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Moderate improvement in the pace of regional growth

The Economic Commission for Latin America and the Caribbean (Eclac) published its updated estimates and forecasts for the regional economies in 2017 and 2018 on 14 December. In the same month it also published an analysis of the 'social panorama' in 2017 which highlighted that overall poverty levels remained broadly unchanged last year, after having notched up a fraction in 2016.

The overall headline from the new report (*Preliminary Overview of the Economies of Latin America and the Caribbean 2017*) is that the region as a whole is on track for a continuing moderate recovery led by favourable international conditions and two main positive domestic factors: rising consumption and growing domestic investment. Overall GDP growth is estimated to have been 1.3% in 2017 and is forecast to rise to 2.2% in 2018. Eclac sees the world economy ticking over at a good rate over the two years, broadly maintaining its current growth rate of around 3%. There are risks: among them President Donald Trump's tax reform plans in the US which could attract inward capital flows and as a by-product create some financial volatility for Latin America. Eclac also warns of the rise of anti-globalisation sentiment in Europe.

But the main focus of the report is on the domestic environment. One of the big changes will be in Brazil which, accounting for nearly half the region's GDP, always has a big impact on the average. Brazilian GDP growth is expected to pick up from 0.9% in 2017 to 2.0% in 2018. A group of countries that were growing at moderate rates are all expected to see a small acceleration – this includes Chile, Colombia, and Peru. For Latin America as a whole the most dynamic economies will be Panama (with GDP growth of 5.5%) followed by the Dominican Republic and Nicaragua. At the lower end of the performance table are Cuba, Ecuador, and Venezuela. Venezuela, already in selective default, is yet again forecast to contract in 2018 – GDP is predicted to drop by 5.5%. The Central American economies on the other hand will continue to grow, at a predicted rate of 3.6% (compared to 3.3% in 2017). The English and Dutch speaking Caribbean, which was flat in 2017, will achieve 1.5% growth in 2018, boosted in part by reconstruction after hurricanes Irma and María, which hit the area last year.

For the region as a whole, growth will be enough to begin to make an impact on labour markets and bring down formal sector unemployment rates. Between 2016 and 2017 urban unemployment increased from 8.9% to 9.4% as more people joined the labour force while overall employment levels remained flat. However, in 2018 Eclac expects rising demand to feed through to create more jobs, with a consequential small reduction in average regional unemployment to 9.2% this year. In terms of macroeconomic policies the report says that coming out of the recession of 2015 and 2016 most governments have emerged with reduced fiscal space (tighter budgets). However, it argues that despite this constraint there are still ways to sustain the current expansion cycle. These include strengthening regulation, productive development (including correcting infrastructure deficits), tax collection and intra-regional trade. Eclac calculates that fiscal avoidance and evasion totalled US$340bn in 2015, so reducing it could provide a major boost to fiscal revenue and spending. Alicia Bárcena, Eclac executive secretary, commented "Spending that has a greater impact on growth and inequality must be prioritised, along with avoiding sharp adjustments in public investment to protect growth in the medium term."

Latin America and the Caribbean: Growth Projections for 2017 and 2018

Country or region	GDP growth	
	2017	2018
Latin America and the Caribbean	**1.3**	**2.2**
Argentina	2.9	3
Bolivia (Plurinational State of)	3.9	4
Brazil	0.9	2
Chile	1.5	2.8
Colombia	1.8	2.6
Ecuador	1	1.3
Paraguay	4	4
Peru	2.5	3.5
Uruguay	3	3.2
Venezuela (Bolivarian Republic of)	-9.5	-5.5
South America	**0.8**	**2**
Costa Rica	3.9	4.1
Cuba	0.5	1
Domincan Republic	4.9	5.1
El Salvador	2.4	2.5
Guatemala	3.2	3.5
Haiti	1.3	2.2
Honduras	3.9	3.9
Mexico	2.2	2.4
Nicaragua	4.9	5
Panama	5.3	5.5
Central America and Mexico	**2.5**	**2.7**
Central America	**3.3**	**3.6**
Latin America	**1.3**	**2.2**
Antigua and Barbuda	4.5	5.8
Bahamas	1.2	2
Barbados	1.5	1.5
Belize	2.5	2.4
Dominica	-8.3	7.6
Grenada	3.5	2.5
Guyana	2.9	3.5
Jamaica	1.2	1.3
Saint Kitts and Nevis	2.1	3.8
Saint Vincent and the Grenadines	0.8	1.5
Saint Lucia	2.8	3.6
Suriname	-0.7	0.7
Trinidad and Tobago	-2.3	0.5
The Caribbean	**0.1**	**1.5**
Source: *ECLAC*		
Preliminary Overview of the Economies of Latin America and the Caribbean 2017 (December 2017)		
Note: *Central America includes the Spanish-speaking Caribbean*		

One of the headlines of the second report (*Social Panorama of Latin America 2017*) is that the gains made in the reduction of poverty during the long commodities boom (a period of more than a decade that came after 2002) have, aided by the subsequent recession, pretty much gone into reverse. Eclac says that for the first time the population classified as living in poverty and in extreme poverty increased in both 2015 and 2016. In 2014 168m people or 29.8% of the regional population was living below the poverty line. This rose to 178m (still 29.8% of the total) in 2015, and to 186m people (an increased proportion – 30.2% of the total) in 2016. Within that total, those living in extreme poverty rose from 8.2% (48m people) in 2014 to 10% (61m) in 2016. In other words, despite the progress made since the start of the century, roughly three out of every ten people living in Latin American and the Caribbean is poor, and one of those three is extremely poor. Pockets of poverty in the region appear to be concentrated among children, adolescents, women, and those living in rural areas.

While there is concern for those at risk of slipping back into poverty, Eclac suggests that the move to reduce income inequalities is holding. The Gini coefficient (which is measured on a scale of zero, signalling absolute equality, to 1.00 signalling maximum inequality) fell from 0.538 in 2002 to 0.467 in 2016. In other words the region became 13.2% more equal during this period. Greater equality flowed from a combination of redistributive policies including higher minimum wages, progressive tax reforms, conditional cash transfers, and other social programmes. Bárcena has called for these programmes to be maintained and developed despite the current, fiscally more difficult times.

The report also highlights the major challenge to pension systems posed by demographic change and the gradual ageing of the regional population. While the elderly are comparatively less poor than the young, a potential crisis is in the making. By 2040 for the first time the population aged 60 and over will exceed the population aged 14 and under. On the positive side the proportion of the population of working age that is paying into some kind of pension scheme rose from 36.9% in 2000 to 47.8% in 2014. But on the negative side some of those schemes are insufficient and more than half the region's working population – a total of 142m people – are making no pension contributions whatsoever.

REGIONAL ECONOMY REVIEW

CUBA

Economic growth surprises on the upside

At the end of each year, the economy and planning minister – currently Ricardo Cabrisas, who has held the post since July 2016 – presents a report to the National Assembly outlining the country's economic performance over the course of the year. The report typically contains estimates for full-year economic performance, including GDP growth, which due to the highly planned nature of the economy tend to be fairly accurate, changing little when the final statistics are published.

Expectations for the end of December report were not particularly rosy, owing to the significant damage inflicted by Hurricane Irma last September and the scaling back of oil shipments from Venezuela. Many commentators expected the economy minister to confirm what many had feared – that GDP had contracted for a second consecutive year in 2017, following a near-1% drop in 2016. However, the final outturn appears to have been much more positive: although GDP growth missed the government's 2% target, at 1.6% it was a reasonable performance in the light of the difficult external backdrop. President Raúl Castro summed up this sentiment, stating that "this outcome is not sufficient to feel satisfied, but we must congratulate ourselves for achieving it, despite the adverse conditions".

Tourism drives overall growth

According to the economy minister, growth was fuelled by a good performance across several sectors, including tourism, construction and transport. A detailed breakdown of the statistics was not provided, but the authorities have previously alluded to the likelihood that tourism grew much more dynamically than the other sectors. Tourist arrivals rose from 4m to a record 4.7m in 2017, implying growth of 17.5%. This came on the back of an exceptionally strong 2016, when arrivals rose by 13%. The 700,000 increase in tourist arrivals registered in 2017 was partly explained by a sharp rise in US tourists, which rose by around 334,550 to nearly 620,000. This came despite the reintroduction of some travel restrictions by US President Donald Trump in June 2017 that essentially make independent travel to Cuba more difficult for American tourists.

Construction and transport are likely to have registered more moderate growth than the tourism sector, but still contributed to the comparatively firm GDP result. Few details were provided about the projects driving growth in each sector, but there was some new investment in tourist facilities across the island last year, as well as some new investment in the Mariel Special Economic Development Zone, which are likely to have lifted construction. Efforts to improve the country's transport infrastructure, in a bid to develop the tourism offering, are likely to explain growth in the transport sector, even if overall quality provision remains poor. Meanwhile, the agricultural sector was affected by Irma, particularly poultry farming but also fruit and vegetable production as well as sugar cane, but this was offset by a better performance earlier in the year, with the sector contributing to overall GDP growth.

2% growth target for 2018 may be optimistic

The government is targeting a further acceleration in the pace of growth in 2018, to 2%, thanks to continued growth in both tourism and investment. The authorities believe that tourist arrivals could reach the 5m mark this year, while further investment could help tackle long-running deficiencies in the country's infrastructure (partly explained by US economic sanctions, which hamper imports of raw materials).

However, several structural factors may hamper a pick-up in GDP growth. A further increase in tourist arrivals may be difficult: while President Trump's mid-2017 reintroduction of travel restrictions did not affect outbound tourism in the months following the announcement, since many of these travel plans were already booked, it will begin to have an effect from early 2018, as US tourists are discouraged from travelling to Cuba. The US is now the second-largest source market, behind Canada, so a drop-off in the number of US tourists visiting the island could dampen activity in the sector. It is unclear whether other large source markets (Canada and Europe) could compensate for a potential decline, particularly given that tourist arrivals from these countries are already at historically-high levels.

Prospects for a pick-up in investment are also uncertain. An expansion of publically-funded investment will be difficult, given that the government is trying to shrink the size of the public sector. Detailed statistics on the size of the budget deficit for 2017 are unavailable, but it is highly likely that reconstruction spending after Irma hit in September will have lifted the already-sizeable deficit. Fiscal consolidation in 2018 will therefore place pressure on government spending. Yet President Trump's rollback of many of the liberalising trade and investment measures introduced by his predecessor, Barack Obama, will discourage foreign investors who had previously been considering investing in the island.

Venezuela remains a major risk factor

The government will hope that the expansion of domestic private investment, in the form of small businesses, will take up the slack and help to drive overall GDP growth in 2018. However, these small businesses continue to struggle as a result of limited access to credit (reflecting an underdeveloped banking system) and severe difficulties in sourcing goods and services, particularly imported parts. The government is also tightening legislation that regulates private businesses, making it more difficult for Cubans to secure licenses to operate in the still-emerging private sector.

The issue of Venezuela also remains a significant risk factor for Cuba. Although lower oil imports from Venezuela did not prevent the Cuban economy from growing in 2017, there is a possibility that this aid may be suspended altogether in 2018, if the economic crisis in that country deepens further. This would force Cuba to pay market price for its oil imports, which would exact a further strain on the public finances, particularly given the country's relatively few sources of foreign exchange. The Cuban government continues to work to diversify trade and investment partners, so a complete withdrawal of assistance by Venezuela would have less of an impact than the cut-off of Russian aid after the dissolution of the Soviet Union. However, a complete suspension in aid from Venezuela during 2018 would almost-certainly put the government's 2% GDP growth target out of reach and may even push the economy into recession.

VENEZUELA

Cash-strapped government pins hopes on crypto-currency

Chronic shortages of US dollars are causing numerous economic problems for the Venezuelan government. Imports of basic food and medicine have been slashed, as the authorities lack the funds to pay for these goods, while the government remains in default on a number of its external bond obligations. The government's latest solution to the deepening crisis is the launch of its own crypto-currency. The 'petro' is expected to launch imminently; backed by the country's oil reserves, the government optimistically hopes to raise between US$20m and US$200m each month from digital currency sales.

President Nicolás Maduro initially announced plans for a crypto-currency in early December, but at the time he gave no details of how the system would function or when it would be launched. Given that the president has frequently alluded to major new currency developments that have subsequently failed to materialise, there was initially some speculation about whether this announcement would be followed by any concrete action.

'Petro' is set for imminent launch

However, while the system has not launched, there are signs that the policy is a work in progress, with the government working towards an imminent start-date. On 8 January, the national crypto-currency director, Carlos Vargas, stated that he envisaged that the 'petro' would launch within the next six weeks. He also provided more details about how the system would function, with one 'petro' being valued at the same price as a barrel of oil. Mr Vargas did not state whether this was the price of Brent crude, but it is likely that it will be pegged to the price of Venezuelan exported oil, which was trading at around US$59/b in the first week of January. In an attempt to boost investor interest, President Maduro signed a decree on 27 December that provides backing for the digital currency, in the form of oil reserves located in part of the Ayacucho bloc (located in the oil-rich Orinoco area).

The plans have been met by significant criticism from both the domestic opposition, as well as the broader international community. Given that the economy is in such dire straits, with the opposition-controlled National Assembly recently declaring that GDP has contracted by a cumulative 34% in the past four years, critics of the 'petro' system allege that even the bravest of investors are likely to steer clear. The main problem is that the government has provided no details about how investors in the 'petro' will be able to cash in their investments if they want to sell their digital currency assets. This will require a financial intermediary and given that this is a state-run scheme, it is likely to be the Banco Central de Venezuela (BCV, the Venezuelan Central Bank), or one of the various state-run banks. These financial institutions remain critically low on US-dollar reserves, so would not be in a position to provide dollar liquidity to investors selling petros. Although the petro is theoretically backed by the country's oil reserves, investors would find it virtually impossible to secure these assets, since doing so would involve a lengthy legal battle with the country's politicised judiciary.

Government's main goal is to raise finance

Given that investors will be unlikely to be able to sell their petros, the launch of a crypto-currency is somewhat of a misnomer. What this instead represents is a loosely-cloaked effort to raise finance. US financial sanctions effectively prevent the government from issuing external bonds, or from restructuring existing liabilities. By labelling the petro as a crypto-currency, the government hopes to benefit from last year's surge in many digital currencies. In other words, the authorities hope that investors will shelve concerns about the economy's underlying frailty, tempted by the attraction of a newly-launched digital currency.

The government hopes that investors will overlook any concerns they may have about getting their money out of the system, believing that there will be demand for millions of issuance of petro units, with President Maduro talking about the sale of 100 million (implying investment of around US$6bn).

The reality is that this is likely to be another of the government's poorly thought-out policy ideas that has very little impact in cushioning the deep economic recession. The fact that the black-market exchange rate has soared from BsF103,000:US$1 in early December to over BsF136,000:US$1 on 6 January indicates that there is no confidence that the launch of the petro will tackle the country's currency problems. The official exchange rate remains pegged at BsF10:US$1, so the massive gap between this rate and the black-market rate continues to distort many economic variables, including fuelling already-rampant levels of inflation.

Money-printing accelerates

Increasingly-rapid money printing is also pushing up inflation. Large fiscal deficits and financing difficulties have forced the Central Bank to print bolivares, to cover the budget shortfall, for several years. However, data on money supply (one of the only statistical series that the Central Bank continues to publish) indicate that the authorities are printing money at a faster and faster pace. Liquid money, as defined by the Central Bank (which incorporates cash in circulation, as well as instant-access bank deposits), is now rising by around 10% per week, compared with levels of around 2% this time a year ago. Frequent and large hikes to the minimum wage – which rose by 40% in its most recent increase in late December – are also forcing the Central Bank to print money, to fund these increases.

In year-on-year terms, this means that the stock of liquid money is more than 11 times larger. With massive amounts of bolivar-denominated liquidity chasing ever-fewer goods, prices have soared. The Central Bank has not published inflation data since December 2015, so it is difficult to gauge the precise level of price increases, but there is a broad consensus that annual inflation currently stands well into four-digits. Local consulting firm Ecoanalítica estimates that inflation ended 2017 at 2,735%. Another firm, Econometrica, forecasts that inflation could easily end 2018 at 30,000%. Economics professor Steve Hanke has aptly described this situation as a "death spiral", implying that things in Venezuela are likely to get even worse in 2018.

PERU

Political storm clouds the economic outlook

Peru experienced an intense political crisis for two weeks in December, leading to a formal vote to impeach President Pedro Pablo Kuczynski. Against the odds, the president survived. Despite losing three ministers, he continues to insist that the economy will recover strongly in 2018. Here we look at the economic impact of the political crisis.

The president had been accused of "moral incapacity" because a company he set up had received funds from Odebrecht, the Brazilian civil engineering group that has admitted paying bribes in Peru and elsewhere in Latin America. Impeachment required a two-thirds majority vote, or 87 out of the 130-seat congress. With the right wing populist Fuerza Popular (FP) party sworn to remove him mobilising its 72 deputies, and other smaller parties promising to swing behind it, it looked highly likely that the president would have to step down. But in the end the FP suffered a last-minute split with a small group loyal to deputy Kenji Fujimori apparently agreeing to support the president in exchange for a promise to pardon Kenji's father, former President Alberto Fujimori (1990-2000), who was serving a long prison sentence on corruption and human rights charges. The bulk of the party remained loyal to Keiko, Fujimori's daughter who was not party to the deal. The split between brother and sister meant that in the end only 79 deputies voted in favour of impeachment, falling short of the total required; 19 voted against and 21 abstained. Fujimori *pére* was duly released on 4 January, despite a wave of protests by those who regard him as an enemy of democracy. Three of Kuczynski's ministers (those responsible for the interior, defence, and culture) resigned in protest.

At this early stage the full economic impact of the crisis is hard to pin down. This is because, looking forward, there are at least two scenarios. In the first, the December/January crisis will turn out to be like a sudden tropical storm: bringing loud thunder and lightning, but blowing away quite quickly as the sunshine returns. The second scenario is more gloomy: in this view the political crisis is ongoing and points to continuing weakness in Peruvian governance and institutions; the battle between the executive and the opposition-dominated congress will continue dogging the country through 2018, undermining business and investor confidence and blocking further economic reforms.

Economy minister Claudia Cooper positioned herself mid-way between the two scenarios during a press conference on 4 January, acknowledging that public sector investment had been put on ice during the crisis. She claimed normal business was now resuming, but warned "The political crisis is not yet over." In the minister's view there had been a "blip" that was not initially significant, but its real lasting impact would depend on whether the crisis could be resolved "in a civilised manner". Cooper went on to say Peru had in the past shown its ability to overcome "political complications". She saw no reason to modify the official forecast that GDP growth would accelerate from 2.7% in 2017 to 4.0% in 2018.

The optimists say that Peru's economic fundamentals remain robust. They highlight three main factors driving the recovery this year: an upturn in both public and private investment, advances in the reconstruction programme following the 2017 floods and mudslides (works totalling US$7.9bn), and favourable global demand for Peruvian mining and other exports. New investment in a number of big mining projects is due to get under way this year including the US$5bn Quellaveco copper project in Moquegua. London-based consultancy Capital Economics has also made the point that Peru is better placed than some of its neighbours to weather political setbacks, with a balance sheet that is in "reasonable shape". In Brazil the impeachment hearings of 2016 were held at a time when there was a fiscal deficit equivalent to 10% of GDP, three times greater than Peru's current fiscal deficit of around 3% of GDP. In a note written when Kuczynski's fate remained uncertain, Capital Economics said it expected growth of 3.5% in 2018, even if he was removed from office.

Those who are a little more pessimistic about 2018 say politics could continue to get in the way of economic growth. Juan José Marthans of Universidad de Piura said that in the absence of a democratic resolution to the crisis of governability, up to one or two percentage points of GDP growth could be at risk in 2018 (in the worst case scenario taking growth down from 4.0% to 2.0%). A reduction in Peru' investment-grade credit rating in early 2018 could trigger a change of heart by investors, Marthans feared. Although business confidence improved in the second half of 2017, a prolonged crisis could conceivably send it back down again. In the public sector, execution of public works projects could fall behind schedule because of red tape, corruption investigations, and regional elections due this year: some big projects could therefore slip back into 2019. Before the impeachment vote Abhijit Surya of the Economist Intelligence Unit told Peruvian news agency Andina that because of "political noise" he was cutting back the 2018 GDP forecast for Peru to 3.0%-3.5% (down from 4.0% previously). Importantly, he said the downgrade would apply even if Kuczynski survived the impeachment vote. Surya was particularly concerned that uncertainty could impact big public-private partnership (PPP) investment projects.

CHILE

Moderate market-friendly reform under Piñera?

Chile's political pendulum has swung back to the right again. Sebastían Piñera won the second round of the country's presidential election on 17 December, defeating centre-left candidate Alejandro Guiller by 54.57% to 45.43%, a better margin than had been expected. The way is now clear for Piñera, who takes office on 11 March, to push for the market friendly reforms he has promise to deliver economic recovery (Piñera says his aim is to double the annual GDP growth rate from 2% to 4% during his term in office). But as he lacks a congressional majority, his approach is likely to be quite cautious.

For over a decade two alternating presidents have set Chile's economic policies. Michele Bachelet, on the centre-left, was in office from 2006-2010;

Piñera, on the centre-right, succeeded her from 2010-2014; Bachelet then returned for a second presidential term from 2014-2018; and now Piñera has also won a second term, which will run through 2018-2022. Inevitably, the two have been almost constantly judging how much of their predecessor's work to accept, criticise, unwind or amend: in short, to decide how vigorously to swing the policy pendulum back towards their own ideological home. Now it is Piñera's turn to make that judgement. Although he won with a convincing nine-point margin, it is likely that he will move with a degree of caution and moderation.

This is because his Chile Vamos coalition will lack an overall majority in either house of congress. It will be the largest group in both the lower chamber (with 73 of 155 seats) and in the senate (with 19 of 43 seats). To achieve a simple majority Piñera will therefore need to attract another five votes in the chamber of deputies and another three in the senate: this points to detailed issue-by-issue negotiations, and to give-and-take compromises.

Piñera's advisers say his ministerial team is likely to be finalised by the end of January. The incoming president has at least three important priorities. One is to boost mining investment and production: he has promised to reduce red tape, relax complex environmental permits, and cut corporate tax rates. Bachelet had increased corporate tax rates from 20% to 25% in 2013; Piñera says he wants to get them back down to the OECD average of 22%. Another priority is to reverse a multi-year fall in private investment. The third priority is to reverse the trend of widening fiscal deficits (in five years, from a balanced budget in 2012, Chile has seen the fiscal deficit widen to around 3.0% of GDP in 2017). This last priority is the one where some kind of cross-party deal will look most likely, given that various parties in Guiller's defeated coalition had acknowledged the need for fiscal consolidation. Piñera is likely to use his election pledge of a US$14bn government-spending plan across the four years of his term in office as the basis for negotiations with other parties.

It looks as if Piñera will not seek to reverse one of Bachelet's big reforms, the introduction of free university-level education: between the first and second rounds of the presidential ballot, to win over centre and moderate left wing voters, he made a pledge to keep universal free education. He can however be expected to tinker with the labour reforms introduced by Bachelet and to seek changes to the existing public-private pension system. Chile was a pioneer in introducing private pension funds back in 1981 (known as Administradoras de Fondos de Pensiones or AFPs) but they have been criticised for high management costs, and for providing relatively low benefit levels. The new government is expected to support the AFP industry, but to look at ways of raising pension benefits and, given the problems posed by an ageing population, seeking to incentivise later retirement.

REGION

Can Cartes do the deal with Europe?

In the tail-end of his five-year term in office, Paraguayan President Horacio Cartes appears to have taken on a new job: trying to steer almost 20 years of free trade negotiations between the European Union (EU) and Mercosur to a successful conclusion. Cartes has just taken over the six-monthly rotating Mercosur presidency from his Argentine colleague, President Mauricio Macri. Macri's attempt to reach a deal in time for the World Trade Organisation (WTO) ministerial summit in Buenos Aires in December did not succeed.

For years protectionist sentiment in key Mercosur members Brazil and Argentina held up negotiations on a free trade agreement (FTA) with the European Union. Current Mercosur governments are more enthusiastic about free trade and globalisation but now the shoe may be on the other foot: EU members France, Ireland, and Poland are concerned to protect their farmers from competitively-priced South American agricultural products. All sides had hoped to finalise the FTA by December, but failed. There are at least three big outstanding issues. The first is that the EU is offering a low quota for reduced-tariff imports of Mercosur beef and ethanol (respectively, 70,000 and 600,000 tonnes). In the past it had offered a beef quota of 100,000 tonnes but EU officials say that is no longer on the table: the European market for beef has shrunk, so import quotas should be correspondingly smaller.

The second issue is that the Europeans want to see bigger reductions in Mercosur tariffs on their key exports to the block (mainly machinery, vehicles and parts, chemicals, and pharmaceuticals). Officials in Brussels say Mercosur is still starting out from a very protectionist position, with ad valorem import tariffs on automobiles at 35%, on machinery at 20%-35%, and on clothing and footwear at 35%. Third, while Mercosur countries accept they need to open up their markets and become more competitive, there is a dispute over the scope and speed at which this should be done in trade with Europe. The Mercosur negotiators proposed phased and partial tariff reductions over a 15-year period. The EU position is that 80% of traded goods between the two blocks should become zero-rated within ten years.

Further negotiations were expected in Brussels in late January, but the political window of opportunity for completing the FTA may be narrowing. While Argentina and Uruguay continue enthusiastic, Brazil's centre-right administration under President Michel Temer faces general elections in October and may be wary of provoking domestic nationalist and protectionist sentiment. In Paraguay, President Cartes would like to crown his presidency with a successful FTA negotiation, but after the controversy over his failed attempt to secure a re-election bid, he too may be distracted by internal political manoeuvring prior to the general elections in April.

MEXICO

Still ticking over

With presidential elections due in July and the fate of the North American Free Trade Agreement (Nafta) hanging in the balance, 2018 will be a momentous year for the Mexican economy. But despite these high levels of uncertainty economists are on balance projecting another reasonably good, albeit transitional year.

There may be high political drama in Mexico this year, and further twists and turns in the country's troubled relationship with the Donald Trump administration in the United States. But for the moment most economists are predicting a fairly average year. The Economic Commission for Latin America and the Caribbean (Eclac) projects GDP growth of 2.4%, up from an estimated 2.2% for last year. The Mexican central bank expects growth of 2.0%-3.0% this year, up from an estimated 1.8%-2.3% in 2017. A group of local analysts polled by Spanish news agency *EFE* came up with a consensus figure of 2.5% GDP growth in 2018. Many are factoring in that the government will want to boost spending in an election year. Gabriela Siller of Banco Base says she expects a public spending boost and an improvement in consumer confidence in 2018. Delia Paredes, an analyst at Banorte says there are "important challenges" in 2018, but her bet is that they will ultimately be resolved and that risks will dissipate as the year progresses. Her judgement is that whoever wins the presidential race, market and political realities will discourage very radical changes in economic policy.

The Mexican peso weakened in the tail end of 2017, depreciating to MXN19.73 to the US dollar. Analysts predict volatility will continue this year, with much in the short term depending on the outcome on the sixth round of tripartite Canada-Mexico-US negotiations on the future of Nafta (*see next article, Decisive round for Nafta?*). Siller says the currency could drop further if any of the presidential candidates makes a formal commitment to reverse the liberalising oil and gas sector reforms of 2014, which ended the state monopoly on production. Currency depreciation may also be driven by a trend among US companies and investors to repatriate capital in response to rising US interest rates and falling corporate taxation levels (the latter forming an important part of the US President's tax reform package). Some analysts say that because of the close links between the two economies Mexico may need to consider a tax reform package of its own to discourage excessive capital flight.

A weaker peso will boost the pass-through effect on inflation. The central bank estimates inflation rose to 6.6% in 2017, well above the existing 3.0% target. Siller thinks it will take at least two years to get back on target, with the rate dropping this year to around 5.1%. The Banco Base economist also points out that the uncertainty over Nafta has already taken a toll on foreign direct investment (FDI) into Mexico that fell by 11% in 2017. She calculates the fall would have been much greater – around 30% – if it had not been offset by new inward FDI coming into the oil and gas sector. The overall consensus seems to be that with major issues unresolved, this will be a transition year. The main milestones will include a decision on the fate of Nafta (which could be resolved at any point this year or might conceivably be pushed back to 2019); the result of the Mexican presidential elections (July this year); the result of the US mid-terms which will influence Trump's Nafta and Mexico policies (November); and, finally, the policies that the new Mexican government will begin to implement when it takes office (December 2018).

A tortilla crisis?

Bad economic news often comes at the beginning of the year in Mexico. Last year it was the *gasolinazo* – a sharp increase in fuel prices of up to 20% caused by the phased deregulation of the local energy market. That led to some protests and incidents of looting. This year there is controversy over the price of tortilla, the traditional flatbreads made from finely ground maize that are a staple of the Mexican diet.

The tortilla producers' union, (Unión Nacional de Industriales de Molinos y Tortillas – Unimtac) claims price increases ranging between 1.50 and 3.00 pesos a kilo are on the way. These would represent an increase of 10.7% to 21.4% relative to the national average price of 14.01 pesos a kilo (there are some quite sharp regional price variations). Unimtac, which represents 80,000 small tortilla producers, says prices are being pushed up by changes in the market for maize, and by higher energy costs for natural gas, petrol, and electricity. But the economy ministry and consumer protection agency Procuradoría Federal del Consumidor (Profeco) have accused Unimtac of getting its facts wrong (they say maize prices actually dropped 11% last year) and potentially breaking the law by trying to 'talk up' prices. The dispute is further complicated by arguments over whether locally produced white or imported yellow maize is being used. Tortillas are important: a recent study suggests 101m Mexicans are regular consumers and that the market is worth MXN81bn (US$4.16bn) in sales each year.

MEXICO

Decisive round for Nafta?

The sixth round of tripartite negotiations between Canada, Mexico, and the United States on the future of the North American Free Trade Agreement (Nafta) was due to be held in Montreal, Canada, on 23-28 January. Various observers said they believed the sixth round could prove decisive.

A Mexican industrialist was quoted off the record by Spanish newspaper *El País* saying "Trump thinks he is on a roll; while it would be logical for him to seek a positive renegotiation of Nafta, he is so unpredictable that I am afraid he may just bang the table and reject the whole deal. We'll come out of Montreal knowing whether this thing is going to move forward or not." A member of the Mexican negotiating team, also speaking off the record, said it was approaching Montreal "ready for anything, including packing up our bags and going home."

Nafta negotiations are now beginning to overlap with the Mexican 2018 presidential election campaign. This has led one analyst, Ignacio Bartesaghi of the Universidad Católica del Uruguay, to suggest Mexican negotiators might simply want to gain time, trying to push things forward to after the July elections.

REGION

New ways of cooperation against corruption

As our Special Focus on Mexico shows (*see below*), notwithstanding intensifying external and internal pressure most governments in Latin America, along with the judiciary, the police, and other state agencies, are still struggling to respond adequately to corruption.

In a year-end blog, John Dunn Smith, Assistant Editor of the Inter-American Development Bank's research department, examined whether governments and civil society organisations (CSOs) might work together, cooperatively, to help tackle the scourge of corruption in Latin America.

Describing corruption as "a public enemy" Dunn Smith looks for more dynamic approaches to dealing with it. As he observes, the public resources available to monitor the implementation of public works projects at state or municipal level, for example, are finite. National government agencies involved in enforcement may have some legal teeth, but they typically lack resources for monitoring. As such they tend to be reactive rather than proactive. Against this, civil society organisations, while often having a strong interest in monitoring public sector activities, lack teeth. They have no enforcement powers (and invariably also lack resources).

Dunn Smith points to a recent research project led by a Columbia University researcher and former IDB visiting scholar, Paul Lagunes. This project, carried out in Peru between August 2015 and May 2017, examined what happened when a CSO and a national government agency informed local authorities that their use of central government funds for infrastructure projects was being monitored.

As Lagunes set out in a November 2017 Working Paper for the IDB*, in the first stage of the project officials in randomly selected districts across Peru received a letter stating that their expenditure on the execution of small infrastructure projects (e.g. roads, pavements, municipal sports grounds etc.) – which were being funded by the central housing ministry in Lima – was being monitored. One letter was sent by Proética, a CSO that serves as Peru's chapter of Transparency International. Proética has national recognition in Peru and is demonstrably independent of the government. Shortly thereafter, district officials received a second letter from the national government's auditor, the Controloría General de la República, notifying them that it was aware of Proética's monitoring activities. A second stage consisted of a follow-up letter from Proética, then another one from the Controloría, reminding the district that the monitoring was ongoing.

According to Lagunes, this intervention yielded notable results. Projects in 'treated districts' (i.e. districts that had received the letters) registered a 51% reduction in final construction costs compared to projects in control group districts (i.e. districts that did not receive the letters).

The reduction, moreover, was found to have been delivered without any perceptible change in the quality of the completed works. Lagunes, along with Proética, verified this by examining the condition of some of the works projects, both first hand and in some cases using satellite pictures of the kind available from Google Earth. Lagunes thereby concluded that the cost reductions in the infrastructure schemes had been achieved by curtailing unnecessary – and quite likely some dubious – outlays.

The project also found that the monitoring scheme appeared to have had a positive impact in neighbouring districts. In other words, other districts, aware of the monitoring, also took a more careful approach to expenditures.

While this was a relatively moderate field study, the author concluded that there were some clear lessons for policymakers. That is to say, when government agencies and CSOs combine anti-corruption efforts, the resulting social benefits significantly outweigh the costs.

However, and as Dunn Smith also noted, cooperation between government and civil society can be tricky. "Mutual relations are often tense and even conflictual", he notes. Trust is very often sorely lacking between civil society and governments and, in Latin America, government-civil society relations are particularly weak. However, when this kind of positive collaboration does take place, corruption almost certainly can be reduced, and significantly.

ECUDAOR

Moreno looks to turn over a new page

In removing his vice president, President Lenín Moreno has made a definitive break with the radical faction of the ruling Alianza País (AP) that remains loyal to his predecessor, Rafael Correa (2007-2017). This will anchor the government closer to the centre in economic policy terms, albeit with a strong focus on social justice and equality.

Jorge Glas, the face of the Odebrecht scandal in Ecuador, had refused to resign his elected position. Glas had been stripped of his official vice-presidential duties by Moreno in August, and while he nominally remained in his elected post, he was replaced in his duties by an interim. In October, Glas was jailed pending his trial. In December, he was found guilty of taking US$13.5m in bribes from Odebrecht and sentenced to the maximum of six years in jail, on charges of illicit association (with further charges and additional sentencing still possible). Yet even after that ruling, Glas still refused to step down.

On 3 January, Moreno declared the post vacant under the constitution, on the grounds that Glas had been unable exercise his vice-presidential duties for a period of 90 days. Days later, the interim, María Alejandra Vicuña, a staunch Morena loyalist, was confirmed as the new VP by the national assembly.

Vicuña's confirmation was another political goal for Morena. He managed to obtain a majority in the assembly to secure Vicuña's appointment, despite the opposition of the Correísta faction. Upon her confirmation, Vicuña promised to combat corruption and work for "unity, dialogue, and democracy", starting with the upcoming 4 February referendum on constitutional reform.

Glas's removal may be the final straw for the Correístas, with a formal split in the AP almost certain now. Of the AP's 74 deputies, 46 are Moreinístas, 23 are Correístas, and five are unaligned. While Moreno would lose majority control of the national assembly with an AP rupture, he is likely to forge a working coalition deal with the opposition after the February referendum.

Correa, meanwhile, is seeking to make an early return from his political career-break in Belgium. He had pledged to sit out this term to spend time with his family in Europe, but Moreno's unexpected break with his predecessor prompted Correa to end his self-imposed political exile. At an unofficial AP convention in Ecuador on 3 December, Correa proposed a new political party bearing his initials, Revolución Ciudadana (RC) and he was due to return back to the country for a second time in mid-January to lead the 'no' campaign against Moreno's referendum.

Public support for Correa, however, has fast dissipated since he left office in May with his record tarnished by the mounting allegations of corruption at the very highest levels of government. He bequeathed a weak and indebted economy, as well a depleted labour market. To huge surprise, however, Moreno immediately moved – in decisive fashion – to disassociate himself from Correa. Heavily criticising his former mentor and close ally, he pledged a new, more open, transparent and politically-inclusive administration. A furious Correa branded him a traitor to the left-wing 'Citizen's Revolution'.

Undettered, Moreno has gradually ejected Correístas from his cabinet, which has allowed the president to strengthen his leadership. Ahead of the Glas sentence, Moreno lost two ministers: his chief of staff, the leftist Nicaraguan Eduardo Mangas; and social minister Iván Espinel, who quit, apparently in solidarity with Glas. Moreno previously had removed Correístas including Patricio Rivera and Diego Martínez.

Among its chief reforms, the 4 February referendum most notably seeks to re-impose a two term presidential limit, which would prevent Correa from running again in 2021. It would also impose heavier sanctions for corruption, including the confiscation of property and other assets and the stripping of civic rights – a clear response to the Glas case. Finally, it would also reform the Council for Citizen Participation and Social Control, a powerful state entity – currently Correísta-controlled – that oversees judicial and other senior appointments. After the referendum, which according to most opinion polls has strong public support, a newly legitimised Moreno may also look to reform the controversial 2013 Communications Law, which Correa used to silence critical media and attack his opponents.

Moving forward, the referendum result could allow Moreno to embark on a more pragmatic economic policy agenda that, if successful, could see him re-elected in 2021 for another term. Already, foreign investor sentiment has revived. An economic recovery, while still tentative and uneven, is also boosting domestic sentiment and expectations.

Nonetheless, the fact remains that dollarised Ecuador remains a cash-strapped petro state, with severe competitiveness problems. Moreno inherited a fiscal deficit of well over 5% of GDP but has been unwilling to contemplate a severe adjustment, instead pledging a gradual programme financed by external debt. Importantly for the government's political base, Moreno has pledged that social spending will be ringfenced.

As such, the 2018 budget remains expansionary, with the deficit unlikely to shift much and the oil price recovery insufficient to Ecuador's revenue needs. In keeping with his pledge to shield Ecuadoreans from a harsh adjustment (and in support of the still-fragile domestic economy) Moreno has sanctioned only very moderate tax changes in support of deficit reduction. Along with continued external indebtedness therefore, the cash-strapped administration may also consider privatisations and asset sales this year in a bid to raise some extra income.

In 2017, Ecuador borrowed almost US$7bn from external sources, a record, of which a full US$5.5bn was in bond issues. Since Ecuador returned to international capital markets in 2014 (it was shut out of international markets for some seven years after Correa selectively defaulted on some US$3bn in bonds in late 2008) it has issued US$11.8bn in sovereign bonds in total. The public debt/GDP ratio has breached the 40% ceiling set under the constitution and looks set to rise again this year. This rising burden will weigh on financing costs for the government – which may encourage it more towards the privatisation option.

This appears good news for investors – especially those with an interest in the country's mining sector, for example. Mining had been identified as an investment priority by the Correa administration from 2014 as it looked for alternative revenue sources to oil, but despite reforms to the mining regulatory framework investors remained wary. That sentiment has now improved, with Ecuador latterly touted as one of the most interesting mining prospects by international industry forums. Other potential assets that could be offered include the national airline TAME and Banco Pacífico.

Moreno appears keen to avoid another available financing option – a lending program from the IMF – not only because he rejects the Fund's typically stringent conditions, but also because an IMF 'bailout' would be politically damaging. However, much will depend on the economic performance this year and were Moreno to forge a formal coalition with the centre-right opposition, for instance, the IMF option might be put on the table.

Dollarisation

The big question in Ecuador is always over dollarisation, which tamed inflation after the major financial crisis of 2000, but it has eaten away at competitiveness. Domestic manufacturers simply are unable to compete with cheap imports, while non-oil exporters equally find themselves undercut on international markets.

Moreno has pledged to maintain dollarisation. Recovering oil export revenues – and renewed foreign investment – should replenish central bank reserve levels, allowing the government to row back from its recent reliance on balance of payments safeguards to protect dollar liquidity. These import tariffs have caused tensions with the European Union and other trading partners.

MEXICO

AML/CFT evaluation – good, but could do better

The Financial Action Task Force (FATF) and its sister organisation, the Financial Action Task Force of Latin America (GAFILAT, comprising 17 countries from South, Central and North America) have been compiling two new evaluation reports on Mexico and Colombia's progress with Anti-Money Laundering and Combating Terrorist Financing (AML/CFT) efforts. The Mexico report was published on 31 January, with the Colombia evaluation due in July. Mexico's performance was found wanting, not least for lack of proactive effort by the relevant authorities.

Mexico and Colombia are among the countries of most relevance to AML/CFT efforts in Latin America, not least because of their large narcotics production and trafficking sectors, and associated organised crime, both of which require significant asset laundering. While there are no exact figures available, Mexico's Institute for Competitiveness (IMCO) in 2015 released a report in which it calculated that corruption cost the country between 2% and 10% of its GDP annually and reduced foreign investment by 5%, while also costing 480,000 jobs from small and medium-sized businesses (SMEs).

Mexico was last assessed in 2008. Since then, its AML/CFT legislation has been updated and includes the 2013 Federal Law for the Prevention and Identification of Resources of Illicit Provenance, as well as the 2014 External Circular No. 304 on obligatory reporting for AML/CFT purposes.

Following its evaluation report, the FATF/GAFILAT said that Mexico would remain under a process of 'intense monitoring'. While praising recent progress, the FATF called on the Mexican authorities to redouble efforts to go after money launderers and confiscate assets. While the report praised the country's Financial Intelligence Unit (UIF, in the Spanish acronym), the FATF complained that the information gathered by the unit did not seem to be acted upon sufficiently, citing a lack of investigations into suspected money laundering and other financial crimes. The report notes that while the Mexican authorities have recently carried out some high-profile investigations into money laundering, these have been reactive, with not enough proactive and systematic work being done. It identified something of a disconnect between the UIF and other authorities, notably including the judicial powers. In terms of the final beneficiaries of money laundering, the report also said that work to identify these actors was limited, thereby limiting the effectiveness of Mexico's overall AML/CFT efforts.

This would not be the first time that legal experts (and opposition politicians) have raised questions about the current government's commitment to rooting out corruption, whether public or private. The opposition – including the 2018 presidential front-runner Andrés Manuel López Obrador (AMLO) – accuses the administration led by President Enrique Peña Nieto of the Partido Revolucionario Institucional (PRI) of paying mere lip service to fighting corruption. The still rudderless new National Anti-Corruption System (SNA), unveiled to great hype in July 2016, is a case in point. The FATF's note of concern about judicial effectiveness, or the lack thereof, is not new either.

Below we summarise the FATF's key findings:

1. Mexico has a mature AML/CFT regime, with a correspondingly well-developed legal and institutional framework. There has been a significant improvement in some areas of the country's AML/CFT regime since 2008. Nonetheless, the country still faces with a significant risk of money laundering (ML), stemming principally from activities most often associated with organised crime, including drug trafficking, extortion, corruption, and tax evasion.

2. Most of the key authorities have a good understanding of ML and terrorist financing (TF) risks, and there is generally good policy cooperation and coordination. Mexico finalised its national risk assessment (NRA) in June 2016 and has since taken some high-level actions to mitigate the risks identified in the NRA. These actions – while leading to some concrete results – have not been sufficiently comprehensive nor prioritised to give an appropriate allocation of resources at the federal, state, and community levels. A national strategy is being developed based on the NRA findings. The success of these measures will depend on their proper implementation.

3. The financial sector demonstrates a good understanding of the primary ML threats from organised crime groups and associated criminal activities, as well as tax crimes; but the recognition of corruption as a main threat is uneven. While recognising the general threat of organised crime, designated non-financial businesses and professions' (DNFBPs) appreciation of the ML risks appears limited. Financial institutions' (FIs) and DNFBPs' understanding of more complex ML techniques, such as the misuse of legal persons, is limited.

4. Financial intelligence and other relevant information is made available by the Financial Intelligence Unit and accessed on a regular basis by competent authorities. Although the Unit functions well, and is producing good financial intelligence, the volume of intelligence disseminated to the Procuraduría General de la República (PGR, attorney general's office) is limited, resulting in a low number of financial investigations.

5. Until relatively recently, the PGR did not rank the identification and investigation of ML as one of its key priorities. ML is not investigated and prosecuted in a proactive and systematic fashion, but rather on a reactive, case-by-case basis, notwithstanding some high-profile investigations recently. In view of the serious threats posed by the main 'predicate offences' (largely organised crime and/or drug trafficking), the competent authorities place more priority on the investigation of these offences than to ML. Consequently, the number of prosecutions and convictions for ML is very low. Significant shortcomings were found in the way in which ML cases are investigated. Specifically, only very rarely are parallel financial investigations conducted, and ML is seldom prosecuted as standalone offense. The level of corruption affecting law enforcement agencies (LEAs), in particular at the state level, undermines their capacity to investigate and prosecute serious offences.

6. Confiscation of proceeds and instrumentalities is not systematically pursued as a policy objective and is not commensurate with the ML/TF risks. The provisional measures available to the authorities are not being used properly and in a timely manner, except for the use of FIU's blocked persons' list (BPL). Suspicious and falsely declared cash is not being adequately confiscated.

7. A serious concern across all sectors is that beneficial owners are being identified only to a limited extent, systematically weighing on entities' effectiveness in assessing and managing ML/TF risks. Owing largely to shortcomings in the legal framework, FIs seek to identify beneficial owners in only limited circumstances. The authorities have reformed regulations to address this gap, but these are not yet in effect. Where FIs are required to identify beneficial owners (legal persons categorised as high risk and natural persons), FIs unduly rely on customers' self-declaration to identify beneficial owners. For the majority of legal persons not categorised as high risk, FIs need only obtain information on corporate customers' first layer of legal ownership, without seeking to reach the natural persons who ultimately own or control the entity. DNFBPs generally believe it is not their role to identify beneficial owners.

8. The financial sector supervisors have a good understanding of the risks within the sectors for which they are responsible, and have implemented reasonable risk-based approaches to AML/CFT supervision. Oversight of the DNFBPs is less developed and is significantly under-resourced. Generally, sanctions have not been applied, to date, in an effective, proportionate, and dissuasive manner.

9. Overall, Mexico has a solid institutional and legal framework in place to investigate and prosecute TF and impose targeted financial sanctions (TFS). The authorities have provided FIs with red flags to detect potential TF cases, and the FIU has conducted some analysis related to TF. Nonetheless, Mexico could do more to ensure that the relevant authorities are better equipped with the right tools in terms of training, expertise, and priority setting to be able to effectively detect and disrupt TF.

10. Finally, Mexico has a solid legal and institutional framework in place to seek and provide mutual legal assistance (MLA) and extradition. The authorities also frequently rely on other forms of international cooperation to exchange information with other countries. In practice, Mexico has decided as a policy matter to strengthen and favour other forms of cooperation, while only pursuing MLA when strictly necessary. It is clear that the use of other forms of cooperation is effective, fluid, and has produced tangible results with the US. The provision of MLA by Mexico is somewhat limited by the absence of a legal basis for certain investigation techniques. As regards seeking MLA, the authorities are neither proactive nor seem to accord a high priority to pursuing MLA when the offence has a transnational element, and where evidence or assets are located abroad which has a negative impact on the effectiveness of investigations and prosecutions.

Based on these findings, the FATF makes the following recommendations, suggesting that the authorities:

- Prioritise the investigation of ML and allocate additional resources, and strengthen financial investigation and internal coordination within the prosecution units, at the federal and state level. In parallel, the attorney general (PGR) should increase the level of specialisation of its units, particularly within those dealing with ML and corruption. Assessors should indicate briefly what action is required, and the reason why it should be prioritised.

- Integrate confiscation as a policy objective within national AML/CFT policies.

- Enhance the quality of Suspicious Transaction Reports (STRs) by providing further guidance to reporting entities, and increase FIU disseminations to support ML investigations.

- Initiate parallel financial investigations in accordance with Mexico's ML/TF risks, and to that end provide training and technical expertise to the PGR and Federal Police.

- Improve professionals' understanding of the ML risks from corruption and their ability to manage such risks (in particular notaries, lawyers, and accountants). This can be done by (i) deepening the analysis of corruption as an ML threat; (ii) requiring entities to determine whether a beneficial owner is a Politically Exposed Person (PEP) and apply controls in line with the standard; (iii) extending the requirements on PEPs to Designated Non-Financial Businesses and Professions (DNFBPs); and (iv) providing guidance on assessing and managing risks associated with domestic PEPs.

- Strengthen measures on Beneficial Ownership (BO) by: (i) extending the requirements on identifying beneficial owners, including those of legal persons introduced in the February/March 2017 amendments to the entities that are not covered; (ii) engaging all professionals (in particular, notaries, lawyers, and accountants) to clarify supervisory expectations regarding the requirements on beneficial owners, and providing guidance on best practices; (iii) discouraging the undue reliance on customers' self-declarations; and (iv) ensuring that adequate, accurate, and current BO information of Mexican legal persons and arrangements is available to competent authorities in a timely manner, by requiring that such information be obtained at the federal level.

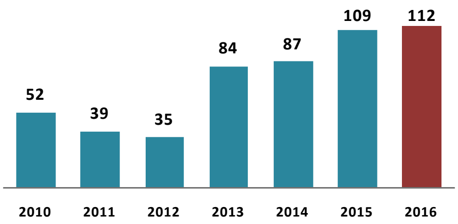
• Review the resources for AML/CFT supervision in the light of the risk profiles emerging from the models developed by the supervisors. Immediate attention should be applied to the tax agency (SAT), which the report says "is significantly under-resourced by any measure".

• Review the financial penalties available to supervisors to establish whether they can realistically be applied in a manner that is effective, proportionate and dissuasive, especially in relation to larger financial institutions. Immediate action should be taken by the tax agency to establish a methodology for applying sanctions other than at the minimum level provided under the law.

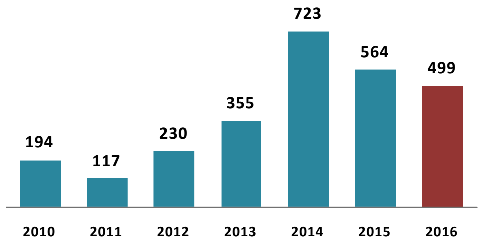
• Ensure that professionals are subject to substantive CFT compliance inspections by either the tax agency or another competent authority

• Finally, the report recommends that the government adopt the necessary legislative measures to allow Mexico to provide the widest possible international cooperation, and to establish a case management system to facilitate the follow-up of both passive and active requests for assistance and adopt proper guidelines describing how requests should be prioritized. And, in addition, it urges the PGR to take "a more proactive approach" to ML investigations that have a transnational dimension.

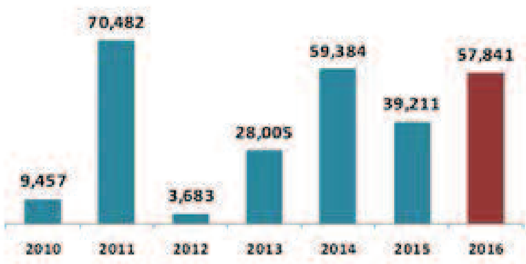
Number of Requests for ML Prosecution Presented by the FIU



Subjects involved in requests for ML prosecution



Amount associated with requests for ML prosecution (Millions of MXN)



Source: *FATF and GAFILAT (2018), Anti-money laundering and counter-terrorist financing measures - Mexico, Fourth Round Mutual Evaluation Report, FATF, Paris*

Figures on ML Prosecutions and Convictions							
	2010	2011	2012	2013	2014	2015	2016
Number of prosecutions	115	108	145	111	109	76	43
Number of convictions				40	23	34	6
Number of convicted persons	12	19	19	17	11	15	10
One comment must be made on these figures: it is not clear why the number of convictions is higher than the number of persons convicted between 2013 and 2016.							
Source: *IMF*							

REGIONAL BUSINESS REVIEW

ARGENTINA

Low cost air travel revolution on the way?

A wave of new low-budget airlines (also known as low cost carriers or LCCs) is arriving in Argentina with plans to shake up the local air travel market. The government hopes they will succeed, thereby strengthening its wider plans to introduce a more deregulated and competitive type of capitalism in the country. But the revolution may take a while.

Since 2016 the government has begun offering new concessions to operate LCC services on many domestic and international routes. Its aim is to shake up the current conventional carrier oligopoly, dominated by state-owned Aerolíneas Argentinas and Chilean airline LAN (part of regional group LATAM Airlines). At present air travel is very expensive in Argentina and as a result comparatively few people fly. "We are almost 100% more expensive than our regional peers due to a total absence of supply," says Hugo Diaz, commercial director of one of the new arriving budget carriers, Avianca Argentina. According to his calculations Argentine travellers pay an average of US$120 for each hour they spend in the air, compared with an average of US$60-65 elsewhere in Latin America.

Transport minister Guillermo Dietrich says per capita air travel in Argentina is well below levels in Europe, the US, Brazil, or Chile. He adds that air travel in Brazil multiplied by a factor of five, from 20m annual passengers in 2001 to 100m now. In the same period Argentine passenger numbers edged upwards by a measly 1.5% a year. Dietrich says one of the government's aims in the shake-up is to cut its subsidies to loss-making Aerolíneas Argentinas. In 2011 the central government spent US$130 in subsidies for each ticket the state airline sold. That has now come down to US$14. Dietrich says he wants to reduce it further to US$7 in 2019 and to eliminate all subsidies by 2020. The message is that Aerolíneas will have to adapt to function profitably in a much more competitive market.

According to Dietrich the low-cost revolution will attract investment totalling US$6.885bn over the next four years. New routes have been awarded to the LCCs usually on 15-year concessions. Avianca Argentina (a subsidiary of Colombia-based Avianca Holdings) began to operate flights from Buenos Aires to Mar del Plata and Rosario last November, and will launch 14 to 18 new routes this year, including to international destinations such as Lima, Santiago and Sao Paulo. The company says it is investing over

US$300m in its Argentine operation. Locally owned Flybondi invested over US$75m and intends to launch services to Santiago, Asunción and Montevideo. On domestic routes Flybondi says its aim is to offer airfares that are cheaper than existing long-distance bus services.

But perhaps the biggest new arrival is Norwegian Air, Europe's third-largest budget airline by passenger numbers. In December it announced it will invest a total of US$4.3bn over several years to base 60 aircraft in the country operating 72 local and 80 international routes, creating 3,200 new jobs. It plans to establish four central operating hubs, based in Buenos Aires, Córdoba, Mendoza, and Salta. It will also offer international services to Los Angeles, New York, and Istanbul, among other cities.

Despite the excitement, local analysts point out that it is going to take some time for the budget revolution to take hold. Avianca is the most advanced as it is already operating in the country. The companies that have won new routes have a year to launch their business plans, and must await the delivery of new aircraft. There will be almost no change in the current summer holiday season. Norwegian will not begin domestic operations until June. Its first aircraft, a Boeing 737-800, was due for delivery in January. Flybondi is also in the process of firming up its plans – it intends to start operations from Córdoba in the centre of the country.

Although it may take a couple of years, the low-cost revolution promises to bring significant benefits to the travelling public and to related businesses (including airport operations, currently dominated Aeropuertos Argentina 2000, a company owned by Argentine billionaire Eduardo Eurnekian). As in other areas there will be resistance. Plans to convert the former air force base at El Palomar into a new commercial airport serving Buenos Aires are being resisted in the courts by local residents concerned over noise pollution. It is not yet clear whether the highly unionised Aerolíneas Argentinas will be able to operate profitably alongside the LCCs.

BRAZIL

Boeing bids for Embraer

US-based Boeing, the world's largest aerospace company, and Brazil-based Embraer, the world's third-largest aircraft manufacturer, acknowledged in December that they were talking about doing something together. Defining that "something" may be critical to whether any deal gets done at all. Boeing would like to buy Embraer outright, but the Brazilian government, which has the right of veto, prefers that "something" should mean a joint venture, a partnership, or a licensing agreement.

News of the talks emerged in late December. Boeing has much to gain from a takeover of Embraer. The US manufacturer has something of a gap in its current commercial aircraft range for shorter-haul regional jets. Airbus, its main competitor, facing a similar gap, already announced a deal last October to work with Bombardier of Canada on that company's CSeries. Boeing angrily denounced that tie-up as unfair competition. But applying the same logic would make it attractive for the US company to work with Embraer on the Brazilian company's smaller E-Jet series (sales of Embraer's E190-E2 have yet to take off). There would be other benefits for both parties. An analyst close to the deal cited by *Reuters* news agency said, "It gives Embraer access to Boeing's balance sheet, greater access to US defence and international markets and alignment of a global supply chain and services." Trade publication *Flight International* has pointed out that there could also be synergies in the manufacture of military aircraft and small executive jets. Another attraction for Boeing: Embraer has up to 4,000 young and well-qualified engineers on its payroll. Both companies have been separately seeking to develop new aircraft projects with Saab of Sweden, which could now be consolidated. The publication described a Boeing-Embraer deal as a potentially formidable alliance of top engineering talent and low-cost manufacturing.

But there is a catch. Embraer is one of Brazil's most successful companies, and although the government of President Michel Temer is enthusiastic about privatisation in general, it has concerns over the national security and strategic implications of an outright sale of Embraer to Boeing. It might also be a political hot potato in an election year. Embraer was initially set up as a state-owned company by the Brazilian Air Force in 1969, but was privatised in 1994. The biggest single shareholder now is Brandes Investment Partners of the US; some 64% of shares are diluted among many small investors. The government holds a minority 5% shareholding, but this includes a 'golden share' giving it the right of veto over key decisions. The Brazilian Air Force describes Embraer as "a strategic and pivotal company for Brazil's national sovereignty".

Defence minister Raul Jungmann told the *Financial Times* that the Brazilian government welcomed a tie-up but that "The only limitation we see is the transfer of shareholding control. Other than that, partnership, joint venture, whatever it is, is very welcome." According to the same newspaper, although Boeing was open to offering safeguards over Brazilian jobs and sovereign defence capability, including maintaining a 'golden share' arrangement for some aspects of the business, ultimately it would "categorically not accept a joint venture".

Talks are ongoing, but there is no confirmation yet that a deal can be hammered out to satisfy both Boeing and Brasília. According to media reports Boeing and Embraer have agreed to a provisional price for the deal of US$28 a share, about 40% above the level before news of the talks broke.

BRAZIL

Good news for the auto industry

Brazilian automobile production rose 25.2% in 2017 to reach 2.699m units, according to industry body Associação Nacional dos Fabricantes de Veículos Automotores (Anfavea). This has been taken as another emerging sign of economic recovery, although production is still below the pre-recession record set in 2013.

Domestic automobile sales rose 9.2% to 2.24m last year, Anfavea said. Export markets also did well with a total of 724,600 vehicles shipped abroad, valued at US$12.8bn. Employment in the industry rose 3.8% to 108,300. As a result only around 3,500 workers will be laid off this (southern hemisphere) summer, down from ten times that amount in the 2016/2017 summer season. Anfavea says capacity utilisation in the industry is still only 55%, but it is confident enough to predict that the enforced summer layoffs will dwindle to zero by 2019.

Looking forward, industry analysts say three or four factors will be critical to determine the strength and sustainability of the recovery. One is the general pace of Brazilian GDP growth and the fall in interest rates (which is encouraging those who delayed buying a new car in the recession of 2015-2016 to consider buying one now). A second is the future of the government's fiscal incentive programme. The old programme, known as Inovar Auto, was highly protectionist and was criticised by the WTO. Full details of its replacement, Rota 2030, are still being finalised. The new scheme is designed to promote innovation and help the industry adapt to new emission and safety standards. Another important and longer-term factor is how the industry in Brazil, currently the world's eighth-largest car producer, begins to adapt to the global move to electric, hybrid, and autonomous vehicles.

REGION

US oil output to hit a record high in 2018 on shale boom

As we went to press on 9 January, the US Energy Information Administration (EIA) issued its latest short-term energy outlook, in which it projected that US crude oil production would average 10.3m b/d in 2018, the highest annual average production in US history, surpassing the previous record of 9.6m b/d set in 1970. It also forecast US production to increase to an average of 10.8m b/d in 2019 and to surpass 11m b/d by end 2019. This will be to the chagrin of OPEC and Russia, who are looking to curb production and reduce competition from US oil and gas.

Global oil demand is also recovering strongly, which should be good news for Latin American producers like Mexico, Brazil, and Ecuador, as well as Venezuela. The EIA lifted its projection for world oil demand in 2018 to roughly 100m b/d, while it increased its 2019 forecast to 101.76m b/d.

The price of US oil, in the form of the West Texas Intermediate (WTI) barrel, was trading at US$62.96/b, the highest since December 2014, while Brent crude was fetching close to US$69/b.

Prices remained steady as markets calculated that output gains from US shale would not surpass the 1.8m b/d in production cuts agreed to by OPEC (in support of a global price floor). However, should prices breach the threshold of US$70/b, there would be a strong risk that the OPEC agreement would not hold, as members big and small – from cartel giants Saudi Arabia and Iran to smaller African states – might look to take advantage of prices above the OPEC target of US$60-US$65/b. Neither does OPEC want to see any further incentive for US shale producers to continue ramping up their output.

REGION

Corporate Radar

Coca-Cola move in Chile

In partnership with local bottling companies Coca-Cola of Chile has announced a US$80m agreement to buy the fruit, ice cream, vegetable and foodstuff businesses owned by Inversiones Siemel and marketed under the Guallarauco brand. A consortium of four companies including Embotelladora Andina, Embonor, Coca-Cola del Valle New Ventures and Coca-Cola de Chile are leading the proposed takeover. Andina, one of the largest bottling plants in South America, will end up with a 35% stake in the new businesses.

Chinese challenge Uber

Chinese ride sharing company Didi Chuxing was reported in January to have completed a takeover of app 99, Brazil's main rival to Uber, for US$600m. The takeover came just a year after Didi had first bought a minority stake of around 30% in app 99 for a reported US$100m. Analysts said the move suggests that Latin America may become the next big battlefield between US-based Uber and China-based Didi, currently the world's two largest ride-sharing companies. The US company has a dominant market position in Mexico, suggesting that Didi may have deliberately chosen the bigger but more fluid market of Brazil as its best entry-point into the region. Originally called 99Taxis, app 99 was launched in 2012 and initially positioned itself to work with existing taxi drivers and unions. In 2016 App 99 was the market leader, followed by EasyTaxi, with Uber in third place. In August 2016 the company launched 99Pop, a service operated by private drivers (similar to the Uber model). Uber, meanwhile, has been suffering some difficulties in Brazil, with a slightly lop-sided performance: it has been more successful recruiting drivers than recruiting passengers. Uber has also suffered allegations of sexual misconduct by some drivers, leading to adverse press coverage.

Alcatel sees Colombian opportunity

France-based Alcatel has announced its intention to become market leader in the supply of mobile handsets in Colombia in 2018, an ambition that will require it to challenge the likes of Apple, Samsung, and Huawei. Recent research shows that 49% of the Colombian population has 2G handsets, with 39% on 3G and 15% on 4G. Alcatel will target the 49% 2G segment to 'modernise' its handsets, selling devices priced at below 700,000 pesos (US$230). The price threshold is significant because any device sold below that point is exempt from VAT at 19%. The company will aim to optimise the capabilities of these cheaper handsets, including a powerful camera and a two-day battery life. However, the battle at this end of the market also promises to be intense, with home-grown manufacturer Kalley announcing it is launching a new phone priced at 300,000 pesos (US$99).

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