0.5	1.5	2.3	2.5
Argentina	-2.3	2.9	3.2	3.5
Brazil	-3.6	0.4	1.7	1.9
Mexico	2.3	2.0	2.1	2.2
Middle East and North Africa	2.8	1.8	2.3	2.6
Saudi Arabia	1.7	-0.5	1.3	2.0
UAE	3.0	2.2	2.9	3.4
Egypt	4.2	4.1	4.9	4.6
Sub-Saharan Africa	1.8	2.5	3.8	4.0
South Africa	0.3	0.8	1.3	1.8
Nigeria	-1.5	1.5	3.0	3.5
Emerging Asia	6.4	6.4	6.3	6.1
China	6.7	6.8	6.5	6.2
India*	7.1	6.4	6.7	6.6
Indonesia	5.0	5.1	5.3	5.4
Malaysia	4.2	5.3	5.0	4.6
Philippines	6.8	6.3	6.3	6.1
Thailand	3.2	3.4	3.4	3.6
Emerging Europe	1.7	3.1	2.8	2.6
Russia	-0.2	1.6	1.7	1.7
Turkey	2.9	4.3	3.3	2.9
Hungary	2.0	3.6	3.3	2.6
Romania	4.8	5.4	3.8	3.6
Poland	2.8	4.1	3.6	3.2

*f = forecast; *Fiscal years ending March 31 (2017 = 2017/18). Source: BMI* sour note comes from Spain, where the ongoing crisis surrounding Catalonia's attempts to secede will weigh on the national economic recovery in the years ahead. We have revised down our Spanish real GDP growth forecasts from 3.0% to 2.9% in 2017 and from 2.4% to 2.2% in 2018.

Meanwhile, the US economy posted its second consecutive quarter of annualised growth of 3.0% q-o-q or above in Q317, beating both consensus and regional Federal Reserve 'nowcast' estimates, which anticipated growth of about 2.6%. While we expected the US economy to largely shrug off the impact of Hurricanes Harvey and Irma in H217, we expected Q3 to be weaker, with losses to be made up in Q4. With the economy more resilient than we expected, we have upgraded our real GDP growth forecasts for both 2017 and 2018 by 0.1pp to 2.2% in each year. While slightly more optimistic, we do not believe the current rate of growth to be sustainable, with underlying expansion (which we gauge by the 'final sales to domestic purchasers' sub-indicator of GDP) somewhere closer to 2.0% than 3.0%.

Emerging Markets

EMs continue to enjoy an acceleration in real GDP growth, on the whole, supported by relatively firm demand in the US, eurozone and China, rising commodity prices and generally positive investor sentiment towards EMs. In tune with this upbeat picture, the main revisions we have made to our growth forecasts over November have been to the upside. We have raised our projections for two EM giants, China and Russia, following better-than-expected data in both cases. That said, as outlined below, we temper our optimism, given structural challenges in both countries – and indeed, many other EMs, particularly the commodity producers.

Focusing first on China, we have revised upward our forecasts for real GDP growth on the back of the latest quarterly GDP data. In Q317, the Chinese economy grew by 6.8% y-o-y, supported by fiscal stimulus as policymakers sought to keep growth elevated in the run-up to the 19th National Congress of the Communist Party of China. Given that the figure was higher than we anticipated, we have notched up our forecasts for real GDP growth to 6.8% in 2017 and 6.5% in 2018, from 6.6% and 6.3% respectively. However, we expect growth to slow gradually over the coming quarters, as the Chinese government allows credit growth and fiscal spending to wind down. The relatively strong economic performance over the past three quarters will provide the opportunity for policymakers to tackle structural issues such as overcapacity, speculation in the property market and rising local government debt.

With regard to Russia, we have raised our real GDP growth forecast for 2017 from 1.2% to 1.6% to account for stronger than anticipated economic activity in Q217. Real GDP growth expanded by 2.5% y-o-y, following an acceleration of 0.5% in the previous quarter, and marking the strongest pace of expansion since 2012. The uptick was driven primarily by stronger household spending and a rebound in fixed investment, which suggests that the economic recovery is finally picking up steam on the back of stronger domestic demand. We have also increased our forecasts for GDP growth in 2018, albeit more moderately, from 1.6% to 1.7%. We expect growth to hover around the 1.7% mark thereafter, mirroring our long-held view that the economy will remain on a sluggish growth trajectory by historical standards, owing to structural constraints stemming from a lack of progress in much-needed reforms.

TABLE: CENTRAL AMERICA – MACROECONOMIC DATA & FORECASTS

		2016e	2017f	2018f	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f
Costa Rica	Nominal GDP, USDbn	56.9	58.6	61.7	65.4	69.0	72.9	76.8	81.2	85.8	90.7	95.8
	Real GDP growth, % y-o-y	4.5	3.9	3.7	3.4	3.3	3.5	3.2	3.5	3.5	3.4	3.4
	Consumer price inflation, % y-o-y, ave	0.0	1.5	2.6	3.5	3.8	4.0	4.0	4.0	4.0	4.0	4.0
	Exchange rate CRC/USD, ave	546.96	555.00	561.68	567.59	576.96	587.92	599.68	611.68	623.91	636.39	649.12
	Budget balance, % of GDP	-4.2	-4.6	-4.5	-4.0	-4.2	-4.1	-3.6	-3.2	-3.0	-2.7	-2.5
	Current account balance, % of GDP	-3.0	-3.5	-3.4	-3.1	-3.1	-2.9	-3.0	-3.2	-3.5	-3.9	-4.2
El Salvador	Nominal GDP, USDbn	26.8	27.0	28.3	29.5	31.0	32.6	34.2	36.0	37.8	39.6	41.4
	Real GDP growth, % y-o-y	2.4	2.2	2.1	2.0	2.1	2.3	2.6	2.5	2.5	2.7	2.3
	Consumer price inflation, % y-o-y, ave	0.6	1.0	2.1	2.3	2.4	2.5	2.5	2.5	2.5	2.5	2.5
	Exchange rate USD/EUR, ave	1.11	1.13	1.1	1.15	1.17	1.17	1.17	1.17	1.17	1.17	1.17
	Budget balance, % of GDP	-2.8	-2.7	-2.6	-2.5	-2.4	-2.3	-2.3	-2.2	-2.1	-2	-1.9
	Balance of trade in goods and services, % of GDP	-14.5	-15.1	-15.5	-15.9	-16	-16.2	-16.4	-16.7	-17	-17.3	-17.7
	Current account balance, % of GDP	-2	-1.4	-1.5	-2	-2.2	-2.5	-2.9	-3.3	-3.6	-3.8	-4.1
Guatemala	Nominal GDP, USDbn	68.8	77.5	86.1	93.1	101.1	110.1	119.5	130.3	142.5	156.4	171.5
	Real GDP growth, % y-o-y	3.1	2.8	3.4	3.6	3.5	4	3.9	4.1	4.1	4.2	4.2
	Consumer price inflation, % y-o-y, ave	4.4	4.5	5	5.2	5.4	5.5	5.5	5.5	5.5	5.5	5.5
	Exchange rate GTQ/USD, ave	7.6	7.38	7.25	7.24	7.29	7.35	7.43	7.48	7.5	7.5	7.5
	Budget balance, % of GDP	-1.1	-1.4	-1.4	-1	-0.1	0.3	0.4	0.8	1	1	1.1
	Balance of trade in goods and services, % of GDP	-8	-7.1	-6.9	-7	-7	-6.8	-6.6	-6.3	-6.1	-5.8	-5.6
	Current account balance, % of GDP	1.3	2.6	2.3	2.1	1.9	1.9	1.8	1.5	1.3	1.1	1.0
Honduras	Nominal GDP, USDbn	21.4	21.8	23.5	24.2	25.2	26.2	27.2	29	30.3	32.9	34.9
	Real GDP growth, % y-o-y	3.6	3.7	3.8	3.3	3.6	3.2	2.3	2.9	2.7	3.3	3
	Consumer price inflation, % y-o-y, ave	2.7	3.8	4.8	4.4	4.3	4.2	4.3	4.3	4.3	4.3	4.3
	Exchange rate HNL/USD, ave	22.92	24.30	24.50	25.50	26.50	27.50	28.50	29.00	30.00	30.00	30.67
	Budget balance, % of GDP	-2.8	-2.7	-2.5	-2.4	-2.4	-2.3	-2.2	-2.1	-2.1	-2	-1.9
	Balance of trade in goods and services, % of GDP	-15.5	-15.5	-15.7	-16.4	-16.6	-17	-17.3	-17.2	-17.4	-16.9	-16.8
	Current account balance, % of GDP	-3.8	-2.4	-2.9	-3.2	-3.5	-4	-4.3	-4.4	-4.7	-4.8	-4.9
Nicaragua	Nominal GDP, USDbn	13.3	13.8	14.5	15.1	15.9	16.8	17.7	18.7	19.7	20.7	21.8
	Real GDP growth, % y-o-y	4.7	4.5	4.3	4	3.8	3.6	3.3	3.5	3.3	3.1	3.4
	Consumer price inflation, % y-o-y, ave	3.1	3.9	4.8	5	5.5	6	6	6	6	6	6
	Exchange rate NIO/USD, ave	28.55	29.98	31.48	33.05	34.71	36.44	38.26	40.18	42.19	44.29	46.51
	Exchange rate NIO/USD, eop	29.32	30.79	32.33	33.94	35.64	37.42	39.29	41.26	43.32	45.49	47.76
	Budget balance, % of GDP	-1.1	-1.3	-1.9	-1.5	-1.6	-1.6	-1.6	-1.3	-1.1	-1	-0.9
	Current account balance, % of GDP	-8.5	-8.1	-7.8	-7.7	-7.4	-7.1	-6.8	-6.5	-6.2	-5.9	-5.6

e/f = BMI estimate/forecast. Source: National sources, BMI

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