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Investment needed for recovery

In July the Economic Commission for Latin America and the Caribbean (ECLAC) published its latest regional economic assessment. With countries behaving quite heterogeneously, it calculates that regional GDP will contract by 0.8% year-on-year in 2016, steeper than the 0.5% fall registered in 2015. Once again, the commission recommends that governments need to do more to promote both public and private sector investment to aid the recovery.

In its latest (2016) *Economic Survey of Latin America and the Caribbean*, ECLAC says that relatively low global economic growth, sluggish trade, low commodity prices and international financial volatility in the wake of Brexit (the UK referendum decision to leave the European Union) have all worked to keep the region in recession for a second year in succession.

By sub-regions, South America will register the worst performance, with a real annual GDP contraction of 2.1%, reflecting the aforementioned global factors plus a significant fall in domestic demand. Central America, by contrast, will grow by 3.8% this year, benefiting from low oil import prices, recovering external and domestic demand, and increased income from remittances. The Caribbean economies will contract by 0.3%.

Taking the individual countries, the commission estimates that worst recessions will be experienced in Venezuela (-8.0%), Suriname (-4.0%), Brazil (-3.5%), Trinidad and Tobago (-2.5%), Ecuador (-2.5%) and Argentina (-1.5%). Regional growth will be led by the Dominican Republic (+6.0%), Panama (+5.9%) Nicaragua (+4.5%), Bolivia (+4.5%) and Costa Rica (+4.3%). Across the region, urban unemployment is set to rise to 8.1% in 2016, from 7.4% in the preceding year.

ECLAC calls on regional governments to respond to the recession by mobilising investment. "The capacity of countries to accelerate economic growth depends on the spaces for adopting policies that support investment. These policies should be accompanied by efforts to change the conversation between the public sector and private companies. Increasing productivity is also a key challenge for moving forward along a path of dynamic and stable growth" noted Alicia Bárcena, ECLAC's longstanding executive secretary.

The report says that to encourage the funding of investment projects it is necessary to reform fiscal structures; improving tax collection and progressivity. Income taxes levied on companies and individuals alike should be strengthened. ECLAC calculates that tax avoidance currently represents 6.7 percentage points of regional GDP (around US$340bn) and needs to be reduced.

A report by BBVA Research on the third quarter outlook for Latin America is broadly in line with the ECLAC view. It expects regional GDP (based in this case on a weighted average of the top ten economies) to drop by 0.9% this year, after a fall of 0.4% in 2015. In the short term, it suggests that signs of a

more dovish path for US Federal Reserve monetary tightening have compensated the negative impact of Brexit on economic sentiment.

BBVA projects regional growth of 1.8% next year, reflecting a stronger external sector (the effect of depreciated exchange rates and better terms of trade) and investment, particularly private sector investment in Argentina and infrastructure investment in Peru and Colombia. Nevertheless, it warns that, "2017 growth will be weak, still below the OECD, and below the region's potential." Of the ten regional counties it monitors, it predicts that the most dynamic next year will be Peru, Argentina, Colombia and Paraguay. Across the region, it expects inflationary pressures to fall, with the exception of Argentina, Colombia and Uruguay.

The BBVA view is that both fiscal and current account deficits will begin to narrow next year. It warns, however, that public expenditure cuts in Brazil will be less ambitious than expected and may be limited by the political environment.

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT

(Annual growth rates)

	2007	2008	2009	2010	2011	2012	2013	2014	2015 a/
Latin America and the Caribbean b/	5.9	4.1	-1.7	6.2	4.5	2.8	2.9	0.9	-0.5
Latin America	5.9	4.1	-1.7	6.3	4.5	2.9	2.9	0.9	-0.5
Argentina	9	4.1	-6	10.4	6.1	-1.1	2.3	-2.6	2.4
Bolivia (Plurinational State of)	4.6	6.1	3.4	4.1	5.2	5.1	6.8	5.5	4.8
Brazil	6.1	5.1	-0.1	7.5	3.9	1.9	3	0.1	-3.9
Chile	4.6	3.7	-1	5.8	5.8	5.5	4	1.9	2.1
Colombia	6.9	3.5	1.7	4	6.6	4	4.9	4.4	3.1
Costa Rica	7.9	2.7	-1	5	4.5	5.2	2	3	3.7
Cuba	7.3	4.1	1.5	2.4	2.8	3	2.7	1	4.3
Dominican Republic	8.5	3.2	0.9	8.3	3.1	2.8	4.7	7.6	7
Ecuador	2.2	6.4	0.6	3.5	7.9	5.6	4.6	3.7	0.3
El Salvador	3.8	1.3	-3.1	1.4	2.2	1.9	1.8	1.4	2.5
Guatemala	6.3	3.3	0.5	2.9	4.2	3	3.7	4.2	4.1
Haiti	3.3	0.8	3.1	-5.5	5.5	2.9	4.2	2.8	1.2
Honduras	6.2	4.2	-2.4	3.7	3.8	4.1	2.8	3.1	3.6
Mexico	3.2	1.4	-4.7	5.2	3.9	4	1.4	2.2	2.5
Nicaragua	5.3	2.9	-2.8	3.2	6.2	5.6	4.5	4.6	4.9
Panama	12.1	8.6	1.6	5.8	11.8	9.2	6.6	6.1	5.8
Paraguay	5.4	6.4	-4	13.1	4.3	-1.2	14	4.7	3
Peru	8.5	9.1	1.1	8.3	6.3	6.1	5.9	2.4	3.3
Uruguay	6.5	7.2	4.2	7.8	5.2	3.5	4.6	3.2	1
Venezuela (Bolivarian Republic of)	8.8	5.3	-3.2	-1.5	4.2	5.6	1.3	-3.9	-5.7
Caribbean	6.5	1.4	-3.4	1.4	1	1.3	1.5	0.4	-0.5
Antigua and Barbuda	9.3	0	-12	-7	-1.8	3.8	-0.2	4.6	4.1
Bahamas	1.4	-2.3	-4.2	1.5	0.6	3.1	0	-0.5	-1.7
Barbados	1.7	0.3	-1.5	0.3	0.8	0.3	-0.1	0.2	0.9
Belize	1.1	3.2	0.8	3.3	2.1	3.7	1.3	4.1	1.2
Dominica	6.4	7.1	-1.2	0.7	-0.2	-1.1	0.8	4.2	-1.8
Grenada	6.1	0.9	-6.6	-0.5	0.8	-1.2	2.4	5.7	5.1
Guyana	7	2	3.3	4.4	5.4	4.8	5.2	3.8	3
Jamaica	17.1	-0.7	-4.4	-1.5	1.7	-0.6	0.5	0.7	0.8
Saint Kitts and Nevis	-0.2	6.3	-3	-2.2	2.4	-0.6	6.2	6	3.8
Saint Vincent and the Grenadines	2.4	2.5	-2.1	-3.4	-0.4	1.4	1.8	1.2	1.6
Saint Lucia	1	4.2	-0.4	-1.7	0.2	-1.4	0.1	0.4	2.4
Suriname	5.1	4.1	3	5.2	5.3	3.1	2.9	1.8	-2
Trinidad and Tobago	4.5	3.4	-4.4	3.3	-0.3	1.3	2.3	-1	-2.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

a/ Preliminary figures.

b/ Based on official figures expressed in 2010 dollars.

BRAZIL

Olympics, impeachment, elections

Perhaps the most important economic story in Brazil right now is that after the worst two-year recession in more than half a century, a recovery is beginning to take shape. However, the country still faces an unusual sequence of events: the completion of the Olympic Games and a formal impeachment trial of the suspended president, Dilma Rousseff, by the end of August, followed by municipal elections in October. In short, the long-awaited return to positive economic growth still faces a complex combination of political risks.

At last, signs of recovery are coming through. It is still a patchy picture, with confidence levels, production and exports beginning to rise in the industrial sector, while retail sales, the services sector, credit and employment levels across much of the rest of the economy are still lagging. The industry confidence index (ICI) prepared by the Fundação Getúlio Vargas (FGV), which hit a six-year low in August last year (at 73.5 points) has now increased in each of the five consecutive months leading up to and including July (when it rose to 86.9 points). FGV's consumer confidence indicator has taken longer to return to positive, notching up three months of consecutive improvement to July (when it reached 76.7). Elsewhere, the index of physical industrial production prepared by the national statistics institute (IBGE), was up by 1.1% month-on-month in June, the fourth consecutive month of improvement (it was still down by 6.0% on June 2015, but that nevertheless was an improvement on the 10%-plus year-on-year falls registered as recently as March). And finally, the central bank's regional economic activity index (IBC-Br), a proxy for GDP, fell by 1.0% year-on-year in the three months to May, the fourth consecutive quarter in which the rate of contraction has eased.

Based on this gradually stabilising data, Brazil appears to be on track for an unfurling recovery in the second half of the year, gathering more strength in 2017. On an annual basis, real GDP fell by 5.4% in the first quarter and analysts are suggesting that the second quarter data, due to be released in late August, will show the rate of contraction easing to around 3% year on year. This would be in line with those economists predicting a return to positive annual growth in 2017. According to the IMF's latest (July) update to its World Economic Outlook, the Brazilian economy will contract by 3.3% in real annual terms this year, but will swing back round to post positive growth of 0.5% in 2017.

Clouding the reliability of most forecasts is the sequence of events coming up in short order. The first is the conclusion of the 2016 Olympic Games in Rio de Janeiro. At the time of writing (the final days of the month-long games), there was a consensus that the event had gone off much better than had been feared. The run-up to the Games was dominated by worries over the Zika virus, political protests, security issues, the condition of infrastructure for the Games and Rio's financial crisis (the State recently was bailed out by the federal government and budget problems have also impacted the Paralympic Games). In the event, none of the worst fears materialised. However, there is also reason to believe that any positive economic effects from the Games probably were marginal, at least on the first analysis. As per a study of the last eight countries to have hosted the Olympics, in over half of them average GDP growth in the quarters preceding and following the tournament was actually lower than before. A London-based consultancy, Capital Economics, has pointed out that even if official predictions of an extra 350,000-500,000 tourists turn out to be correct, their extra spending in Brazil would be equivalent to no more than 0.05% of GDP.

The second event is the expected conclusion of the impeachment trial of President Dilma Rousseff. The president is accused of budget irregularities. The final federal senate vote on impeachment is expected to go against her. A two-thirds majority is required to impeach: the senate voted 55-22 to suspend her in May, and then by an increased margin of 59-21 voted to indict her in August. On these numbers, it is hard to see her staying in office. Impeachment can be construed as positive for the economy. This is because Rousseff, of the left-wing Partido dos Trabalhadores (PT), had presided over a disastrous widening of the fiscal deficit and a generalised loss of business confidence in government policy. The argument is that Michel Temer, her former vice-president, who since May has been interim president at the head of the more centrist Partido do Movimento Democrático Brasileiro (PMDB), supports more orthodox policies, and that these are likely to be better for the recovery. A definitive vote to impeach Rousseff will also reduce uncertainty, as it means that Temer will serve out the rest of the current term until the scheduled general election in October 2018.

The third event is the municipal elections. These will be held in two rounds on 2 and 30 October, with voters electing mayors and city councils in the country's 5,568 municipalities. Although the economic impact of these polls is open to interpretation, from one point of view they could be negative for the recovery.

From the perspective of investors, the key step needed to put Brazil on a sustainable economic recovery path is the approval of deep structural fiscal reforms. The Rousseff administration promised many reforms but failed to secure the necessary congressional support to see them through. The Temer administration has delivered some initial reforms, and has promised more. However, there is a risk that its plans too will be postponed or diluted as the October elections approach and the authorities bow to political expediency. On 19 August, Temer and his finance minister, Henrique Meirelles, were trying to convince members of congress to pass legislation limiting state-level spending and giving the government greater flexibility in the way it uses federal tax revenues. Deputies from poor northern states had blocked the bills. A government official who wished to remain anonymous told the *Reuters* news agency: "The government is worried and wants to push for the approval of these measures. We need to get these bills approved so we can move with the more important fiscal measures".

COLOMBIA

Worries over a fiscal crunch

In politics and economics, timing is everything, some say. That dictum is about to be tested in Colombia. Amid reduced oil revenues and increased spending commitments linked to the historic pending peace settlement with the rebel group Fuerzas Armadas Revolucionarias de Colombia (Farc), the government of President Juan Manuel Santos is running out of money. Santos says the situation is in hand, and that a major tax reform will be introduced before the end of this year to balance the books. But with a referendum on the peace agreement also due to be held before the end of the year, critics say the tax reform may slip back, with damaging consequences.

It has been argued for years that Colombia has an inefficient tax system, which doesn't generate enough money, is too complicated and bureaucratic and manages to over-tax companies while under-taxing the rich. In fact, central government tax revenue in 2015 was equivalent to only 14.5% of GDP, one of the lowest in the region. A review of the tax system carried out by the Organisation for Economic Cooperation and Development (OECD, to which Colombia is in the process of accession) concluded that it relied heavily on Value-Added Tax (VAT), which tended to be regressive and is complicated by

a multitude of exemptions and special rates. Personal Income Tax (PIT) has a high tax-free allowance and a series of exemptions that benefit the wealthy.

The corporate tax burden, on the other hand, is extremely high, with companies paying income tax, a wealth tax on net assets (CREE) and non-refundable VAT on fixed assets. Here too, a series of exemptions generate distortions between different types of companies and industry sectors. According to Raimundo Díaz of a local consultancy, Grupo TMF, multinationals operating in Colombia complain that they face a high tax burden, complex tax requirements, high penalties for non-payment, and a proliferation of new taxes.

Two factors have made the need for reform particularly acute. One is the collapse of international oil prices. Oil related revenues (such as dividends paid by the state-owned oil company, Ecopetrol) represented around one-fifth of central government income, and have dropped to virtually zero. In June, Finance Minister Mauricio Cárdenas described the oil price slump as "the biggest shock to our income that the national government has received in recent history".

The other is the peace agreement with the Farc, which includes a wide range of commitments to pay reparations, retrain and resettle former fighters, carry out sweeping land reform, and boost social programmes in isolated rural areas. Estimates of the total cost range from US$15bn to US$45bn (5%-15% of GDP), spread over a number of years. In time, these will be partly offset by the beneficial effects of peace (such as a higher real GDP growth rate), but in the next few years there clearly will be considerable demand on government resources.

Some of these strains are already showing in the 2016 and 2017 budgets. Cárdenas had described this year's budget as an exercise in "intelligent austerity", implementing a series of spending cuts to limit the fiscal deficit to not more than 3.6% of GDP. In June, he was forced to admit that the target would be overshot, with the deficit reaching 3.9% of GDP. Cárdenas recently submitted a draft 2017 budget to congress that envisages total spending of COP224.4bn (US$72.6bn). This proposal is due to be debated and approved by mid-October. Assuming real annual GDP growth of 3.5% next year, it aims to limit the deficit to 3.3% of GDP. But to meet that target it includes some drastic cuts. Because of peso depreciation, debt service costs are set to surge by 15.1%. Meanwhile, public sector investment has been slashed by 10.3%, to COP32.9bn, equivalent to just 1.1% of GDP. Colombia's national association of financial institutions (ANIF) says that after debt servicing is put to one side, and taking inflation into account, budget spending will fall by 2.7% in real terms in 2017, relative to this year. It predicts continuing "fiscal turbulence" in 2017 and 2018.

Anticipating the fiscal squeeze, President Santos had named a commission of experts to propose a major package of tax reforms. They duly submitted their report in December last year. Recommendations included increasing the VAT rate from 16% to 19%, widening the scope of personal income tax, introducing a single tax on corporate profits at 30% (down from the 34% rate currently being paid by many companies), increasing sales taxes on soft and alcoholic drinks and tobacco products, and eliminating many small and complex taxes that generate only marginal revenue.

While the government is not bound to accept all these recommendations, President Santos is on record as saying the executive will give the report due consideration before it presents a package of structural reforms in the second half of this year, aimed at guaranteeing the sustainability of budget finances and social programmes. But many now doubt that the tax reforms can be approved by congress before the end of the year.

The problem is that the government has also agreed to hold a referendum on whether to ratify or reject the peace agreement with the Farc. The exact date for the referendum has yet to be fixed, but it is expected in late September at the earliest, and probably is more likely in October or even later. Politically, the government wants to keep the two issues of peace and tax reform separate, particularly as aspects of the tax reform (such as any increase in VAT) are likely to be unpopular. This suggests that the tax reform might only be submitted to congress after the referendum, which means it could well slip into early 2017.

Does it matter? Many say yes, for various reasons. One is that without tax reform, public investment has had to be squeezed down to minimal levels, which will damage future growth. Another is that putting back the reform will delay the necessary fiscal deficit reduction process. Most importantly, it could lead ratings agencies to downgrade Colombian debt, leading to a further increase in debt servicing costs. In July, Fitch Ratings revised its outlook on Colombian debt to 'negative' from 'stable' citing the country's high current account and fiscal deficits. It noted that Colombian government debt stood at 46.5% of GDP last year, above the 40% average among countries that share Colombia's 'BBB' rating. Nevertheless, Fitch said its base scenario was that congress would approve "revenue positive tax reform" before the end of 2016.

EASTERN CARIBBEAN

Stuck in the slow lane

The countries and territories of the Eastern Carribean Currency Union (ECCU) are benefiting from growth in numbers of visitors and lower oil prices. However, they will continue to be hampered by structural challenges such as high levels of indebtedness, over-dependence on tourism and vulnerability to natural disasters.

On 11 August , the IMF published its evaluation of the common policies of the ECCU. It noted that "the regional recovery is gaining ground, supported by continued low oil prices, strong tourism arrivals, and robust [receipts from Citizenship By Investment Programs – CBIPs]. Three failed banks have been resolved with no spill-overs to the rest of the region and fiscal management has improved." This assessment followed a number of generally upbeat statements following four Article IV consultations with ECCU governments since April.

However, latest published statistics highlight the risks and challenges facing the ECCU. **[1]** For the sub region as a whole, economic growth is accelerating, but from a low base. In part because of the fall in oil prices, and in part because of the currency peg managed by the Eastern Caribbean Central Bank (ECCB), which fixes the Eastern Caribbean dollar to the US dollar at a rate of EC$2.70/US$, inflationary pressures have been minimal. Commercial banks have been very cautious, with the result that lending to the private sector has contracted over recent years. Although the details vary from country to country, the region as a whole would be running a fiscal deficit of about 4% of GDP this year if it were not for the revenues from CBIPs (*see box*). Public debt is moving downwards slowly relative to the overall economy, but is still a long way from the 60% of GDP target for the region in 2030. Tourism remains the key industry, with receipts accounting for nearly a fifth of GDP. Finally, although the region's current account deficit with the rest of the world is small in absolute terms and relative to many benchmarks, it is still significantly larger than 10% of GDP.

Debt dynamics vary markedly. Six of the ECCU countries have had a major debt restructuring since 2010. Thanks in part to stronger economic growth

Chart 1. Eastern Caribbean Currency Union (ECCU)*			
	2015	2016	2017
Real GDP Growth %	1.9	2.1	2.6
CPI Inflation %	-0.9	-0.2	1.3
Private Sector Credit Growth %	-4.3	-1.7	0.8
Overall Gov't. Balance % GDP	-2.1	-2.0	0.0
Excluding CBI Programs	-4.7	-4.0	-1.7
Total Public Debt % GDP	81.7	81.7	78.1
Travel Receipts % GDP	18.4	18.1	18.0
External Current Account Balance % GDP	-12.8	-11.8	-12.9
Source: *IMF Press Release No. 16/376 of 11 August 2016*			
*Antigua & Barbuda, Dominica, Grenada, St Kitts & Nevis, St Lucia, St Vincent & the Grenadines, Anguilla and Montserrat			
2015 figures are preliminary. 2016 and 2017 figures are projections.			

(which has been boosted by revenues from its CBIP), St Kitts & Nevis has achieved a substantial reduction in its debt/GDP ratio over the last 15 years. For the ECCU as a whole, though, the ratio has risen by 19.5 percentage points to 88.7%. Interest payments equate to about one tenth of government revenues across the ECCU. However, in St Lucia, they equate to nearly one fifth. **[2]**

Chart 2. ECCU Debt Dynamics				
	Gov't. Debt / GDP	Change in Debt Ratio 2000-15 (pp)	Interest as % Gov't Revenue 2015	Restructuring Since 2010?
Antigua & Barbuda	106.9	-3.9	13.7	Yes
Dominica	78.5	10.2	7.2	No
Grenada	107.1	65.5	14.7	Yes
St Kitts & Nevis	74.5	-22.3	5.6	Yes
St Lucia	88.0	49.0	17.6	No
St Vincent & Grenadines	77.1	18.6	6.5	No
ECCU	88.7	19.5	10.9	
Source: *MIS, IMF, cited by FT Alphaville 23 February 2016*				

The tourism industry has been growing, but slowly and unevenly. **[3]** Across the ECCU countries, total receipts in Q1 16 amounted to EC$1.27bn, up from EC$1.16bn in Q1 15 and EC$1.12bn in Q1 14. The numbers of tourist arrivals have been growing. However, the more valuable 'stay over' visitors, who arrive by air (as opposed to day trippers from cruise liners) continue to account for about one sixth of the total.

The ECCU countries remain vulnerable to natural catastrophes. The probability of a hurricane striking in any one year ranges from about 9% in Grenada (the southernmost of the ECCU countries) to over 16% in St Lucia, according to the IMF and the EM-DAT database. By these metrics, the ECCU countries are among the 50 most disaster-prone countries globally.

Through 2015 and 2016, the ECCU countries have benefited from three trends. One is fiscal reform, which generally has not boosted growth but has improved the risk profiles of some countries. The second is the fall in the price of imported energy, which appears likely to persist. The third relates to the economic recoveries in the US, Canada and the UK, which has provided a boost to the tourism industry, if not a dramatic (nor necessarily sustainable) one.

Nevertheless, the main structural challenges remain unresolved. The ECCU countries are overly dependent on tourism, and face strong competition

Chart 3. Tourist Arrivals

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16
Anguilla	51,984	44,847	38,264	41,685	58,702	45,858	41,788	39,720	52,640
Of which: Stay over by air	21,538	18,888	13,543	16,958	22,836	18,519	14,759	17,118	23,348
Antigua & Barbuda	365,407	111,520	89,666	233,068	405,670	140,052	94,974	268,964	412,480
Of which: Stay over by air	79,550	58,767	49,810	61,189	74,493	58,922	50,172	66,863	84,566
Dominica	191,746	46,418	23,061	121,337	175,886	50,618	22,286	114,518	181,732
Of which: Stay over by air	20,128	18,562	21,085	22,110	20,753	18,393	20,353	20,821	21,941
Grenada	171,318	58,742	46,267	118,672	180,249	59,228	43,932	160,982	232,299
Of which: Stay over by air	36,280	29,050	35,469	32,750	38,023	31,390	37,770	33,552	43,271
Montserrat	3,701	2,882	2,094	3,657	4,622	2,698	3,004	4,766	7,378
Of which: Stay over by air	2,355	1,831	1,597	3,021	2,272	1,756	1,906	3,010	2,880
St Kitts & Nevis	314,208	138,564	107,676	262,836	376,965	199,711	148,195	310,306	440,831
Of which: Stay over by air	32,977	28,707	24,245	27,007	35,429	29,010	23,936	28,598	34,256
St Lucia	384,178	185,049	159,266	305,575	407,274	203,629	159,384	302,732	366,322
Of which: Stay over by air	92,316	83,701	78,993	83,148	98,219	87,205	77,771	81,713	97,367
St Vincent & Grenadines	88,663	35,588	22,114	58,569	90,493	30,668	24,519	60,982	94,607
Of which: Stay over by air	19,503	16,865	16,305	18,040	20,658	16,414	17,687	20,622	21,453
TOTAL	1,571,205	623,610	488,408	1,145,399	1,699,861	732,462	538,082	1,262,970	1,788,289
Of which: Stay over by air	304,647	256,371	241,047	264,223	312,683	261,609	244,354	272,297	329,082

Visitor Spending (EC$m)

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16
Anguilla	106	84	72	84	113	79	74	80	111
Antigua & Barbuda	289	195	162	215	274	197	164	236	314
Dominica	92	77	81	93	96	78	80	91	100
Grenada	119	87	109	110	117	80	105	96	159
Montserrat	7	4	4	7	7	4	4	7	9
St Kitts & Nevis	104	83	69	83	114	87	71	90	106
St Lucia	320	240	217	277	359	253	205	255	377
St Vincent & Grenadines	84	56	46	63	87	53	49	70	90
TOTAL	1,121	827	759	933	1,166	832	752	925	1,266

NB US$1= EC$2.70

Source: *Central Statistics Offices, ECCU and ECCB*

from nearby countries with similar offerings that are cheaper for North American and European tourists. Commercial banks are taking a cautious approach to lending, and are vulnerable to a further erosion of correspondent banking relationships.

The ECCU countries generally do not have reserve funds to provide a buffer against the impact of major natural disasters. The small size of the countries (given that their combined population is around 600,000) and geographic situation (essentially an archipelago, but without a single shipping company that serves all destinations) means that commercial costs are relatively high in the sub region. Further, it is not really feasible for the ECCU to consider diversification into high value-added financial services, given that Bermuda, the British Virgin Islands (BVI), The Cayman Islands and, to an extent, The Bahamas, Barbados and Trinidad & Tobago have already made that transition.

In short, 2016 will be a year that, in terms of economic conditions, is better than recent times. However, there has not been a decisive improvement in the fortunes of the ECCU countries, where per capita annual incomes range from around US$7,000 in Grenada to about US$16,000 in St Kitts & Nevis and Antigua & Barbuda.

A possible and partial exception is St Kitts & Nevis, where the burden of public debt is falling quite quickly. However, even that economy depends on continuing revenues from the CBIP – which cannot be taken for granted. Overall, the ECCU countries remain stuck in the economic slow lane.

Recent IMF Article IV Consultations with ECCU governments

In mid-May, the IMF completed its annual Article IV consultation with the government of **Grenada**, and approved the disbursement of US$2.8m under the Extended Credit Facility (ECF) in place since mid-2014. Resources made available to the government by the IMF through the ECF now amount to about US$14m. At the end of 2013, when the government paid arrears owing to Kuwait and multilateral creditors, debt amounted to about 107% of GDP. Thanks mainly to a successful restructuring in Q3 15 (with a debt exchange, an agreement with Paris Club creditors, restructuring of amounts owing to the National Insurance Scheme (NIS) and clearing of arrears in budgeted spending), the ratio is now around 94% of GDP.

The IMF was upbeat in its assessment of Grenada. It noted that the government had met all the requirements for the ECF to the end of 2015. Thanks to an expansion of agriculture and tourism, as well as a surge in construction, real annual GDP rose by an estimated 4.6% in 2015. The IMF is looking for growth of 3% this year. Fiscal reforms include "strengthened tax administration, improved public finance management, an overhaul of the tax incentives regime, and a new rules-based fiscal policy framework, which now need to be made fully effective". The government is also taking steps to control the public sector wages bill and to improve the general business environment.

In early July, the IMF concluded its Article IV consultation with the government of **St Kitts & Nevis**. The Fund noted that the country had successfully completed its Post-Program Monitoring Framework in October 2015. With real GDP growth of 5.0% in 2015 (following increases of 6.1% in 2014 and of 6.2% in 2013), St Kitts & Nevis has had one of the region's strongest economies. Growth has been boosted by construction, tourism and 'surging' receipts from the country's Citizenship By Investment Program (CBIP). The current account and fiscal balances have been trending downwards. The IMF believes that St Kitts' & Nevis' debt/GDP ratio will fall to 60% in 2017, which is the target that the ECCU as a whole is looking to achieve by 2030. The IMF expects GDP growth of 3.5% this year, settling at 3% annually in the medium-term.

Relative to the other countries, the Fund discussed potential reforms in greater detail. For instance, it suggests that CBIP receipts could be channelled into a new fund to provide a contingency buffer for future shocks. It argued that more could be done to improve financial management, including through an improvement to the budget framework of the Nevis Island Administration (among other measures). It also recommended that the government do more to improve oversight of the financial system and to lift the quality of published statistical data.

The IMF's mid-July statement following its Article IV consultation with the government of **Dominica** highlighted the impact of Tropical Storm Erika, which contributed to a 3.9% contraction in activity through 2015. The tourism sector is now largely operating normally. However, agriculture is still recovering. Lower fuel prices ensured that the current account deficit fell from 11.2% of GDP in 2014 to 9.4% of GDP in 2015. The IMF expects real annual GDP growth of 1.3% this year, rising to 1.7% annually over the medium-term. The Fund also looked favourably on the Dominican government's measures to improve its fiscal position and strengthen the financial sector.

In mid-July, the IMF also concluded its Article IV consultation with the government of **St Vincent & the Grenadines**. As is the case in Dominica, activity was hampered by natural disasters in 2015, and real GDP rose by just

1.6% (having contracted the year before). However, lower oil import costs contributed to a reduction in the current account deficit from 29.6% of GDP in 2014 to 24.8% in 2015.

The IMF highlighted the impact of a new airport to be completed in 2016, and the development of geothermal energy. Thanks to growth in tourism, GDP growth is expected to accelerate to 2.2% this year and to 3.1% annually over the medium-term. It commented favourably on the soundness of the country's banks and its regional leadership in terms of supervision of credit unions.

The IMF completed its Article IV consultations with the governments of **Antigua & Barbuda** and **St Lucia** in late 2015 and early 2016 respectively. According to its World Economic Outlook, the IMF is looking for real GDP growth in Antigua & Barbuda of 2.0% this year, or a little less than the 2.2% posted in 2015. Over the medium-term, annual growth should be about 2.7%. Growth in St Lucia is expected to slow from 1.6% in 2015 to 1.4% in 2016, with medium term growth of about 2%.

Citizenship By Investment Programs (CBIPs)

Four ECCU countries offer High Net Worth Individuals (HNWIs) the opportunity to purchase citizenship.

According to a report published in 2014 by consultants Wealth-X and Arton Capital, citizenship of Antigua & Barbuda is available to anyone who donates at least US$250,000 to an approved charity, invests at least US$400,000 in a government-approved real estate project, or US$1.5m in a business. Antigua & Barbuda's CBIP was launched in 2012. Antigua & Barbuda's CBIP is the only one which requires people who buy citizenship to maintain a physical presence in the country, albeit for a minimum of five days over five years.

Citizenship of Dominica is cheaper to acquire. Applicants must donate between US$100,000 and US$500,000 to a charity (depending on the number of family members) or invest US$200,000 in a government-approved real estate project. Dominica's CBIP commenced in 1993.

Grenada offers citizenship to people who buy an approved property for at least US$1m, or a quarter interest in a property for at least US$250,000. The newest of the four CBIPs, it began in 2014.

Citizenship of St Kitts & Nevis can be purchased for a contribution of US$250,000 (for a single applicant) to the Sugar Industry Diversification Foundation of via investment of at least US$400,000 in a government-approved real estate project. St Kitts & Nevis' CBIP was introduced in 1984.

Arton Capital assessed the ECCU CBIPs in relation to those offered by governments in other part of the world. Its criteria included: the overall cost of purchasing citizenship; the speed of the process; the number of countries that the holder of the (new) passport can visit with or without a visa; the general quality of life; and simplicity (in terms of not having to learn the local language, not having to be physically present and meeting other requirements). The four ECCU countries were rated more highly than the US, but less highly than certain European Union countries such as Bulgaria and Cyprus.

VENEZUELA

Microeconomics: How to survive the crisis

Much has been written about Venezuela's macroeconomic crisis – with oil prices still low and economic policy chaotic, this year the country will have one of the world's deepest recessions and one of its highest rates of inflation (-8.0% and 481.5% respectively, as projected by the IMF). What do people do to survive?

The collapse in oil revenues, massive money printing to cover a soaring fiscal deficit and severely market-distorting and bureaucratic exchange rate and

price controls have combined to drastically limit essential imports of food and medicines into Venezuela. This has resulted in widespread shortages and triggered hyperinflation. Venezuelans currently are only permitted to shop for basic price-controlled necessities in state controlled supermarkets on certain days of the week (fingerprint recognition is used to enforce this regulation). The upshot is extremely long queues, with people waiting for hours only to be turned away when supplies run out.

Into this tense and troubled environment comes the practice of *bachaqueo* – black market traders. The Spanish newspaper *El País* spent some time with Daniela (not her real name), a 27-year-old mother of two and now a full time *bachaquera*. Her core activity is queuing (or jumping queues) to buy goods at controlled prices, so as to re-sell them at heavily-marked up prices to people who for whatever reason were unable to acquire the items through the correct channels. "It is easy money" Daniela explains, "it is not worth looking for a job now, and no-one has one to offer, anyway. And people need the products". From very early in the morning, Daniela and her friends check the availability of goods like flour, rice, milk and personal hygiene items like soap; sharing information across mobile apps like WhatsApp. They then acquire the items, often bribing police or supermarket staff to evade controls.

After going home for a mid-morning rest, in the afternoon the traders begin selling their haul. "A bag of rice, which I've bought for Bs450, I'll sell at Bs1,500; milk, which costs Bs800, will go for Bs3,000; nappies, bought for Bs100, will sell for Bs1,500" she says. How many people are involved in *bachaqueo* is not known. According to pollsters Datanálisis, up to 70% of the people queuing may be *bachaqueros*. Like all black marketeers, *bachaqueros* are both loved and hated. They are necessary for survival but intensely resented. According to Miguel Ángel Campos, a sociologist at the Universidad de Zulia, "The fact that half the population is buying basic necessities on a massive scale to sell them to the other half with a mark-up of 100 times the price is not just about the evil of self-interest, it is like an act of genocide".

Another long-standing survival strategy has been to resort to smuggling across the Venezuelan border with Colombia. This, after all, is where the name *bachaqueo* originally came from: the *bachaco* is a large ant, native to the border area, which carries its food on its back. The long land border between the two countries was reopened on 13 August after a yearlong closure imposed by Venezuelan on security grounds. According to Colombian authorities, some 57,000 Venezuelans crossed the border that day to buy basic necessities. Sources say that despite the closure of formal border crossings, contraband activity has nonetheless remained high: traditionally, cheap Venezuelan petrol is sold in Colombia in exchange for basic necessities. At the San Antonio del Táchira-Cúcuta border crossing, Angel Enrique Borrego told the Spanish news agency *Efe*, "I am a diabetic and I can't get the medicines I need in Venezuela so I am crossing into Colombia to support myself". A 17 year-old engineering student told *Reuters* that she had travelled 800kms to the frontier to buy food "because we can't get anything where we live". Taxi drivers also said they had to buy spare parts for their vehicles in Colombia. There were also some reports of Venezuelans using their annual holidays to take a 36-hour trip to bulk-buy rice and flour (available at some 45% below *bachaqueo* prices) in Pacaraima, a Brazilian border town.

Urban agriculture is another option. The government has been encouraging city residents to grow vegetables on the balconies of high-rise apartment blocks, in urban gardens, and on the roofs of residential and office buildings. Officials claim that in the past three months 135,000 people have grown 272 tons of fruit, vegetables and aromatic herbs. The official target for urban agriculture is to take production up to 3,500 tons per annum, but critics note that this would meet the food needs of only some 1,000 people. To set an example, President Nicolás Maduro has claimed that he and his wife raise chickens and grow pumpkins. But some critics suggests that it would be better to

boost long-neglected rural agriculture in traditionally fertile areas, where output fell after many commercial farms were expropriated by the Socialist government in power since 1999.

Perhaps ironically, given Venezuela's long-standing over-reliance on oil revenues, another response to the crisis has been a form of homemade do-it-yourself diversification. According to Alexis Blanco, writing for the blog *Caracas Chronicles*, in the town of Catia street sellers now offer home-made corn flour, locally fished sardines, and handmade soaps. Some have begun manufacturing home-made deodorants: "For a mere Bs400 you can get a small jar of a paste whose main ingredient is sodium bicarbonate – baking soda – plus some kind of oil to give it some aroma and moisturising properties" Blanco says, noting there is also a multitude of second hand household goods on sale: "It's easy to see what's going on here: this is the next stage in the decapitalisation of Catia's fast-pauperising middle class."

HAITI

The economy stagnates

At a time that Haiti's political situation remains very complex, the economy is slowing. Activity should be boosted slightly by the central bank's easing of monetary policy in June. Nevertheless, there are no signs that the country's structural problems will be resolved anytime soon.

In its review of monetary policy for the second quarter, ending in June, the central bank (Banque de la République d'Haïti, BRH) forecast real annual GDP growth of about 1% in the current fiscal year (ending in September 2016). GDP growth in the 2015 and 2014 fiscal years was 1.2% and 2.8% respectively.

Latest data from the national statistics agency (Institut Haïtien de Statistiques et d'Informatique, IHSI) confirmed that the deceleration has been broadly based **[1]**. Overall industrial production in first quarter rose by 4.1% year on year. However, it was down by 2.3% quarter on quarter. In the 12 months to March, industrial electricity consumption had fallen by 1.5%, even as overall consumption had risen by 15.5%. Overall energy consumption dropped in the first quarter (by 3.0%), as did construction activity (by 2.7%), construction employment (by 3.1%) and domestic commerce (-6.9%).

Chart 1. Haiti: Variation in economic indicators (%)

Periods to end March 2016

Index	QoQ	YoY
Industrial production	-2.3	4.1
Of which: food, drink etc.	0.2	5.8
Energy production	3.5	11.7
Of which: Hydro power	-67.7	-76.2
Energy consumption	-3.0	15.5
Of which: Industrial sector	-3.3	-1.8
Construction activity	-2.7	3.6
Construction employment	-3.1	2.9
Domestic commerce	-6.9	6.3
Import prices	5.1	6.1
Import quantities	11.6	3.0

Source: *IHSI*

The dramatic fall in hydroelectric power production in the first three months of 2016 highlights the brutal impact of drought, which has curtailed food

production for much of the last two years. Higher food prices have contributed to inflationary pressures. Latest IHSI data indicated that the national consumer price index (CPI) increased by 0.7% month on month in May, and by 15.1% year-on-year. For food, drink and tobacco, the corresponding rises were 0.9% and 16.7%. The general softness in the currency has also contributed to this. Over the year to May, the gourde weakened from HTG48/US$ to HTG62/US$1. Imported food prices were 0.9% higher in May, and were up by 20.4% year-on-year.

At its meeting on 8 June, the BRH eased monetary policy. Interest rates on the benchmark bonds issued by the central bank were cut by 200 basis points. Rates on 91-day bonds were cut from 16% to 14%. Rates on 28-day bonds were lowered from 12% to 10%, while rates on seven-day bonds were trimmed from 10% to 8%. The BRH also eased reserve requirements that pertain to credits to the agricultural sector (a major source of employment and an important element of GDP). The central bank was responding to the impact of the drought on an already weak economy, and the fall in assistance available to Haiti through its membership of Petrocaribe, including preferential oil imports from Venezuela. The BRH expects that the annual inflation rate will slip to 12% by the end of the year.

The central bank also commented on the conservatism of Haiti's banking sector. As of May, the loan/deposit ratio stood at a little over 37%. Over the preceding year, loans grew significantly more slowly than deposits. The BRH's policy settings also need to take into account the high and rising trend of dollarisation of the banking system. US dollar deposits accounted for 54% of M3, the broadest monetary aggregate, at the end of March, from about 48% a year previously.

Low imbalances, but low competitiveness

Fortunately, the BRH's scope for action is not constrained by the current account, the fiscal balance or the government's external debt. The IMF, for instance, is looking for the current account deficit to slip from 2.4% of GDP in 2015 to 1.9% of GDP this year. The deficit is expected to stabilise at around 2.5% of GDP over the medium term. In absolute terms, the IMF expects a current account deficit of US$155m in 2016. In June, the central bank's net foreign assets amounted to US$820m, having risen marginally since the end of March. The IMF thinks that the government's overall and primary (i.e. before interest payments) deficits this year will equate to 1.8% and 1.3% of GDP, respectively. Gross public sector debt is growing a lot faster than nominal GDP. Nevertheless, the debt/GDP ratio has increased from 26.5% in 2014 to 30.4% in 2015 and is expected to rise this year to 35.2% in 2016.

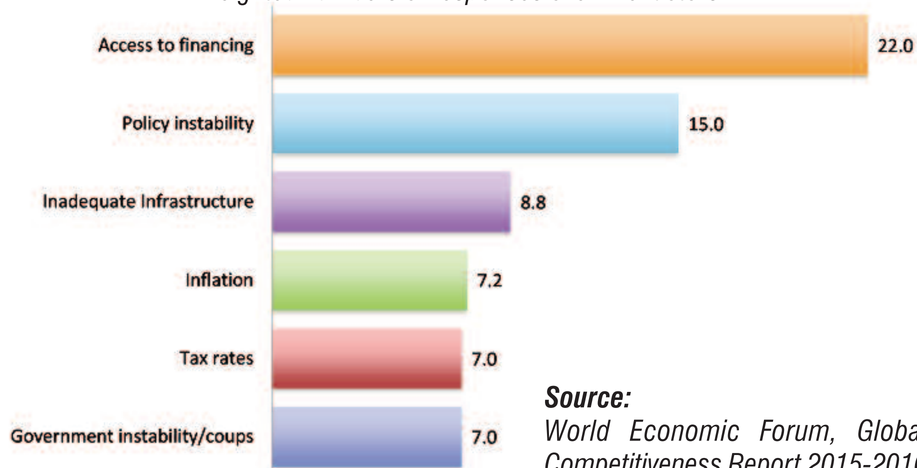
That this ratio is very low by the standards of other countries in the Caribbean (or Central America) is a sign of weakness and the reluctance of foreign creditors to lend to the government of Haiti. The country has long been seen as one of the hardest in the world in which to operate. In the World Economic Forum's Global Competitiveness Report for 2015/2016, Haiti was ranked 134th out of the 140 countries assessed. In the three preceding Global Competitiveness Reports, Haiti's rankings had been 137/144, 143/148 and 142/144.

The World Economic Forum's survey of businesses operating in Haiti confirms that lack of credit from local banks is the largest single problem. **[2]** Unsurprisingly, given the complex and uncertain political situation, policy instability is seen as the second most serious challenge. Other problems include the inadequacy of infrastructure, persistently high inflation and the instability of governments.

Just over a year ago, in June 2015, we noted that the prospects for Haiti were uncertain. This remains our view. The economy is not expanding at a rate that can have an impact on the country's entrenched poverty. There are no

Chart 2. The most problematic factors for doing business in Haiti

Weighted numbers of responses over five factors



Source: *World Economic Forum, Global Competitiveness Report 2015-2016*

signs of improvement in the business environment. Regardless of trends in the prices of food and oil, the weakness of the currency will probably contribute to inflation for at least some months to come.

Nevertheless, we the positive wildcards that we identified in mid-2015 also remain in place. One is a renewed downturn in the international price of oil for this oil-import dependent country. Another is higher-than-expected remittances from Haitian expatriates working in the US. The third is growth in employment, trade and investment thanks to the opening in early July 2015 of Port Lafito by the local conglomerate, GB Group. GB Group sees the port as a central element in the development of Lafito Global, an economic zone that will include a business park, an industrial free zone and a residential precinct.

REGIONAL BUSINESS REVIEW

REGION

Renewables go mainstream?

Non-conventional renewable energy (NCRE) such as solar, wind and wave power is beginning to attract big investment flows into Latin America. In 2015, these investments totalled US$7.1bn in Brazil, US$4bn in Mexico, US$3.4bn in Chile and over US$500m each in both Honduras and Uruguay. With technology improving and generating costs falling, non-conventional energy is becoming more mainstream.

At first sight, the energy balance in Latin America and the Caribbean (LAC) hasn't changed much. Although total energy use has more than tripled over the past 40 years to reach 848 million tonnes of oil equivalent (MTOE), it remains largely fossil-fuel dependent (the proportion of the total provided by coal, oil, and gas actually rose a little from 68.9% in 1971 to 74.4% in 2013). But a closer look shows that there has been some significant movement. Within the fossil fuel category, there has been a shift to greater use of the cleaner natural gas (representing 23.4% of the total in 2013, up from 10.9% in 1971). There is less reliance on biofuel and waste (for example, wood burning for cooking) as electricity usage has spread. The category known as "other renewables" (essentially geothermal, solar, and wind energy) has come from zero to reach 1% of total energy use.

Some of the biggest changes are happening in the electric power sector. Here, LAC as a whole can claim to have the world's greenest electricity matrix –largely because of its unique hydro resources. To try and keep up with an explosion in demand caused by urbanisation, industrialisation and

the rise of the middle classes, electricity generation has been growing at a relentless 5.4% per annum across the region. Just over half of the region's total supply (52.4%) now comes from renewable resources (mainly hydropower), well over twice the world average (of 22%). This reflects the region's massive hydroelectric potential and the investment that has gone into developing big hydro complexes.

Hydro-potential is not evenly distributed among all LAC countries, however. If Brazil, a nation with extensive rivers and lakes, is excluded from the total, the share of renewables in regional power generation drops from 52.4% to 38.2%.

Hydropower also has a short-term disadvantage: it can be less reliable at times of drought and needs to be backed up by other power sources. While still a small part of the overall picture, the outlook for non-conventional renewables is promising. Solar, wind and wave power output has grown by a spectacular average annual rate of 34% for the last decade. These sources are still, however, contributing only 0.9% of total electricity supply in the region (but a lot more in some countries).

Environmentalists and private sector investors expect that percentage to grow, and fast. Walter Vergara of the World Resources Institute (WRI) makes the point that the development of NCRE is an essential part of the battle to limit the negative effects of climate change. "The region has all the elements to decarbonise its economies. Low-carbon actions are the best way to guarantee sustainable economic development. A future with fewer greenhouse gas emissions is possible," he says, adding that Latin America could yet become "the Saudi Arabia of renewable energy". According to the renewable energy country attractiveness index (RECAI) compiled by consultancy Ernst & Young, Chile, Brazil, and Mexico are among the world's top ten in the ranking, while Argentina is one of the fastest risers. Ernst & Young global power specialist Ben Warren says, "We are now in an era where policymakers and regulators must shift their focus onto market access and fair play; where technology improvements and cost curves will lead to a level of renewables deployment not even imagined."

Total energy use in Latin America & the Caribbean

(Million tons of oil equivalent, Mtoe)

Energy source	1971	% share	2013	% share	CAGR %
Total	248.4	100%	848.7	100%	3.00%
Coal	8	3.20%	42.8	5.00%	4.10%
Oil	135.9	54.70%	389.6	45.90%	2.50%
Gas	27.2	10.90%	199	23.40%	4.90%
Nuclear			8.5	1%	
Hydro	7.6	3.10%	62.8	7.40%	5.20%
Biofuel and waste	69.7	28.10%	136.7	16.10%	1.60%
Other renewables			8.6	1%	

Note: *"Other renewables" include geothermal, solar, and wind*

Source: *Lights On? Energy needs in latin America & the Caribbean to 2010, IDB*

Investment

One sign of private sector excitement is that mergers and acquisitions (M&A) activity in the renewables sector is rising. Global M&A in the energy sector fell by 16% to US$199bn last year, but within that total renewable deals nearly doubled (+95.4%) to US$55.3bn, according to PricewaterhouseCoopers (PwC). In other words, one in every four dollars of global energy M&A involved renewables.

Within Latin America, M&A in renewables nearly tripled to US$7.6bn, up from US$2.7bn in 2014. "There is increasing interest in the region.

Multinationals are taking stronger positions in Latin America where there is a perspective on lack of power supply in the long term. And many countries are offering low risk models of energy contracts for investors" says Arthur Ramos, a PwC partner.

Incentives

The regulatory framework for the power sector has undergone some big changes. While there are differences between countries, broadly speaking since the 1990s the trend has been towards the "unbundling" of large, vertically integrated and state owned monopoly generators and distributors, creating instead mixed or part-privatised wholesale power markets, which are monitored by newly-created regulatory agencies. These liberalised markets offer a role to independent power producers (IPPs). Within this context, a variety of mechanisms have been used to stimulate investment in renewables, including setting feed-in-tariffs or net metering arrangements. In some but not all cases, these have involved setting an initial subsidy to stimulate diversification of power sources supply (i.e. away from fossil fuels and towards hydro or other renewables).

Chile

Chile is considered one of the most attractive destinations for NCRE investment, according to a report by the Renewable Energy Policy Network for the 21st century (REN21). REN21 also highlights Brazil and Mexico as investment destinations within the region. It notes the importance for solar power of the Atacama Desert in northern Chile, the world's driest region, with some of its clearest skies.

Chile currently has around 1.18GW of installed solar photovoltaic (PV) capacity. The US$800m, 105MW Camarones solar facility, based in Arica in the north, has received environmental approval and is expected to come into service in the near future. In July, a new electricity transmission law was approved, which, by creating an interconnected grid stretching from north to south, will facilitate clean energy distribution.

NCRE accounted for 11.1% of total electricity generation in Chile in April: the government has an ambitious long-term target for 70% of total electricity supply to be generated by renewables (conventional and non-conventional) by 2050. Among current projects, in May the national irrigation commission launched a tender for distributed NCRE projects of up to 150KW each, to support small farmers and their surrounding communities.

Power Matrix 2013: Brazil makes it look cleaner

(% contribution to total electricity supply)

	LAC	LAC without Brazil	World
Renewables	52.4%	38.2%	21.9%
Nuclear	2.1%	1.8%	10.6%
Fossil fuels	45.5%	60.0%	67.4%

Note: *"Renewables" defined to include hydro, geothermal, solar, wind, biofuels, and waste*

Source: *Lights On? Energy needs in latin America & the Caribbean to 2010, IDB*

Argentina

Argentina is something of a late starter in renewables, but is committed to catching up. The new government led by President Mauricio Macri, which took office in December 2015, has begun reducing electricity subsidies that had held back private sector investment in the power sector. In May, the administration passed a law requiring industrial electricity users to source 8% of their supply from renewables by 2017, rising to 20% by 2025. An auction has been scheduled for October, when companies will bid to supply

600MW of wind power, 300MW of solar power, and 100MW of biomass, hydropower and biogas plants, on 20-year US-dollar denominated contracts. Officials say they expect bid prices to come in at around US$40-80 per megawatt hour (MWh), confirming the recent downward trend. Total estimated investment will range up to US$1.8bn. According to Renato Santos, head of wind-energy at GE, "Argentina's time has come. GE has decided it is the right moment to increase its business in the country."

Honduras, Mexico, Central America

Second in Latin America for total installed PV capacity is Honduras, with around 500MW, but it is expected to be overtaken quite rapidly by Mexico, which held a highly successful renewables auction in March this year. That auction attracted around US$2.5bn of investment, with over 2GW worth of solar and wind capacity allocated in power purchase agreements (PPAs) across 16 projects. A second auction is due to be completed before the end of this year.

Most Central American countries rely on a mixture of hydropower and fossil fuels for their electricity generation, but have been attracted to NCRE because of concerns about hydrocarbons dependency, climate change, and energy security. Costa Rica, El Salvador, Honduras, and Nicaragua have developed geothermal projects, Costa Rica, Honduras and Nicaragua have a combined 350MW of wind farm capacity, and Panama has 158MW of wind capacity in the development pipeline.

Brazil

Brazil was the world's eighth largest wind power generator in 2015, with a claimed capacity of 16.6GW (of which 9.3GW was in operation, 3.4GW was under construction and 3.9GW was ready to start construction). In 2015, 13% of Brazil's power generation came from NCRE, a figure that compared to a European Union (EU) average of 18%.

The Spanish power company Iberdrola is one of the big players in Brazil. In the second quarter, its local Brazilian subsidiaries boosted the electricity generated from renewables by 83.9% year-on-year, giving Iberdrola a 25.1% share of total renewable power generation in the country. The company says that its global renewable capacity will reach 17.5GW by 2020, up from 14.2GW at present, with 888MW of that located in Brazil and Mexico.

Caribbean

In the Caribbean, low oil prices are forcing a traditional hydrocarbons exporter like Trinidad and Tobago to seriously consider renewables, with current plans focusing on wind generators on the eastern coast of the island of Trinidad.

Some Caribbean islands have been able to make major progress. Dominica now produces 28% of its total electricity from hydropower and wind. It is also aiming to develop geothermal power, and to reach self-sufficiency by 2020. A recent report by the Economic Commission for Latin America and the Caribbean (ECLAC) noted that other countries in the Caribbean making progress in switching to renewables include Jamaica and St Vincent & the Grenadines.

MEXICO

Is business falling out with Peña Nieto?

Mexico's powerful business community is showing signs of irritation with the government led by President Enrique Peña Nieto. In part, this reflects the mid-term blues: the president's popularity has slumped, violence linked to organised crime is trending up again, there are question marks over government policy on corruption, and the economy is sluggish. But the real catalyst has been a long-running and disruptive strike by militant teachers.

Mexico's normally soft-spoken business leaders are beginning to show their teeth. The private sector is incensed over a nearly three-month long strike by militant teachers from the Confederación Nacional de Trabajadores de la Educación (CNTE) designed to oppose education reforms. These demos have been intensely disruptive across a number of states in the south of the country, involving everything from occupations though to road blocks, protest marches, intimidation and violence.

Business leaders are making it clear that they hold the Peña Nieto government responsible, citing its failure to settle the strike, or to guarantee the necessary freedom of movement to allow the private sector to get on with business. To this end, the national business council, Consejo Coordinador Empresarial (CCE), came out and called on the government to use force if necessary to re-establish public order. Thereafter, the confederation of chambers of commerce, Confederación de Cámaras Nacionales de Comercio, Servicio, y Turismo (Concanaco), said its members should be compensated for the costs of the strike, which it estimated at MXN7.5bn (US$418m) – and rising. Concanaco leader Enrique Solana said the government should condone a range of business taxes (including corporate income tax and payroll social security payments) for companies in the most affected sectors. He went even further, suggesting that, in the absence of any action, his members might consider withholding their tax payments unilaterally.

The main employers' federation, Confederación Patronal de la República Mexicana (Coparmex) went a step further again by initiating legal action against the federal government and four state governments (Chiapas, Guerrero, Michoacán and Oaxaca), on the grounds that these authorities are failing to protect constitutional rights including the freedom of movement, the right to work and the right to education. Coparmex head Gustavo de Hoyos Walther fired off a warning: "society is not prepared to contemplate a situation where negotiations with dissident teachers are based on non-application of the law" he stated. A federal court has admitted the complaint and indicated that it will hold a first hearing on 20 September.

Another business lobby, Confederación de Cámaras Industriales (Concamin), said that its members would freeze over MXN50bn (US$2.7bn) in investments planned for the four most affected states. Concamin leader Manuel Herrera Vega declared, "this situation is affecting the south of the country, where 20m of the 55mn Mexicans who live below the poverty line are based, and where it is most urgent to encourage education, production and employment for local residents". Manuel Trejo García, a Michoacán based cable TV operator, complained that, "we have no law here in Michoacán, because everyone does what they like, and the authorities have done nothing, which is very serious." He added that he was thinking of moving his businesses out of state. In Oaxaca, local businesses organised their own one-day strike protest.

By recent historical standards, the deterioration in government-private sector relations is indeed significant. Some business leaders suggest that things haven't been this bad since the economic crisis of 1994, when the government nationalised the banking system. Enoc Gutiérrez, a Coparmex leader in the state of Chiapas, says that in his opinion the teachers' strike has caused greater economic damage than the Zapatista guerrilla rebellion in the same state, also in the early 1990s.

Admittedly, the teachers' strike is localised, and has hardly affected the industrial north of the country. But for the business community, it is one of various signs of general malaise. Economic recovery has faltered: real GDP fell by 0.3% in the second quarter relative to the first, the first such decline in three years (on an annual basis growth was still 2.4%, but this remains below the expectations of many companies). Business leaders are concerned that violence linked to organised crime appears to be trending up again (homi-

cides were up by 15% in the first half of this year, on official data). A recent report by the American Chamber of Commerce (AmCham) highlights persistent corporate worries over poor security and high levels of corruption. Despite the passage of new anti-corruption legislation, many business leaders are unimpressed by what the government is achieving. New conflict of interest allegations affecting the president's inner circle have surfaced (this time involving the use of luxury flats in Miami). President Peña Nieto's ruling Partido Revolucionario Institucional (PRI) suffered a big setback in state elections in June, and according to a recent opinion poll, the PRI is on track to lose the 2018 presidential election to the right wing opposition Partido de Acción Nacional (PAN). The president's personal approval rating has slumped to an all-time low of 23%.

CHILE

Questions of adequacy

Amid widespread dissatisfaction with the administration led by President Michelle Bachelet, August saw massive demonstrations calling for wholesale reform of Chile's private pensions system. The central issue behind these protests is that the retirement incomes provided by the system are far too low for many. It should be possible for the government to address the issue. However, a solution will require greater contributions from the government, as well as employers and self-employed workers. Reform will neither be quick nor easy.

Technical assessments of the efficiency of Chile's private pensions system, which was established in 1981 by the military government led by General Augusto Pinochet are generally favourable. (*see box 1*).

One example is the latest (October 2015) *Melbourne Mercer Global Pension Index* report. Despite a favourable assessment, the report advocated four changes to strengthen the system. One recommendation suggested a continued review of the minimum pension available for the poorest pensioners. Another suggested an increase in the retirement ages for both men and women. A third suggested measures to promote higher household savings. And finally, the report authors also recommended an increase in the level of mandatory contributions. The aim should be to increase the net replacement rate, which corresponds to the ratio of the average pension paid over a particular time period to the average level of income in that same time period .

Other reports have agreed with these recommendations. Wholesale pension reforms undertaken by President Bachelet's first administration in 2008 improved the social safety net inherent in the pensions system. However, the reforms did not go far enough in addressing the low replacement rate and the low adequacy of the retirement incomes paid out (*see box 2*).

This deficiency is reflected in the size of the latest demonstrations, which have again demanded wholesale reform of the pensions system. On 9 August, President Bachelet proposed a number of changes. These included:

- An increase in employers' contributions from 10% to 15% of workers' incomes over the next decade.

- Strengthening of the 'solidarity pensions' paid to the poorest 60% of the population not covered by private pensions.

- Greater input on investment decisions by the pension fund administrators (Administradoras de Fondos de Pensiones, AFPs) from contributors.

- Possible reimbursement of contributors by the AFPs after periods of losses.

- The establishment of a state-run AFP to compete with private sector counterparts.

The first two proposed changes are consistent with the recommendations of the *Melbourne Mercer Global Pension Index* report and other assessments. The last three are consistent with a significant worsening in the risks of doing business as an AFP relative to the potential returns. The concept that AFPs would, under certain circumstances, compensate contributing members for losses implies that they would become guaranteed funds, which would greatly increase the amount of capital that they would need, however.

The proposed changes also fail to recognise another very fundamental change in the 35 years since the pensions system was originally established. The global economy as a whole has entered an unprecedented period, in which cash and fixed income markets are characterised by near zero (or negative) interest rates and where equity markets are frequently volatile. It is much harder than previously for the AFPs to boost the benefits available to retirees through investment.

Although the proposed changes envisage that the government would contribute to the strengthening of the system by boosting solidarity pensions, as yet there is no suggestion that the government would make co-contributions to AFPs on behalf of retirees (as happens in some other countries with broadly similar systems). The fall in the price of copper – Chile's main export commodity and an important source of revenues for the government – means that its ability to pay more money into the pensions system is limited.

Amidst these challenges two things are clear. First, reform of Chile's pensions system will not be a quick process. Objections are likely from employers (and self-employed workers) and almost certainly there will also be objections from the AFPs to President Bachelet's proposed changes.

Box 1: The view from Melbourne

The October 2015 *Melbourne Mercer Global Pension Index* report gave the Chilean system a B rating, with a score based on the authors' proprietary index of 65-75. This indicates "a system that has a sound structure, with many good features, but has some areas for improvement that differentiates it from an A grade system." Other countries in which the pensions systems are assessed similarly include Sweden, Switzerland, Finland, Canada, Chile and the UK. Australia's system is accorded a B+ rating (with a score of between 65 and 75). Only two countries – Denmark and the Netherlands – are given an A rating and a score of more than 80. Another 16 countries had ratings of C+ or lower.

The proprietary index is based on three sub-indices. A 40% weighting is assigned to *adequacy* factors, such as benefits, savings, tax support, the design of benefits and exposure to growth assets. Another 35% weighting is assigned to *sustainability* factors, which include the number of people covered, total assets, contributions, demographics and exposure to government debt. The remaining 25% is assigned *integrity* factors, such as regulation, governance, protection, communication and costs.

The headline score for Chile's pensions system is 69.1. It receives a very high score – 84.8 – for integrity. The score for sustainability is lower, at 65.0. However, the score for adequacy is lower again, at 62.8. In 2014, the score for adequacy was 57.3. The rise in the headline index score – from 68.2 in 2014 to 69.1 in 2015 – was the result of a rise in the household savings rate, which was partly offset by the effect of increased life expectancy.

Box 2: Problems with Chile's pensions system

Chile's pensions system is well regarded internationally. However:

- Between 2007 and 2014, half of retirees received monthly benefits of

CLP82,650 per month (about US$150) or less. This amount is about 40% of the minimum wage in 2014 and includes the tax-financed solidarity benefit.

• While half of women of retirement age received monthly benefits equal to or less than CLP42,561, men received benefits of CLP112,333 or less.

• Half of retirees received benefits that were equal to 34% of their average wages over the preceding 10 years.

• Men receiving only the solidarity benefit typically received CLP107,073 per month. For women, the equivalent figure was CLP84,298.

• 70% of the population considered that the benefits provided by the pension system were insufficient for an adequate standard of living.

• Just over two thirds – 69% – of the total workforce made contributions to the system. However, for workers actually affiliated to the system, the corresponding figure was only 50%.

• The wage contribution rate for social security pensions of 10% of taxable income appeared to be low relative those in countries whose overall level of development is similar to that of Chile.

• Retirees can buy an annuity or opt for phased withdrawals from the balance that they have accumulated with their AFP. If they choose the latter, they often experience benefits that decrease over time.

• Annuities for women are more expensive, because they have a longer life expectancy than men.

Source: *Fabio Bertranou, International Labour Office, Geneva, 'Pension benefits in Chile: is it possible to improve adequacy and solidarity', 29 February 2016, pp8-9.*

VENEZUELA

Kicking the debt bill down the road

Press reports in late July indicated that the state-owned oil company Petróleos de Venezuela SA (Pdvsa) was in negotiations to roll over the US$4.38bn in debt coming due in the second half of 2016, of which US$4.2bn matures in the fourth quarter. Together with other developments, this confirms our view that the Venezuelan government sees maintenance of Pdvsa's liquidity and solvency as its paramount policy objective. However, both the government, and Pdvsa, face the additional challenge of falling production volumes at the oil company.

Venezuela's well-documented financial, economic and social crisis has come about largely because of the heterodox economic policies followed by the administrations of President Nicolás Maduro and his predecessor, the late Hugo Chávez (1999-2013). In essence, an extraordinarily high inflation rate has resulted from the monetisation of a persistently large deficit. Government spending on politicised social programs has soared, and has operated in conditions of opacity and without accountability. This has resulted in persistent over-valuation of the currency, which the authorities regularly devalue when pinched for cash. Price and other controls have contributed to a business environment that has become one of the world's most challenging. Oil and gas, of which Pdvsa is essentially a monopoly producer (although it does operate joint ventures with foreign companies) is now almost the sole source of export revenues and cash for the government.

In this context, the government simply cannot allow Pdvsa to default on its borrowings. The government has no other source of revenues. Through its CITGO refining and distribution business in the US, Pdvsa has very significant foreign assets that could be seized by creditors. Those assets are integral to the overall operation of Pdvsa's business. The scale of Pdvsa's massive reserves of oil and gas mean that the company is at little risk of insolvency. However, maturities of long-term borrowings, at a time of depressed oil, mean that actual and perceived liquidity crises are frequent.

Although a default by the sovereign itself would be less cataclysmic than a default by Pdvsa, it is still an outcome that the government will want to avoid at all costs, given the sacrifices (such as dramatically reduced real incomes and shortages of basic goods) that have been demanded of the Venezuelan people: such a default would involve an enormous loss of face.

Last month we argued that, in extremis, Pdvsa could borrow money from the Chinese government (and its state-owned enterprises) to cover payments on bonds maturing in coming months. We presumed that, in line with well-established arrangements, Pdvsa would service the new debt to the Chinese with shipments of oil.

There were two other developments in late July and early August. One was an agreement between the Caracas government and the Fondo Latinoamericano de Reservas (FLAR, a multinational reserve fund) for the FLAR to lend US$482.5m to the Banco Central de Venezuela (BCV) for a period of three years.

The other was confirmation by Energy Minister and Pdvsa president Eulogio del Pino that he was in discussions to roll over Pdvsa bonds due to mature later this year. This is the classic 'kick the can down the road' approach. Nonetheless, a rally in Venezuelan government and Pdvsa bond prices indicated some market optimism about the talks.

In short, there are ways in which the Venezuelan government can keep cash within Pdvsa, change the debt maturity profile and/or find cash from unorthodox sources. But notably, a roll over arrangement has the advantage of not requiring the commitment of any more oil production to debt servicing obligations, as with China.

In part because of underinvestment in production capacity in the past, output has been falling. This represents a potentially serious threat to Pdvsa cashflows. In August, Del Pino indicated that average production of crude oil and liquids in July was 2.64bn barrels per day (b/d). This represents a significant reduction to average output levels in 2012 and 2013 (reported at 3.0bn b/d), 2014 (2.89bn b/d) or 2015 (2.86bn b/d). Deliveries to Chinese parties for debt repayment amounted to 579,000 b/d in 2015, Del Pino said.

REGION

Corporate Radar

América Móvil feels the squeeze: Mexico-based telecoms giant América Móvil reported a 45% fall in second quarter profits to MXN7.7bn (US$442m), reflecting a worsening performance in its home market, where it has been facing tighter competition and regulations under the Mexican government's recent structural reform of the telecommunications sector. Profits were down by just under 44% in the first half of 2016; the company share price, listed on the NYSE, was down by 39% on year-earlier levels. The telecoms reform has obliged América Móvil to share its infrastructure (such as cell towers) and give smaller companies access to its network at regulated interconnection rates. Carlos Slim, the businessman who controls América Móvil and is regularly

listed as one of the world's richest men, told the *New York Times* that the reform had delivered a degree of regulatory clarity that all businessmen appreciated, but he was critical of the way his company had been targeted. Slim acknowledged that profits were down, attributing the fall to increased competition from the US-owned AT&T, and currency volatility across Latin America.

Aerolíneas cutting costs, not routes: Isela Costantini, the new head of the state-owned airline, Aerolíneas Argentinas, said that the company's current strategy is to cut costs, not routes. Costantini, a former head of General Motors in Argentina, was appointed to head Aerolíneas at the beginning of this year by the new centre-right government led by President Mauricio Macri, taking over a heavily loss-making company with a troubled history of past privatisations and re-nationalisations. She said she knew, on taking the job, that the company would be a "black box": what she found inside it was a deficit of around US$1bn; she had been most surprised by the failure of the previous authorities: "there was no management, no objectives, no business plan, not even a proper route plan", she said. Costantini added that the approach now would not be just to cut loss-making routes or activities. "We are saying let's maximise the use of our aircraft, let's use them to fly more than they are flying now, let's improve productivity, let's carry more cargo, let's change the planes around" she said, adding that the aim was to boost the company's credibility.

PERU

The market darling

Peru's S&P Lima General Index has outperformed all emerging markets in local currency terms to date this year, surging by 58% to mid August. That compares to a bounce of 37% in Brazil's Bovespa and 33% in Argentina's Merval. Investor expectations are high for the new business-friendly government led by President Pablo Kuczynski.

Peru's stock market is small still, with a market capitalisation of US$75bn. The country's MSCI index includes only three companies – Credicorp Ltd, which owns the country's main Banco de Crédito, and two mining companies, Compañía de Minas Buenaventura and Southern Copper Corporation. Given its commodity-base, the Lima index has tended to be volatile. For example, it rose by 168% in 2006, 101% in 2009 and 65% in 2010, and it last peaked in April 2012, at 24,095.29 points, on *Reuters* financial data.

But nonetheless, sentiment is strong. In comments to *Reuters* on 19 August, Will Pruett, manager of the Fidelity Latin America Fund (in Boston), observed that while the market is shallow (and equities not very liquid), it remains a good bet, singling out the "very well run, very profitable" local banking sector as "one of the most attractive in emerging markets", while noting also that "there's good corporate governance, [and] long growth opportunity".

Another fund manager, Javier Creixell, of Epiphany Funds in Dallas, described Peru as" in the best shape that it has been in the last 50 or 60 years," noting that, by contrast to his like-minded counterparts in Brazil and Argentina, Kuczynski is starting out on a relatively sound base, with orthodox monetary and budget policies well entrenched over the life of several successive governments in Peru. So, while Brazil is struggling with a fiscal deficit of over 10% of GDP and a debt/GDP ratio nearing 70%, Peru's deficit is just above 3% of GDP, with a public debt/GDP ratio of about 25%. (Total external debt, public and private, is around 33% of GDP).

Kuczynski, a former economy minister and prime minister, and a veteran international financier, sent all the right signals with the appointment of a team of highly-qualified technocrats to his 19-strong cabinet, including

Alfredo Thorne, a respected former World Bank economist, at the helm of the economy ministry. Upon taking office on 28 July, Kuczynski reiterated his plans to lower taxes, cut red tape, formalise the large informal labour market (66% of the workforce), improve infrastructure and boost foreign investment, while also pledging to improve the country's parlous education standards and provide universal access to potable water and sanitation by the end of his term in 2021.

Thorne, however, has sought to temper expectations, warning that domestic demand remains subdued and the fiscal position weaker than expected. In testimony to congress on 19 August, ahead of a requisite vote of confidence in the new cabinet, Thorne said his new team had inherited a "worrying" deficit that could make it difficult to initiate some of Kuczynski's priority projects. He reported that the deficit was 3.3% of GDP to end July, well above the 2.5% that the previous government led by Ollanta Humala had pledged to hand over to its successor.

As such, Thorne has adjusted down his deficit improvement targets, to around 3% of GDP by the end of this year and 2.5% in the 2017 budget. This is a notable increase from the Humala government's targeted 1.8% of GDP. The 2015 deficit was 2.1% of GDP, a sharp jump from 0.3% in 2014 (when the country's budget went into the red for the first time since 2010). Thorne still aims to get the deficit down to 1% of GDP by 2021, but now intends to do so more gradually, so as not to choke off the domestic recovery or force excessive austerity on the new administration.

This additional leeway (amounting to about US$1.5bn in 2017) may help cushion the revenue impact of the government's planned tax reforms (including a phased reduction in VAT), and will also allow more room for its spending and investment plans, which aim to lift real GDP growth to 5% from 2018 onwards. Thorne said he would also consider re-structuring some debt and noted that he had asked the International Monetary Fund (IMF) to review the public finances, alongside an autonomous team inside the economy ministry.

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