CANNING HOUSE EDITION

latin american economy & business

July 2016 - EB-16-07

ISSN 0960-8702

CONTENTS

LEADER 1
Looking at post-Brexit scenarios
REGIONAL ECONOMY REVIEW
Argentina 3
The IMF decides that new inflation data is believable
Colombia 4
The economics of peace
Ecuador 5
Building bridges with the IMF?
Nicaragua 8
Economic tailwinds for Ortega
Peru 9
Stable growth with low inflation to continue
SPECIAL FOCUS
Venezuela 11
The government protects Pdvsa at all costs
REGIONAL BUSINESS REVIEW
Brazil 16
More airports could be sold off
Chile 17
The difficult road to free education
CITIES SPECIAL
Region 18
Urbanisation increases the need for 'Smart Cities'
Region 20
Urban crime: one problem, varying solutions
POSTSCRIPT 23
Corporate Radar

This edition of *Latin American Economy & Business* has been produced for Canning House Corporate Members by LatinNews (www.latinnews.com).

Latin American Newsletters since 1967

Looking at post-Brexit scenarios

In surprise result, on 23 June the British electorate voted to leave the European Union (EU). This decision, dubbed 'Brexit', triggered a political crisis in the UK (the prime minister, David Cameron, resigned and was replaced by Theresa May) and significant turbulence on global financial markets (in the immediate aftermath the British pound dropped 10% and global stock markets dipped, albeit later recovering). Initial assessments are that Brexit will have a relatively limited impact on Latin America. In this edition we look at two alternative 'post-Brexit' scenarios. In one of these, there could yet be a significant downside for the region.

In principle, there are two main transmission mechanisms through which Brexit will have an impact on Latin American and Caribbean economies. The first is the direct effect. Slower economic growth in the UK, a widely expected consequence of the Brexit decision, could reduce UK-Latin America trade, as well as cutting UK investment in Latin America. This effect will be limited, because the UK is not a major regional trading partner. By way of example, last year UK-Brazil trade was worth US$6.8bn. That represented 10.4% of total EU-Brazil trade and only 1.9% of Brazil's total trade with the world. Similarly, UK-Mexico trade was valued at US$5.6bn, or 10.5% of EU-Mexico trade and only 0.7% of Mexico's total trade. UK investment is quite significant in some countries, such as Colombia (where the UK is the second largest source of investment after the US) and Peru (where in 2014 it was the largest foreign investor, accounting for 18% of the total). But even in those cases the impact will be relatively limited. After all, the UK will not stop trading or investing.

The second and potentially more significant transmission mechanism is indirect. There is concern that the Brexit decision could trigger an extended period of global uncertainty, causing lower growth and investor nervousness. Financial turbulence could ripple out from the UK to the EU and other developed economies. This could impact emerging markets and hit global demand for commodities, just as the first signs of a price recovery for Latin America's raw material exports have been emerging. However, it will take time to assess the strength of these indirect effects, and much will depend on the policy responses by governments to contain them. The global economy retains a degree of resilience. One factor offsetting the Brexit impact may be an inclination by the US Federal Reserve to tighten monetary policy at a slower rate than had previously been expected – which would be beneficial for Latin America.

The initial assessment by the International Monetary Fund (IMF) was reassuring for Latin America, despite the stronger global headwinds. In a late July update of its World Economic Outlook, the Fund noted that, "the Brexit vote implies a substantial increase in economic, political, and institutional uncertainty, which is projected to have negative macroeconomic consequences, especially in advanced European countries." The IMF's chief economist, Maurice Obstfeld, put it bluntly: "Brexit has thrown a spanner in the works". As such, the Fund cut its UK GDP growth forecast for 2017 to

1.3%, down from 2.2% previously. It also said that as a result of Brexit it was trimming back its global growth forecast to 3.1% this year and to 3.4% in 2017 – both down by 0.1 percentage points on the previous forecast.

By contrast, the Fund actually improved its forecasts for Latin America and the Caribbean. It now expects regional GDP to fall by 0.4% in annual terms this year (better than the 0.5% contraction expected previously), with a "modest rebound" of +1.6% expected in 2017, up from +1.5% previously. According to Alejandro Werner, the IMF's Western Hemisphere director, the negative effect of the global Brexit-related uncertainty has been offset by various factors in Latin America, including the relative recovery in commodity prices and a more gradual pace of monetary tightening in the US.

Local factors also play a role, with the long recession in Brazil, the region's largest economy, expected to bottom out this year, setting the scene for positive growth in 2017. Mexico is expected to continue expanding at a moderate rate. Despite this relatively benign outlook, Werner warned that Latin America needed to stay alert to further signs of global turbulence, using flexible exchange rates as a first "buffer" against external shocks and creating greater fiscal space for manoeuvre (in other words, reducing existing fiscal deficits, particularly in countries with large debt-to-GDP ratios (Brazil's is now almost 70%, for example)).

With a high level of uncertainty expected to continue for some time, one way of assessing risks to Latin America is to consider two possible post-Brexit scenarios. Two potential scenarios can be posited. One could be described as 'Latin America friendly' and the other as 'Latin America hostile'.

In the 'Latin America-friendly' scenario, Brexit turns out to be no more than a glitch. Over the next two years, the UK negotiates a broadly amicable divorce from the EU. It experiences lower growth; some UK-based financial activities move to Frankfurt or Paris, but the wider European economy is not significantly weakened. Importantly, other EU member countries do not seek to follow the UK example and leave the union. Integration between the remaining 27 EU members might actually accelerate, helping correct weaknesses in the European banking system and thereby improving overall resilience. In this scenario, despite delays, the EU (minus the UK) eventually reaches a free trade agreement with the founding members of the Southern Common Market (Mercosur), Argentina, Brazil, Paraguay and Uruguay (with new member Venezuela acceding later).

While global public and political opinion cools slightly towards globalisation and relatively free migration, the now-enlarged group of market-friendly Latin American governments end up with enough political space in which to pursue greater integration between them, and greater trade with the rest of the world. The Pacific Alliance (comprising the free trade pioneers Mexico, Colombia, Peru and Chile) and Mercosur draw closer together. Through the North American Free Trade Agreement (Nafta), Mexico continues to benefit from a strong US economy. Also important to this scenario is a victory by the moderate Democrat Party candidate Hilary Clinton in the US presidential elections in November 2016.

The Latin America-hostile post-Brexit scenario is more dramatic. Brexit turns out to be a distant but significant early warning sign of a big political backlash against globalisation and immigration that sweeps right across the developed economies. A revolt by right-wing populist parties leads one or two other countries to follow the UK's example and leave the EU, which is therefore seriously weakened and experiences a recession. The process is disorderly and leads to further uncertainty. The EU-Mercosur FTA is abandoned. The real sting in the tail for Latin America and the Caribbean is the victory of Donald Trump in the US election, setting off further uncertainty, particularly over his economic policies, the future of Nafta, and trade and political relations with Mexico. The net result is a period of slower growth in world trade,

hampered by the onset of a new wave of protectionism. In some versions of this scenario, the triumph of Trump's right-win populism in the US could also help trigger a Mexican backlash, bringing victory in the 2018 elections to a left-wing populist such as Andrés Manuel López Obrador (AMLO).

Both these scenarios are grossly simplified and speculative, but they do illustrate that these are uncertain times and that over the next 2-3 years economic policy risks for Latin America could be substantial. Governments will need to work on contingency plans. Some of that is beginning to happen, with, for example, a number of Mexican officials and analysts trying to assess what a Trump presidency in the US could mean for trade. Just as the UK is expected to invoke Article 50 of the Treaty of Rome to formalise its departure from the EU, in the worst-case scenario a Trump White House might seek to invoke Article 2205 of Nafta, which would give the US six months to pull out. Even without that happening, Luis de la Calle, a former Mexican deputy trade minister, has noted Trump's pledge to slap tariffs of 35% on imports of cars and trucks produced in Mexico (most cross-border trade is currently virtually tariff free under Nafta rules). De la Calle also points out that President Obama had made campaign promises to renegotiate Nafta provisions, but didn't do so once in office. Even so, "We should suspect that Trump means what he says", De la Calle warns. He also points out, however, that US agricultural exporters from the Midwest might try to discourage Trump from starting a trade war with a country that in fact is a very important export market for US farmers.

At the core of the debate is how to adapt to globalisation. At a time when more Latin American governments appear to be accepting the need to compete globally, so political opinion in the US and parts of the EU appears to be going in the opposite direction, rejecting that need, and shifting towards protectionism. De la Calle says that Trump's anger over the decision by Carrier, the US air conditioning manufacturer, to move its assembly plant to Mexico neatly sums up the change. "They compete with Samsung and LG, and those firms all have plants in China and Thailand. The only way Carrier can compete is to dedicate itself to research and development, building its brand in Indiana and doing its assembly in Mexico, which is what they are doing," he said. "Carrier cannot succeed globally if it doesn't have core production in Mexico. How are they going to compete with Samsung and LG in Asian markets?"

REGIONAL ECONOMY REVIEW

ARGENTINA

The IMF decides that new inflation data is believable

New data compiled by Indec, Argentina's national statistics institute, will show high and possibly rising inflation through the remainder of 2016. However, the general price trend likely will head downwards from early next year.

In early July, the International Monetary Fund (IMF) noted that a staff mission to Buenos Aires in late June had been favourably impressed by the commitment of the Indec and the economy ministry to boosting the quality and transparency of Argentina's official inflation data. The mission will report formally to the IMF's Executive Board on in late August.

This was another step in the rapidly improving relations between the IMF and Argentina under the centrist new government led by President Mauricio Macri. In 2013, the IMF had taken the unusual step of censuring the previous radical left-wing administration led by Cristina Fernández (2007-2015) for Indec manipulation of data, which had resulted in artificially low and scarcely-credible inflation statistics. Upon taking office in December 2015, President Macri immediately moved to revamp the Indec, with publication of official inflation data temporarily suspended.

On 15 June, the Indec released its first official inflation figures since its revamp in late 2015. According to these new figures, the consumer price index (IPC) rose by 4.2% in May compared to the previous month. (The last [statistically dubious] figures from the old Indec, had been released in October 2015, and put the monthly inflation rate at closer to 1%.)

In May, the Indec reported, the costs of food & beverages, transport & communications and housing, respectively, were 3.7%, 5.6% and 5.2% higher than they had been in April. The price of other goods and services soared by 16.1%, thanks in part to higher utility tariffs. The new figure could have been even worse. Just days before the Indec's new release, the City of Buenos Aires' government statistics agency, a proxy for Indec while it attempted to sort out its methodology, claimed that monthly inflation in May was 6.5%. The Argentine federal congress, which also produces its own inflation data, had suggested it was 3.5%. On that basis, Elypsis, a local economic research firm, estimated that year-on-year inflation was running at over 40% in May.

Nonetheless, most commentators considered the new Indec data for May a much more accurate portrayal of inflation in Argentina. In its April 2016 *World Economic Outlook*, the IMF had suggested that consumer price inflation could reach 24.95% this year.

The production of more credible inflation figures should have favourable effects. For a start, it will be easier for investors to make an informed decision about the attractiveness of index-linked (inflation-protected) bonds issued by Argentina's government. Consumers and businesses also will have a clearer idea of the true level of inflation in the country, and from there will have a much better base from which to develop expectations about trends.

And those expectations will look for declining inflation. Inflation in 2016 will remain high, boosted by one-off factors such as the Macri government's adjustments to utility tariffs (previously fixed at artificially low levels) and recent wage increases agreed with country's powerful unions. But the IMF, tentatively, is now looking for inflation to gradually fall to 20% in 2017, 15% in 2018 and 10% in 2019; before reaching 5% in 2020-2021.

As such, by end-decade Argentina should cease to be among the world's high-inflation countries. In this context, local savers should shift their focus away from real assets (such as real estate or gold) back towards financial assets (such as bank deposits and bonds). This, in turn, would be supportive of the country's banks and other financial institutions – which currently remain underdeveloped by many metrics.

COLOMBIA

The economics of peace

On 23 June the government led by President Manuel Santos signed an indefinite cease-fire agreement with the country's main left-wing guerrilla group, Fuerzas Armadas Revolucionarias de Colombia (Farc). A definitive peace settlement may be signed in August, which could be subject to ratification by referendum as early as September. Is the Colombian economy ready for peace?

In broad terms, there is agreement that peace is a good thing for the Colombian economy. There are many qualifications of course, one of them being that Colombia's second left-wing guerrilla force, Ejército de Liberación Nacional (ELN), has not yet sat down for separate peace negotiations with the government, and there are still a multitude of other security threats, such as the remnants of right-wing paramilitary groups, some converted into powerful criminal gangs. But is seems reasonable to assume that the downward trend in indicators of violence seen over the last few years (such as fall in the number of armed clashes and bomb attacks, and the reduction in the homicide rate) will continue or accelerate.

One of the difficulties in assessing the impact of peace on the Colombian economy is that it brings a mixture of costs and benefits. While the benefits are seen as exceeding the costs, the timing of both is hard to predict. Many of the costs – for example extra fiscal spending to re-absorb former guerillas into civilian life, or to meet commitments on reparations and social reforms made by the government as part of the peace settlement – will be front-loaded, while some of the benefits will only emerge over the medium to longer term. According to the government's Departamento Nacional de Planeación (DNP), peace could raise long term economic growth by between 1.1 and 1.9 percentage points every year (implying Colombia's GDP could accelerate from a trend rate of around 4.0% to as much as 5.9%. The DNP also lists other benefits, such as a tripling of foreign investment inflows (to US$36bn per annum) or a doubling of GDP per capita, along with significant boosts to construction, agriculture and tourism. The DNP study is one of various and generally optimistic reports published locally in recent months.

However, a London-based consultancy, Capital Economics, takes a more cautious view. In a recent report it suggested that the boost to GDP growth probably would be less than one percentage point per annum "at least in the next few years". This, it argued, is because much of the 'peace dividend' has already been priced in, given that violence began to fall after 2002 – more than ten years ago. Secondly, Capital Economics argues that the peace agreement will not immediately offset slower growth triggered by the fall in commodity prices. It expects real annual GDP growth this year to decelerate to 2.0%, down from 3.1% in 2015. The cost of the government's peace commitments – everything from reparations to major investments in infrastructure, health and education – are hard to pin down. Suggestions range from US$15bn to US$45bn, or 5%-15% of GDP, spread over a number of years. While some will come from international aid (the US has already pledged US$450m in 'Peace Colombia' funding), and some will be offset by savings elsewhere (security spending is eventually expected to decrease), it is clear that the government budget will come under added pressure, at a time when the fiscal deficit for this year has already grown to an estimated 3.9% of GDP.

What this points to is the need for fiscal reform, already on the Santos government's agenda for the second half of this year. Colombia's overall tax take is significantly lower than the OECD average, and the tax system places an excessive burden on companies, while (arguably) under-taxing individuals. Fiscal concerns were cited by Fitch Ratings as a factor behind its July decision to downgrade Colombia's long-term foreign currency debt to 'BBB' (from 'BBB+') and to change its outlook to 'negative' (from 'stable'). Fitch also expressed concern about the current account deficit (6.4% of GDP in 2015, but expected to narrow to 5.8% in 2016). However, the agency did note Colombia's solid record of macroeconomic management and its solid external buffers (with accumulated international reserves of US$47bn). Subject to successful fiscal reform, the agency said, "the implementation of a peace agreement could provide a confidence boost in the short term and medium- to long-term benefits (i.e. with investment in energy and agriculture) that could increase growth prospects."

ECUADOR

Building bridges with the IMF?

With oil prices set to remain subdued, and dollar liquidity levels growing ever scarcer, there is a growing consensus that Ecuador's next government, to be elected in February 2017, may have no choice but to seek a formal new lending agreement with the International Monetary Fund (IMF).

On 8 July the IMF announced financial support of US$364m for Ecuador to help the country in the wake of the 16 April earthquake. The loan was provided by way of a Rapid Financing Instrument (RFI), which provides quick and low-access financial assistance to member countries facing an urgent balance-of-payments need, without the need for a full-fledged economic program or reviews. The loan was disbursed immediately, at an annual interest rate of 1.1%, with a three year grace period and repayment in five years.

The left-wing government led by President Rafael Correa has costed the April disaster, the worst in 40-years to hit the country, at US$3.3bn. Of this, the private sector will provide US$1bn overall, with the State and multilaterals providing the rest. This new IMF credit adds to the US$640m in earthquake relief support already pledged by the CAF-Development Bank of Latin America, the Inter-American Development Bank and the World Bank.

De-dollarisation not an option

Despite occasionally railing against the lack of monetary independence in Ecuador, which makes life difficult for the export sector in particular when the US dollar is strong, President Correa has admitted on more than one occasion that de-dollarisation would be a lot more painful for the economy than any IMF fiscal prescription; and as such is not a policy option for his government.

While RFIs come without conditions, and Correa has long been clear that his left-wing government would never accept IMF prescriptions, relations between the two have improved of late. In May 2014, for instance, Ecuador agreed to the resumption of IMF Article IV consultations (which require the government to provide detailed macroeconomic statistics to the Fund for joint review). This was among the conditions requested by international financial markets for Ecuador to issue sovereign bonds in 2014 for the first time since Correa had declared a default on US$3.2bn of 'illegitimate" debt in December 2008. This year, with the dollarised country getting deeper into liquidity difficulties, there has been mounting speculation that the leftist government might have no option but to return to the Fund in search of a formal bailout.

This latest emergency loan is in fact the second from the IMF to the Correa government – it previously gave US$405m in (also unconditional) support during the 2008-2009 financial crisis. Indicative of the 'warming' relations, the Fund in its statement praised the Quito government's prompt response to the earthquake disaster, by way of an emergency fiscal package that included a temporary increase in VAT and a one-off solidarity surcharge tax on wages, corporate profits, and personal assets. Min Zhu, the Fund's Deputy Managing Director and Acting Chair, also observed that the finance ministry was committed to re-prioritising capital spending and calling a halt to low-priority projects not related to earthquake reconstruction, in case of financing shortfalls.

"They have also expressed willingness to implement additional income and expenditure measures if needed to bring the fiscal position in line with available financing and avoid increasing the stock of arrears", he noted. This suggests that the finance ministry, led by Fausto Herrero, does not discount further tax measures and/or spending cuts. And as the scale of the earthquake disaster became apparent, President Correa himself also said that government was considering looking for private investment in state companies like the Corporación Nacional de Telecomunicaciones, while he also mooted the sale of the Sopladora hydroelectric project so as to raise funding for the reconstruction effort.

Payment problems

With reserves dipping to just US$2.1bn in May (before recovering to over US$3bn following the inflow of the new multilateral funds and also further Chinese loans), the Correa government has admitted to payment difficulties, with around US$1bn owing to domestic suppliers for the period 1 January-mid July, according to the finance ministry.

According to the Observatorio de la Política Fiscal (OPF, the fiscal policy observatory), an independent watchdog, the government ran up bills worth US$4.85bn for goods, services and investment, along with other items, in the first seven months, but to date has paid only US$3.9bn of that, leaving a

deficit of US$937m. Delayed transfers estimated at up to US$330m are also pending from the treasury to local authorities (Gobiernos Autónomos Descentralizados, GAD), as well as from the education and health ministries to universities and hospitals; while the construction sector chamber, Cámara de la Industria de la Construcción (Camicon), has also complained of delayed payments. The situation latterly has sparked protests outside the finance ministry and the presidential palace.

The government had aimed to issue US$1bn in fresh global bonds to cover some of these pending internal payments, however the Brexit crisis forced a delay, according to complaints by President Correa. On top of that, after losing a recent international court appeal, Ecuador was also due to make an arbitration payment of US$112m (US$96.3m plus interest) to the US oil firm Chevron by 20 July (which it paid on time).

With the government already running a sizeable fiscal deficit since 2013 (when it was 4.6% of GDP, peaking at 5.3% in 2014 before falling back to 5% in 2015), public debt has risen rapidly in recent years to cover the gap. In fact, total public debt (i.e. external plus internal) has more than doubled from about 15% of GDP in 2009 to 34.6% of GDP (or US$35.3bn) as of June 2016, according to the finance ministry.

Oil

In 2015, Ecuador exported an average of 416,000 barrels of oil per day (bpd), valued at US$6.35bn (at an average oil price of US$41.88 per barrel). From January to May 2016, exports averaged 382,000bpd, valued at US$1.67bn (at an average price of US$28.73 per barrel).

Correa has dismissed concern about this rising public sector debt, which is constitutionally capped at 40% of GDP, making the point that European countries including Germany and Italy have debt ceilings of 80%-90% of GDP. Closer to home, Brazil's debt is nearing 70% of GDP. However, private economists make the point that while the headline debt level might not be particularly high, relatively speaking, Ecuador's debt is both expensive and short term (due to its long history of defaults). One option for the government would be to restructure the debt to lengthen maturities and secure better payment terms. For that to happen, creditors might first expect a formal renewal of relations with the IMF, by way of a guarantee of future policy accountability and transparency.

Considerable opacity over Chinese lending

Ecuador's bilateral debt with China, its 'strategic partner' since 2009, is neither cheap nor long term. It is also tied, committing Ecuador to lengthy infrastructure contracts with Chinese firms and years of guaranteed oil shipments (possibly at preferential rather than market prices, although there is very little clarity around this). There is also very little transparency over the detail of the multiple loans agreed (with increasing frequency) over the past seven years.

For instance, in January the finance ministry signed a US$920m deal with the Industrial and Commercial Bank of China (ICBC), over five years. In April, it signed another US$2bn deal with the Development Bank of China over eight years, with a two-year grace period. This deal was split into two tranches. A first tranche, for US$1.5bn, was (apparently) unconditional and had an interest rate of 7.25%. The second, for US$500m, had a slightly lower interest rate of 6.87%, but was tied to specific projects in Ecuador for Chinese companies.

At around the same time, PetroEcuador and PetroChina signed new financing deals for very similar amounts. In January, the two signed a US$1bn oil-backed loan, in exchange for 76.m barrels, to be shipped over five years to 2021. And in April, there was another US$1bn deal, backed by 181m barrels of oil, to be shipped over eight years with a two-year grace period (meaning that shipments would physically start in 2018). In total, these two deals commit PetroEcuador to shipments of 257.3m barrels. That is no small amount of crude – in fact, it is over 18 months worth of production (based on 2015 output).

The Correa government calls these latter arrangements 'oil pre-sales' ('preventas de crudo') rather than loans; albeit it is worth noting that they carry interest rates of up

In a Cedatos-Gallup poll released on 21 July, two thirds (66%) of Ecuadoreans said the country was on the wrong path, while three quarters (75%) wanted economic policy changes. Amid recession and rising unemployment, voters are increasingly frustrated with the radical left-wing government led by President Correa.

to 7%. This categorisation allows the finance ministry to exclude them from its official calculations of public debt, thereby reducing the reported debt-to-GDP ratio. Private economists have been very critical of what they say is merely 'creative accounting', but the government is vehement that it is not accumulating onerous debt for future governments.

Moreover, it is rather difficult to discern what actually took place with these latest Chinese financing deals, which looked so similar. In response to queries in June by the daily *El Comercio*, the finance ministry insisted that it was mere coincidence that the loans in January and April were signed at around the same time and for about the same amounts/periods, insisting that there were four distinct transactions that were processed all at once, for the sake of convenience.

NICARAGUA

Economic tailwinds for Ortega

On 6 November Nicaragua's President Daniel Ortega is expected to be re-elected for a third consecutive term in office. Critics say the elections will not be free and fair; they describe Ortega as an authoritarian leftist who persecutes a weak and divided opposition. Whatever the politics, however, it the economy has been performing comparatively well.

Although there may be some clouds on the horizon, the Nicaraguan economy has performed strongly in recent years. Subsequent to the global economic crash in 2009, real GDP has grown at an average annual rate of 4.8%, boosted by high commodity export prices, remittances sent home by expatriate Nicaraguan workers and preferential financing terms for oil imports from Venezuela (under the Petrocaribe programme). Some of these positives are now weaker (the commodity boom lost steam after 2012, and the future of Petrocaribe is in doubt due to Venezuela's economic crisis). But the economy is still holding its own.

According to the Banco Central de Nicaragua (BCN), first quarter growth was 4.9% year-on-year, down only marginally on the 5.1% result registered in the same year-earlier period. Fishing, hotels & restaurants, finance, and retail, in that order, led growth. Construction slowed after a high year-earlier baseline, which had been lifted by building work at the Ciudad Belén social housing project and the Ciudad Esmeralda airport. In GDP terms, exports rose by 2.4% year-on-year in the first quarter, lagging behind import growth of 7.4%. Key exports include coffee, beef, gold and sugar. The US is Nicaragua's main export market, followed by Central American neighbours such as El Salvador and Costa Rica. Real GDP growth was 4.9% in calendar 2015, with inflation well contained at 3.05%, according to the BCN. This year, the government is forecasting growth in a 4.5%-5.0% range, with inflation expected to rise moderately to between 5% and 6%.

Part of Ortega's success (in economic terms) is that despite his left-wing credentials as a leader of the Frente Sandinista de Liberación (FSLN), which led the 1979 revolution against the right-wing Somoza dynasty, he has remained pragmatic on economic policy, done deals with the private sector, and maintained low rates of corporate taxation. Indeed, some critics say he has not been above developing his own brand of crony capitalism. What matters, however, is that the macroeconomic numbers are broadly strong. Foreign direct investment (FDI) has grown steadily to US$1.5bn last year. Poverty rates remain significant (around one third of the 6.1m-strong population lives below the poverty line, down from 42.5% in 2009) but the unemployment rate is low, and the debt-to-GDP ratio is also low. According to Geoff Thale of the Washington Office on Latin America (WOLA), a think tank, "Ortega has pursued fairly centrist policies. If Washington is unhappy about violations of freedom of speech and anti-US rhetoric, they're happy with his openness to investment and trade."

In fact, the recently published US State department 'Investment Climate Statements for 2016' is almost enthusiastic, highlighting the relatively low-cost and young labour force and the low crime rate, relative to its Central American neighbours. "To attract investors," the report says, "Nicaragua offers significant tax incentives in many industries, including mining and tourism. These include exemptions from import duties, property tax incentives, and income tax relief. The country has a well-established free trade zone regime with major foreign investments in textiles, auto harnessing, medical equipment, call centres, and back office services. The construction sector has also attracted significant investment, buoyed by major infrastructure and housing projects. The country's investment promotion agency, ProNicaragua, is a well-regarded and effective facilitator for foreign investors."

Nicaragua: selected economic indicators 2012-2016

	2012	2013	2014	2015e	2016f
GDP growth (%)	5.1	4.5	4.7	4	4.2
GDP Nominal US$mn	10,460	10,851	11,806	12,102	12,754
Consumer prices (%) eop	6.6	5.7	6.5	3.5	6.1
Fiscal sector overall balance (% of GDP)	-0.8	-1.3	-2	-2.7	-2.5
Current account balance (% of GDP)	-10.6	-11.1	-7.1	-8	-8.2
Public sector debt (% of GDP)	41.9	43	40.8	42.6	41.9

Source: *IMF. e=estimate, f=forecast.*

However, the report does go on to highlight negatives including weak institutions, deficiencies in the rule of law, and discrimination in favour of those who can demonstrate "positive relations with the ruling party".

Could anything go wrong on the economic front? The answer (for almost any country) must be yes, but it is hard to see a sharp deterioration in the short term before the elections. The trade deficit has begun to widen, but the country's low debt gearing gives it considerable room for manoeuvre. Tourism could be hit after the government expelled a number of visiting US citizens and the State Department issued a travel advisory. Tourism revenues rose by 19% last year to US$528m; one in every four tourists comes from the US. Nicaragua's main private sector body, the Consejo Superior de la Empresa Privada (Cosep), has pointed out, rather nervously, that over 30% of Nicaraguan economic activity depends one way or another on the bilateral relationship with the US.

A potentially more serious longer-term risk is the government's commitment to building a new inter-oceanic canal, formalised in 2013 when it signed a 100-year concession with the China-based Hong Kong Nicaragua Development Group (HKND). With a cost of over US$50bn (about four times Nicaragua's annual GDP) the project would potentially deliver a massive macroeconomic boost to the country. On the other hand it was awarded without competition, the financial terms are less than transparent, and there are a host of associated political financial, technical, and environmental risks.

PERU

Stable growth with low inflation to continue

Peru's economy has managed a relatively successful adjustment to the fall in commodity prices and the general deterioration in its terms of trade. Growth in mining production, led by copper, and progress with large infrastructure projects should underpin growth in the near term.

On 15 July 2016, the International Monetary Fund (IMF) concluded its annual Article IV consultation with Peru's government. The IMF's assessment was favourable.

Peru has had to contend with a fall in exports of around one fifth through the two years to the end of 2015. **[1]** The country's terms of trade dropped by around one eighth over the same period. In spite of this, the current account deficit has remained broadly unchanged at about 4% of GDP. Both real GDP and real domestic demand have also held up – thanks to higher production volumes in the mining and fisheries sectors, as well as a recovery in Peru's services sector.

There was also a pick up in inflation, by around 1 percentage point, to 4.4% in calendar 2015. This was due partly to higher food prices, as well as policy-driven increases in energy tariffs and the effect on import prices of the depreciation of the sol, which slipped from PEN2.80/US$ in early 2014 to around PEN3.5/US$ at the end of 2015. The response of the central bank (BCRP) has been to increase its key policy rate by 100 basis points since September 2015, to 4.25% currently.

Most other metrics are favourable. Foreign reserves of about US$62bn are more than twice the level of foreign currency deposits within the banking system and well over five times the level of short-term external debt. The primary (i.e. before interest payments) and overall budget balances of the non-financial public sector have been around 1% and 2% of GDP respectively. Total foreign debt is only a little over one third of GDP. Through 2013 and 2014, broad money has been rising by around 10%-11% annually. The banking system has been recycling deposits as loans to Peru's private sector, which have been expanding by about 13%-14% each year. In part because of the rise in interest rates, in part because of the relatively steady growth of the economy and in part because of stronger appetite for emerging markets risk on the part of investors, the Sol has appreciated since the beginning of 2015, moving from PEN3.50/US$ to a current level of about PEN3.35/US$.

The IMF takes a bullish view of Peru's economic prospects over the remainder of the year and through 2017. Real GDP growth is expected to accelerate to 4.1% next year, and inflation is projected to fall to 2.5%. The IMF notes that the main downside risk comes from a possible further deterioration in the global economy. Upside risks include higher-than-expected confidence and investment following the April general election. A new centrist and business-friendly administration, led by President-elect Pedro Pablo Kuczynski, who has appointed a cabinet of skilled technocrats, takes office on July 28. Kuczynski will oversee a minority government however, which looks set to complicate governance.

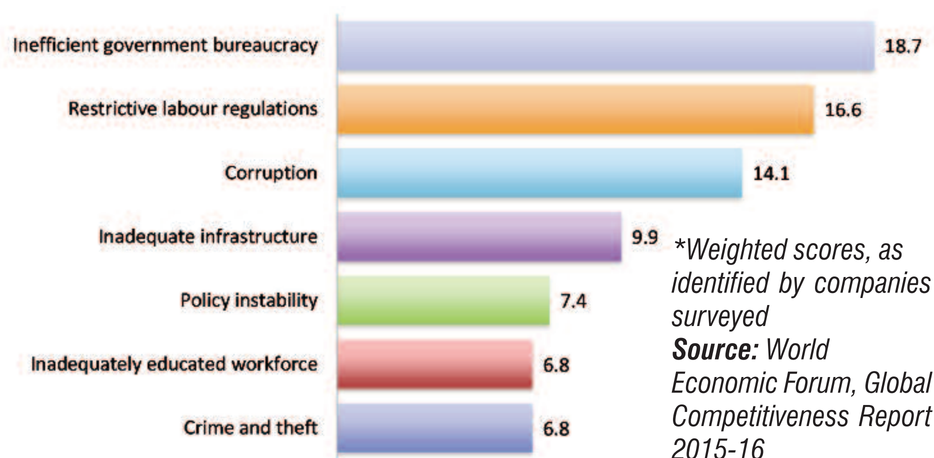
Aside from political and governance issues in the immediate term, the main constraints on Peru's longer-term growth prospects arise from the continued weakness of its institutions and the poor quality of its education system. According to the World Economic Forum's *Global Competitiveness Report* for 2015-16, Peru ranked in 69th place overall for the level of its competitiveness, of 140 countries assessed. For its institutions and its health

Chart 1: Peru's economy - as the IMF sees it

	2014	2015	2016	2017
% Change				
Real GDP	2.4	3.3	3.7	4.1
Real domestic demand	2.4	2.9	2.4	3.3
Consumer prices (end of period)	3.2	4.4	3.2	2.5
Exports	-7.8	-13.4	-1.0	7.1
Imports	-3.1	-8.9	-4.5	3.9
Terms of trade	-5.4	-6.3	-1.7	-0.1
Broad money	9.5	11.6	13.7	14.0
Net credit to the private sector	13.2	14.0	13.7	14.0
% GDP				
Non-Fin. Public Sector primary balance	0.8	-1.1	-0.9	-0.2
Non-Fin. Public Sector overall balance	-0.3	-2.1	-2.1	-1.6
External current account balance	-4.0	-4.4	-3.9	-3.5
Total external debt	29.7	33.7	37.7	36.5
Of which, Non-Fin. Public Sector debt	20.7	24	25.9	25.8
Gross reserves (US$m)	62,353	61,537	62,230	63,930
% of short-term external debt	508	554	559	601
% of foreign currency bank deposits	258	224	222	209
Source: *IMF*				

and primary education systems, it ranked at a low 116 and 100 respectively. Companies asked by the World Economic Forum to identify the most problematic factors for doing business in Peru highlighted inefficient government bureaucracy, restrictive labour regulations and corruption as the top three. Inadequate infrastructure was also cited, in distant fourth place. **[2]**

Chart 2: The most problematic factors for doing business in Peru*



**Weighted scores, as identified by companies surveyed*
***Source:** World Economic Forum, Global Competitiveness Report 2015-16*

SPECIAL FOCUS

VENEZUELA

The government protects Pdvsa at all costs

Finally published in mid-July, the full 2015 accounts of Venezuela's state-owned energy company Petróleos de Venezuela SA (Pdvsa) confirm that the fall in crude oil prices has hit cash flow hard. The impact would have been much greater but for the dramatic reduction in the amount of cash being extracted from the company by the government.

Recent news about Pdvsa has not been positive. In mid-July, the International Energy Agency (IEA) reported that the company's estimated output in June was just 2.18m barrels of oil per day (b/d), the lowest level since February 2003 – when production collapsed amid a major strike by oil workers. And although the price of Venezuelan oil, which was trading at US$37.6/b in the week of 18-22 July according to the energy ministry, is higher than it was earlier this year (it bottomed at US$24.3/b in January), it is still well below the average 2015 price of US$44.6/b (and less than half the 2014 average of US$88.4/b).

Further, Pdvsa has had to think creatively about how it pays Schlumberger, Halliburton and other multinational oil services companies on which it relies to maintain production (including drilling). In part because of delays in being paid by Pdvsa, the multinationals reduced their activity in Venezuela through early 2016. Although Pdvsa's accounts do not provide details, its balance sheet as at the end of 2015 indicated that it owed US$19.1bn to suppliers. According to mid-July industry reports, Pdvsa is working with the oil services companies to facilitate the securitisation of its debts. Should these plans come to fruition, the services companies should be able to turn that debt into cash: with risks of non-payment borne by whoever acquires the debt.

In the meantime, the latest accounts revealed that in the first half of 2016, Pdvsa raised US$831m via the placement with its suppliers of promissory notes (effectively IOUs). These had an interest rate of 6.50% and mature in 2019. Over the same period, Pdvsa honoured US$1.62bn on maturing debt and a slightly greater amount – US$1.66bn – in debt interest payments.

Chart 1: PDVSA's cash flow, 2012-2015 (US$m)				
	2012	**2013**	**2014**	**2015**
Cash at beginning of year	8,610	8,233	9,133	7,911
Cash at end of year	8,233	9,133	7,911	5,821
Movement in cash (A+B+C+D+E)	**-377**	**900**	**-1,222**	**-2,090**
Issuance of debt	7,130	6,923	18,197	8,123
Repayment of maturing debt	-1,537	-2,892	-7,068	-8,088
Payment of cash dividends to government	-1,395	-952	-289	0
Other financing items (1)	-897	-1,546	-28	432
A. Impact of financing activities	**3,301**	**1,533**	**10,812**	**467**
B. Capital expenditure	**-25,221**	**-21,902**	**-14,292**	**-15,183**
Net Profit After Tax (NPAT)	4,335	15,835	9,074	7,345
Depreciation	7,105	8,335	8,441	8,995
Write downs of assets etc.	1,568	1,540	8,276	5,852
Non-cash currency gains included in NPAT	-19	-7,817	-19,127	-15,039
Non-cash expense or (benefit) from deferred tax in NPAT	2,297	-5,094	-4,610	-6,889
Non-cash profit on sale of stake in ENA		-9,524		
Other items (2)	1,052	1,736	362	823
C. Cash from operations	**16,338**	**5,011**	**2,416**	**1,087**
Increase in accounts receivable	-12,113	-21,588	-17,975	-9,257
Change in inventories	-2,902	-2,319	760	1,516
Prepayments etc.	-6,674	-435	-7,502	2,743
Tax credits	-2,875	-2,155	-964	-1,555
Increase in accounts payable	4,371	7,924	6,598	2,542
Increases in employee/retirement benefits payable	4,602	3,210	8,732	-559
Increases in provisions	549	138	569	-19
Increase in tax payable and other liabilities	34,048	56,930	46,727	20,254
Reduction in interest payable	-1,645	-2,060	-429	-400
Cash payment of tax and royalties	-12,156	-22,753	-24,640	-1,169
D. Movement in working capital	**5,205**	**16,892**	**11,876**	**14,096**
E. Adjustments for currency movements		**-155**	**-1,878**	**-385**
Contributions to FONDEN etc.	*-17,336*	*-13,023*	*-5,321*	*-9,189*
Dividends to government	*-1,395*	*-952*	*-289*	*0*
Taxes and royalties	*-12,156*	*-22,753*	*-24,640*	*-1,169*
Apparent extraction of cash by government	***-30,887***	***-36,728***	***-30,250***	***-10,358***
Net issuance of debt	*5,593*	*4,031*	*11,129*	*35*
Revenue from sales of crude and products	*124,459*	*110,719*	*101,552*	*55,339*
Net profit before tax less financial income	*12,460*	*2,592*	*-4,026*	*-15,361*
1. Mainly dividends to external shareholders in subsidiaries				
2. Non-cash adjustments to inventory and accounts receivable				
Source: *PDVSA*				

In our last detailed look at the Pdvsa accounts, a year ago [*Latin American Economy & Business Report, August 2015*], we noted that the fall in the global price of oil, together with a number of other unfavourable trends, had already created a cash flow crisis for the company. We suggested that Pdvsa could respond to the fall in oil prices (from an average of US$88/b in 2014 to US$45/b in 2015) in one of three ways. One was to increase financial debt by borrowing from global markets. The second was to curtail capital expenditure. The third was to run down working capital.

Pdvsa's cash flow statement for 2015 **[1]** shows that the company has followed the third course. Debt was rolled over, but not increased. Capital expenditure amounted to US$15.18bn. Given the company's stagnant (at best) production profile, this is almost certainly less than the company needs to spend to maintain production levels. While last year's Capex was a lot less than in 2012 and 2013, it was still an increase relative to 2014. By contrast, working capital generated US$14.09bn in cash, from US$11.88bn in 2014 and US$16.89bn in 2013.

Royalties and taxes down; inflation up

A very significant change in 2015 is that the left-wing government led by President Nicolás Maduro dramatically reduced the amount of cash that it was extracting from Pdvsa. For years, the Socialist government has used the company as its cash cow to fund its multitude of welfare schemes (known as 'missions').

On average, Pdvsa's cash transfers to the government in the form of taxes and royalties, dividends and inputs for the off-budget national development fund (FONDEN) and other social programs totalled about US$33bn in each of the preceding three years (or nearly US$100bn in total in 2011-2014). In 2015, by contrast, cash transfers from Pdvsa to the government amounted to just US$10.36bn.

A part of this is explained by a dramatic reduction in payments to the FONDEN. In 2013 and 2014, Pdvsa's gross transfers to the FONDEN were

US$10.4bn and US$8.5bn, respectively. After accounting for other amounts recovered from the FONDEN, net transfers amounted to US$5.19bn and US$3.3bn. In 2015, gross and net transfers to the FONDEN were just US$974m. However, as the Maduro government sought to maintain its welfare spending, Pdvsa transferred more cash to the government for social programs. Thus, the company's transfers for social programs rose sharply from US$5.3bn in 2014 to US$9.19bn in 2015– almost one fifth of Pdvsa's receipts from energy sales last year.

In another major change, the Venezuela government appears to have stopped extracting taxes and royalties from Pdvsa in 2015. These payments were reported at US$12.1bn in 2012, US$22.8bn in 2013 and US$24.6bn in 2014. By contrast, in 2015, they came to just US$1.17bn.

The implication is that the Maduro government has been working rather assiduously to ensure that sufficient cash remains in Pdvsa for the company to continue to service its debts. Obviously, this would have had significant implications for the Maduro government's budget (potentially including its budget for essential imports of food, medicine and other essential provisions). However, the Caracas government has long been printing money to cover its spending – which has been the key driver of Venezuela's sky-high inflation.

Chart 2: PDVSA - Key performance indicators	**2012**	**2013**	**2014**	**2015**
Production of oil and gas liquids ('000 BOPD)	3,034	3,015	2,899	2,863
Exports of crude oil and products ('000 BOPD)	2,568	2,425	2,357	2,425
Of which: China and Petrocaribe ('000 BOPD)		787	727	764
Export basket price (US$/barrel)	103	98	88	45
Selected income statement items (US$m)				
Sales of crude and products	124,459	110,719	101,552	55,339
Financial income	3,152	9,316	20,343	16,830
Crude oil purchases	40,012	36,754	37,266	22,965
Operating, sales and administration costs	22,974	23,733	27,400	16,828
Depreciation and amortisation	7,105	8,096	8,038	8,995
Royalties and other taxes	17,730	19,262	13,466	6,294
Financing costs	3,401	2,880	4,065	2,393
Other costs	3,441	4,379	10,022	4,036
Contributions to FONDEN etc.	17,336	13,023	5,321	9,189
Net profit before tax	**15,612**	**11,908**	**16,317**	**1,469**
Income tax	7,279	7,186	5,106	-3,717
Net profit after tax	**8,333**	**4,722**	**11,211**	**5,186**
Selected balance sheet items ($USm)				
Property, plant and equipment	115,905	129,831	141,248	127,033
Deferred tax and other long-term assets	27,637	33,557	30,304	20,975
Total non-current assets	143,542	163,388	171,552	148,008
Cash	8,233	9,133	7,911	5,821
Other current assets	66,649	58,599	47,297	48,114
Total assets	**218,424**	**231,120**	**226,760**	**201,943**
Shareholders' funds	**72,486**	**84,486**	**89,757**	**90,879**
Long term debt	35,647	36,353	39,871	36,916
Other non-current liabilities	39,231	45,055	46,094	21,456
Short term debt	4,379	7,031	5,865	6,800
Income tax payable	2,267	10,116	9,554	3,444
Other current liabilities	64,414	48,079	35,619	42,448
Total shareholders' funds and liabilities	**218,424**	**231,120**	**226,760**	**201,943**
Source: *PDVSA*				

Trends: still mostly unfavourable

Meanwhile, Pdvsa's latest income and balance sheets **[2]** confirm the same unfavourable trends we identified a year ago. Production and exports have remained stagnant; the basic business of extracting and refining oil and gas is unprofitable; and depreciation has been insufficient to cover capital expenditure.

Without contributions from 'financial income', Pdvsa would have recorded large losses in both 2014 and 2015. Within Venezuela, Pdvsa typically has large net liabilities (such as amounts payable to workers, the government and some suppliers). These liabilities are overwhelmingly denominated in the local currency. The company's revenues, of course, are overwhelmingly denominated in US dollars. To the extent that the US dollar value of Pdvsa's net liabilities within Venezuela has declined, as a result of progressive currency devaluations (or, more precisely, the introduction of new currency arrangements that have resulted in the US dollar buying more Bolívares Fuertes), the company has booked the movement as 'financial income'.

In recent years in fact, 'financial income' has become a very substantial part of Pdvsa's total revenues. In 2012, Pdvsa's receipts from sales of crude oil and other products amounted to US$124.46bn. 'Financial income' that year amounted to just US$3.15bn. In 2015 however, the corresponding figures were US$55.34bn and US$16.83bn. Receipts have been hit by the plunge in prices, while 'financial income' has soared due to the government's various changes to currency markets.

Some trends in 2015 were favourable. Lower oil prices meant that the costs of the (lighter) foreign crude that Pdvsa needs in order to operate its refineries dropped from US$37.27bn in 2014 to US$22.97bn. Operating, sales and administration costs also fell – from US$27.40bn to US$16.83bn. And notably, Pdvsa's supply of crude and fuel products on highly concessional terms to Cuba and other countries in the Caribbean and Central America through the Petrocaribe agreement fell from 139,000b/d in 2014 to 99,000b/d in 2015, having been 186,000b/d in 2013. This has had a particularly detrimental impact on Cuba, Venezuela's main concessional oil client under Petrocaribe (*see box – Cuba*).

Cuba takes a big hit

On 8 July, *Reuters*, citing figures from Pdvsa, reported that Cuba had received some 53,500 b/d of crude from Pdvsa in the first half of this year, down some 40% over the first half of 2015. Typically, Pdvsa has shipped about 90,000 b/d to Cuba. According to the report, Pdvsa has partially offset these smaller crude shipments by sending more refined products such as fuel oil, diesel and liquefied petroleum gas (LPG) instead. Nevertheless, its overall shipments to Cuba, including both crude and products, still fell by almost 20% to an estimated 83,130 b/d in the first half of this year. Moreover, Pdvsa reportedly has been dispatching heavier crude to Cuba, holding onto the medium blend that it formerly sent to its strategic partner for its own refining needs. Faced with this heavier crude, Cuban refineries are said to be struggling to produce the necessary mix of fuels required by the local economy.

Nevertheless, nearly one third of exports in 2015 were pre-committed to debt repayment and barter deals. Products delivered to Chinese parties increased from 472,000 b/d in 2014 to 579,000 b/d in 2015. This was partly offset by a fall in other shipments for debt repayments, from 116,000 b/d to 86,000 b/d.

The top priority – ring-fencing Pdvsa

In short, it appears that the Maduro government has concluded that maintenance of Pdvsa's liquidity and solvency is a top policy objective, if not the primary policy objective, amidst the current economic emergency. The costs of ring fencing the state oil company have been borne by various parties. In the first instance, the government itself has suffered through dramatically reduced transfers, which has hit its budget and the FONDEN, while public sector workers – and indeed all Venezuelans – have also endured real cuts to wages and benefits on the back of higher inflation (thanks to the government's incessant money printing to pay its way). Other losers, as mentioned above, include Cuba and Petrocaribe countries, as well as (until recently) the various international oil services companies working with Pdvsa.

Pdvsa's creditors and the default question

While the 'losers' are numerous, the 'winners' are few. But they do include the Chinese government, to whom payments in oil, in return for financing and cooperation funds, have been maintained. They also include Pdvsa debt holders, who have been paid in full to date.

The implication of this is that investor demand for promissory notes and/or other securities, as per the various arrangements between Pdvsa and oil service companies and other suppliers, could well be surprisingly strong.

The massive imbalances within Venezuela's economy and society will ultimately have to be resolved. Exactly how remains unclear. However, at this stage, it appears that the bankruptcy of Pdvsa is unlikely to be a part of the resolution. The government, clearly, has the willingness – and the need (*see box – Why Pdvsa is not the Argentine Republic*) to make tough decisions to safeguard the solvency of Pdvsa and to protect the company.

Why Pdvsa is not the Argentine Republic

Pdvsa's accounts show that US$6bn in debt is due for repayment through calendar 2016. Repayments in the first half of the year amounted to US$1.62bn. Therefore, some US$4.38bn is due to repaid in the final six months of 2016, including about US$4.2bn in the final quarter of the year. In the context of a company that is turning over around US$100bn annually from its main business, which was the case for Pdvsa as recently as calendar 2014, that is not a particularly large sum of money.

However, the slump in oil prices through 2015 meant that revenues from sales of

crude oil and products fell last year by about 45%. The relative burden of the debt repayments has increased hugely. The further slippage in the oil price over the last year or so, the deterioration in what was already a very difficult economic and social situation generally in Venezuela, and assessments by commentators who are not supporters of President Maduro and his government have highlighted a key question: could Pdvsa default on its bonds?

We argue that the government will maintain the liquidity and solvency of Pdvsa at any cost. A comparison of Pdvsa's position with that of Argentina's government following its default in 2001 helps to explain why. The Argentine government was essentially barred from access to global capital markets for 15 years because of litigation with creditors ('vulture funds') in relation to securities for which Collective Action Clauses did not exist. This situation persisted for a number of reasons. The Argentine government was assiduous in its use of heterodox economic policies – and ensured that, among the population as a whole, beneficiaries were numerous most of the time. There were not significant overseas assets that could be seized by creditors. The economy – and public finances – received a massive boost from the rise in commodity prices through the middle years of last decade. The functioning of Argentina's entire economy was not dependent on the government's access to capital markets.

None of these factors currently apply to Venezuela, or to Pdvsa in particular. Although official statistics are scant and opaque, it is clear that the government's pursuit of heterodox economic policies is seriously reducing the welfare of most of the people. Pdvsa's CITGO refining operation in the US represents an important, indeed integral, element of the company's entire business that could be seized by creditors. It is very difficult to see a catalyst for a strong surge in energy prices in the coming two-to-three years. Most importantly, Pdvsa's inability to operate for even a few months would have a cataclysmic effect for the government, the economy and society. Pdvsa is virtually the only source of export revenues for the country and of income for the government.

Some commentators suggest that the government of Venezuela could default, because its bonds do have Collective Action Clauses. Our view is that a default by the government – as opposed to Pdvsa – would be far less serious than a default by Pdvsa: nevertheless, it is an outcome that the government is extremely keen to avoid. A default by the government could further damage Pdvsa's access to global capital markets, even if the oil company remained solvent. It would be a massive loss of face given the sacrifices that have been demanded of the population.

Producing and selling around 2.5m b/d, Pdvsa's monthly revenues from its main business amount to about US$3bn if the oil price remains at around US$40/b. In other words, the cash that is required to repay maturing debt through the second half of 2016 is roughly equivalent to one-and-a-half months of oil revenues – or about one quarter of the total received through the six months to the end of December. All of this assumes, of course, that the company can continue to maintain production at the levels of 2014 and 2015. In the event that production were to fall, as appears to have been the case in June, or to cease temporarily (as a result of a massive strike by the workforce, for instance), Pdvsa might have to find most or all of the US$4.38bn that it needs from some other source.

The most likely financier is China's government and/or state owned enterprises that are based in that country. If Pdvsa were to raise, say, US$4bn against shipments of oil – which is how it has collaborated with Chinese creditors in the past – its obligations would be equal to 100m barrels. With repayment over four years, that would be equivalent to just over 68,000 b/d. This would represent a significant increase on the 579,000 b/d that was committed to obligations to Chinese parties in 2015: however, the increase would be tolerable, especially if commitments to Petrocaribe partners were renegotiated or reduced.

In short, the position of the Venezuelan government and Pdvsa in 2016 is diametrically opposite to that of the Argentine government in 2001. The Venezuelan government places the highest priority on avoiding a default by the oil company. The government needs to prevent a default by Pdvsa at all costs. A default by Pdvsa would have a cataclysmic effect on the long-suffering population of Venezuela. Pdvsa can cope with the heavy burden of debt repayments through late 2016, even if it has to rely entirely on further backing by Chinese creditors.

BRAZIL

More airports could be sold off

Facing an ongoing recession and fiscal squeeze, the government is looking at opening up the aviation sector to foreign investors. The existing cap on foreign ownership of Brazilian airlines could be raised, and key airports in São Paulo and Rio de Janeiro could be privatised.

A first attempt to lift the 20% upper limit on foreign ownership of Brazilian airlines was frustrated in June when Interim President Michel Temer partially vetoed a bill that would have raised it to 100%. However, according to official sources, the president's move was purely tactical, as he was responding to objections by some federal senators. Transport Minister Mauricio Quintella said that a new attempt to legislate would be made later this year. "We will insist on 100%, we have to think now about re-opening the debate in the senate", he said. Quintella also criticised Antonoaldo Neves, chief executive of local airline Azul, who had opposed liberalisation of ownership rules. "Azul is the only airline opposing this. It is natural that he doesn't want competition, but that's not what the country wants," the minister said.

Brazil's two-year recession has hit the aviation sector. A sharp depreciation of the local currency, the Real, has increased the cost of fuel and aircraft leases, which are fixed in US dollars, thereby impacting on operating margins. Opening the doors to greater foreign investment could help strengthen local airlines in advance of a hoped-for recovery. One of the domestic market leaders, budget airline Gol, has been struggling to reduce its heavy debt burden; bringing in a foreign partner might help achieve that. HNA of China took a US$450m stake in Azul in 2015. There has also been interest in Avianca Brasil from Delta and United Airlines of the US.

Avianca Brasil sent an upbeat signal about recovery prospects when its parent, Synergy Aerospace Corp, controlled by Brazilian businessman Germán Efromovich, said in July that it would go ahead with the purchase of 62 narrow-bodied planes from Airbus at a list price of over US$6bn (airlines typically secure discounts on list prices, which are not made public). The aircraft, from the A320neo family, will bolster the current fleet of 40 A320s and one A330 freighter. According to Airbus executive John Leahy, Brazil's domestic air traffic will nearly triple by 2034, putting it among the world's top ten fastest growing aviation markets. The new planes, he said, would help Avianca Brasil "capitalise on this growth and deliver enhanced performance capabilities in challenging airports such as Rio de Janeiro's Santos Dumont." Avianca's bullish stance is in sharp contrast to the approach by Gol, which has been seeking to return 20 leased aircraft to their owners as part of a downsizing programme.

Another area of potential foreign investment is airport ownership and operation. Quintella said the government was planning to offer concessions to operate four medium-sized airports, located in Florianópolis, Salvador, Porto Alegre and Fortaleza, which together could bring in up to BR1bn (US$303m) over the course of 2017. President Temer himself later told the newspaper *Folha de S. Paulo* that in addition the government was considering selling concessions to operate Santos Dumont airport in Rio and Congonhas in São Paulo. "After extensive analysis, we may well go ahead on the privatisation of the airports. This could provide substantial amounts of money for the government", Temer said. Congonhas, used principally for domestic services, is the second largest São Paulo airport, ranked after the international hub at Guarulhos, already privately operated. The high-traffic São Paulo-Rio shuttle service is between Congonhas and Santos Dumont. Selling these additional concessions would help Finance Minister Henrique

Meirellles' plan to reduce the fiscal deficit from an estimated BRL170bn (US$51.6bn) this year to BRL139bn (US$42.2bn) in 2017.

CHILE

The difficult road to free education

It seemed like a simple and beneficial trade-off, as set out by Michelle Bachelet during the 2013 election campaign: Chile would introduce free university education, to be funded by a package of higher business taxes. But now, three years later, Bachelet's government is still struggling to deliver, and finds itself caught in the cross-fire between a disaffected business community and a radical student movement.

The original calculation was that introducing free university education would cost US$3.5bn or 1.5% of GDP, and that it would be phased in gradually, funded by higher tax revenues, so that by the end of Bachelet's term in office in 2018, the poorest 70% of university students would have their fees paid. A full 100% of students would have their fees paid by 2020. But that projection was made before Chile's economic growth slowed, largely because of the fall in international copper prices. The government has just slashed its real annual GDP growth forecast for 2016 to just 1.75%, from 2.75% previously. It has also cut its forecast for international copper prices to US$2.15/lb, from US$2.50/lb previously.

In the latest versions of the education reform bill, officials are now saying that the rate at which free university education will be phased in is open to discussion. Everything points to it being slower. According to Finance Minister Rodrigo Valdés, "If Chile had the money – let's suppose we are lucky enough for the copper price to go back up the three dollars – then the next question society has to ask, and which the education bill puts on the table, is 'Do we want to use all of that money for higher education, or are there other competing needs, such as health or pensions?'" Student organisations have reacted angrily to the idea that free education should be conditional on future economic growth. "At this rate we will get free universal education when we grow to be like China or Japan", complains Carlos Vergara of the Confederación de Estudiantes de Chile. According to some analysts, without new tax measures it could actually take 30 to 50 years to bring in 100% free university education. The government has already made it clear it has no intention of introducing another big tax package.

One of the problems is that as a result of changes made during the military regime in the 1970s and 1980s, Chile has inherited a large, complex and highly privatised university system. There are over one million students in universities, professional institutes (PI), and centres of technical formation (CTF). There are 16 state and 44 private universities. Roughly 80% of university students go to private universities. There is little regulation or control of academic standards. Chile has some of the world's highest university fees, relative to GDP per capita. Chilean families finance 73% of higher education (versus an OECD average of 16%). The State currently funds 15% of higher education costs (vs. the OECD average of 69%). Funding is based on a formula linked to academic performance in entrance exams, and means that the State can (and does) end up contributing more funding to privately-owned than to state-owned universities.

In a detailed presentation to a congressional committee, Finance Minister Valdés outlined some of the numbers. He said that government commitments to improve pre-school and school education represented 1.9% of GDP, while free university education represented a further 1.6% (higher than originally planned). The total cost came to 3.48% of GDP. The tax reform package introduced by the Bachelet government upon taking office was now expected to raise revenues equivalent to 3.03% of GDP, meaning there was a shortfall. But Valdés also highlighted the impact of lower economic growth since 2013,

which, he noted, had led to the equivalent of a 2-percentage point fall in revenue. The authorities also needed to calculate that introducing free university education would probably boost the number of students (perhaps to 1.2m, up from the current 1m). Nor could they focus exclusively on student numbers, without taking into account the need to improve education quality. Valdés described Chilean universities as "good, but not fantastic".

CITIES SPECIAL

REGION

Urbanisation increases the need for 'Smart Cities'

According to a report published in July by the Inter American Development Bank (IDB)[1], demographic trends mean that Latin American cities are seeing "one of the most significant processes of population growth ever experienced in the planet". The proportion of the population living in the region's cities has rocketed from 42% in 1950 to 80% in 2014 and will rise further to an expected 90% in 2050. About 70% of the region's GDP is produced in its cities. This trend, coupled with the opportunities created by the revolution in digital technologies, is making the development of 'Smart Cities' both possible and necessary, the report says.

The management of cities is changing. Advances in information and communication technology (ICT) are revolutionising everything from garbage collection to traffic management. The IDB argues that one of the big challenges facing the region is the need to move from the way traditional cities have been managed to a new 'Smart Cities' model. Perhaps because urbanisation in Latin America has been such a massive (even overwhelming) trend, the problems in its cities are particularly acute, and the gains to be made from applying new technology are correspondingly greater. The report defines a 'Smart City' as one that uses ICT and other means to improve the quality of life, the efficiency of urban operations and services, and competitiveness, while also ensuring that a city meets the economic, social and environmental needs of present and future generations. The IDB's account of specific initiatives in a number of Latin American cities gives a better sense of what is involved.

Rising crime rates have bedevilled many Latin American cities. Starting in 2011, Buenos Aires, Argentina's capital, has made a concerted attempt to integrate disparate police computer systems, voice and data communications, security cameras and emergency calls routed through the 911 emergency service. Officials say that the city's new Centro Unificado de Control y Coordinación (CUCC) has led to better coordination, quicker response times, the more efficient use of police and an improved sense of citizen security. A similar system is being used in Medellín in Colombia, with the added feature that geo-referenced police mobile phones are linked with 823 video surveillance cameras, allowing incidents and emergencies to be rapidly tracked. While not yet introduced in Latin America, Santander in Spain is using geo-referenced audio sensors which, when they detect sirens, rapidly rearrange traffic light sequences to give priority to emergency response vehicles.

Traffic congestion is a notorious diseconomy of scale. Since the 1990s, Colombia's capital, Bogotá, has sought to tackle it through the TransMilenio project, a low-cost Bus Rapid Transit (BRT) system, combined with the development of bicycle lanes. The bus network uses 12 services operating on dedicated carriageways, which now are 113km long and cover 137 stations. There are 400km of bike lanes. The city also has rolled out an integrated transport system (ITS) using smart traffic lights and monitoring cameras; passengers use a prepaid card system. According to a survey by the local newspaper *El Espectador*, the initiative has led one in five car users to migrate to the public transport system, which can be faster and cheaper.

[1]The Road toward Smart Cities – Migrating from Traditional City Management to the Smart City, available at ttps://publications.iadb.org/handle/11319/7743

In Brazil's Rio de Janeiro, soon to host the Summer Olympic Games, there has been an emphasis on disaster management, as the city has suffered from mudslides and is particularly exposed to climate change risks. In line with priorities set out in the Kyoto Protocol, the city has begun by investing in weather radar, along with a digital rain gauge network using sensors placed in mobile phone towers. The authorities have also begun to build a landslide prevention system using data collected by sensors in hazardous slope areas. COR-Rio (the city's operations centre) is now able to issue high precision alerts ahead of probable storms, floods and landslides. It has also created an interactive element, where citizens can report problems through SMS, online or social media networks.

Efficient water use is a high priority in The Bahamas, as 90% of drinking water comes from desalination plants. In the capital Nassau, the Water and Sewerage Corporation (WSC) has struggled with leaks in the pipe system, theft and measurement errors. In 2012, 58% of the city's total water supply was lost in this way. In response, the WSC introduced a centralised computer-controlled loss-containment programme, using a range of technologies for pipe repair and replacement, leakage control, pressure management, micro-measurement management and fraud detection. This helped reduce water losses to 29% in 2014. The system also identified optimum timings for repair work, when it would have little or no effect on normal supply.

Another challenge for Latin American cities is waste disposal and management – many have uncoordinated systems and limited recycling. In Itu, a city in Brazil's state of São Paulo, the authorities have entered a public-private partnership (PPP) to create a selective garbage collection system using 3,300 containers distributed throughout the city. Households take their waste to the containers and sort it into recyclable and non-recyclable components. The containers have fill-level sensors allowing them to be emptied as necessary. Their distribution by type (organic, recyclable, underground) is matched to the locations of waste-generating businesses. A software programme determines the ideal routes for waste collection trucks. Itu is collecting 10 tons of recyclable waste every day. It has a target to convert 70% of the 3,600 tonnes per month of wet waste it collects into electricity or gases.

Smart City enthusiasts also emphasise the need for citizen participation in local administration and for electronic government, or e-government – faster, more convenient ways of using ICT to carry out a whole range of municipal administrative tasks. One city pursuing this is Chihuahua in northern Mexico, which offers free Wi-Fi Internet access to its population of just under 1m inhabitants, alongside e-government services and ICT training. Residents can request tax payment forms and certificates online; the city also promotes access to civil society groups that provide support for women, pensioners and entrepreneurs. Residents are encouraged to report any problems with city services through a geo-referenced system.

One of the cities recognised as being at the forefront of innovation is Colombia's Medellín. A case study by the IDB notes that Medellín has sought to reinvent itself, leaving behind its image, acquired in the 1980s and 1990s, as a centre of drug trafficking and violence, to become instead "an international reference for technological and social innovation, urban transformation, equity, and citizen participation". Some of the more important innovations have included a traffic management system called Sistema Integrado de Movilidad de Medellin (SIMM), which has sought to integrate the way the city's various transport systems work. Officials say that the SIMM has delivered a measurable reduction in the number of accidents, an increase in mobility, and a fall in incident response times.

On the security and emergency side, there is another integrated system, Sistema Integrado de Emergencia y Seguridad Metropolitana (SIES-M), that coordinates the work of over 10 local and national government agencies. The IDB says that while systems used in the city vary, they all share a common

feature, in that "they are aimed at serving the citizens, and they have created mechanisms to communicate and interact with them to promote the continuous improvement of smart services". It also notes that there has been a range of difficulties, including the slow integration of services, resistance to information-sharing and technological backwardness in some areas, along with a shortage of resources in others.

The IDB's case study of Rio de Janeiro stresses the importance of COR-Rio as the city's single overall operations centre, operating on a round-the-clock basis. COR-Rio seeks to integrate everything from traffic management to weather emergencies, with involvement by local communities and intensive use of social media. The case study recognises that the August 2016 Olympic Games, "is perhaps one of the greatest challenges for the city in the near future". Media reports have stressed potential problems arising from Rio's financial difficulties, as well as concerns over security and terrorism, plus the Zika epidemic. While these are undoubtedly serious issues, it is also the case that COR-Rio may get an opportunity to show its worth.

REGION

Urban crime: one problem, varying solutions

In 2015, eight of the world's 50 most murderous cities were located in the US and South Africa: the remainder could all be found in Latin America and the Caribbean.

Data from a Mexican NGO, Consejo Ciudadano para la Seguridad Pública y la Justicia Penal (CCSP-JP), shows that among these cities the murder rate varied widely, however **[1]**. Moreover, initiatives backed by civic leaders in particular cities have often had significant and positive effects, as per a recent report by a Brazilian think tank, the Igarapé Institute.[2]

[2]Igarapé Institute, Making Cities Safer: Citizen Security Innovations from Latin America, Strategic Paper 20, June 2016.

Chart 1: The world's most murderous cities in 2015

Murder rate per 100,000 people

1	Caracas, ve	120	21	São Luís, br	55	*41*	*Durban, za*	*36*
2	San Pedro Sula, hn	111	22	Cuiabá, br	49	*42*	*Nelson Mandela Bay, za*	*36*
3	San Salvador sv	109	23	Manaus, br	48	43	Porto Alegre, br	35
4	Acapulco, mx	105	24	Cumaná, ve	48	44	Curitiba, br	35
5	Maturín, ve	86	25	Cd. Guatemala, gt	47	45	Peireira, co	33
6	Distrito Central, hn	74	26	Belém, br	46	46	Victoria, mx	31
7	Valencia, ve	72	27	Feira de Santana, br	46	*47*	*Johannesburg, za*	*30*
8	Palmira, co	71	*28*	*Detroit, us*	*44*	48	Macapá, br	30
9	*Cape Town, za*	*66*	29	Goiânia, br	43	49	Maracaibo, ve	29
10	Cali, co	64	30	Teresina, br	43	50	Obregón, mx	28
11	Cd. Guayana, ve	62	31	Vitoria, br	42			
12	Fortaleza, br	61	*32*	*New Orleans, us*	*41*			
13	Natal, br	61	33	Kingston, jm	41			
14	Salvador, br	61	34	Gran Barcelona, ve	40			
15	*St Louis, us*	*60*	35	Tijuana, mx	39			
16	João Pessoa, br	58	36	Vitória da Conquista, br	36			
17	Culiacán, mx	56	37	Recife, br	38			
18	Maceió, br	56	38	Aracaju, br	38			
19	*Baltimore, us*	*55*	39	Campos dos Goytacazes, br	36			
20	Barquisimeto, ve	55	40	Campina Grande, br	36			

Italics highlight cities outside Latin America and the Caribbean

br- Brazil co- Colombia gt- Guatemala hn- Honduras jm- Jamaica mx- Mexico sv- El Salvador us- United States ve- Venezuela za- South Africa

Source: *CCSP-JP*

The combination of drug trafficking, street gangs, income inequality, weakened institutions and cyclical economic trends mean that Venezuelan and Brazilian cities are over-represented in the rankings of the most violent global cities. However, as the Igarapé Institute notes, murder rates across Latin America and the Caribbean vary hugely – from over 180 per 100,000 people in Honduras and El Salvador to fewer than 3 per 100,000 in cities in Chile and Costa Rica.

Crime is a local issue and particular cities in the region have benefited massively as crime rates are reduced. The homicide rate in Medellín, Colombia, dropped by an impressive 85% between 2002 and 2014. In Ciudad Juárez, Mexico, the murder rate dropped by over 90% over the five years to 2015. Other cities that have benefited very notably from a reduction in the homicide rate include Bogotá in Colombia, Belo Horizonte in Brazil and Kingston in Jamaica.

In its analysis of 10 different interventions to address major crime problems in the region, the Igarapé Institute noted that, "there are no silver bullets". In general however, successful citizen initiatives in the region have combined a number of features. They have had clear objectives, and have looked at both short- and long-term outcomes. They have focused on high-risk populations and places and have addressed the root causes of security problems, identified as "persistent inequality, youth unemployment, weak security and justice institutions, and organised crime groups, fuelled by drug trafficking". Anti-crime initiatives also have been based on close collaboration between the police and security services, local governments, community leaders and the residents of high-crime areas. Perhaps most importantly, the initiatives have been holistic, in that they have not focused soley on "hardline law and order approaches". Instead, they have (generally) included investment in the training and education of young people and the provision of improved infrastructure and better social services.

Eight of the ten case studies examined by the Igarapé Institute looked at the responses by governments to soaring murder rates. Although details varied from city to city, problem factors common to all cities included: the presence of gangs and drug trafficking; deficient policing (and often poor relations between the police and affected communities); a weak or minimal state presence in the worst-affected areas; and notable income inequality. In one of the eight cities – Venezuela's Caracas – the problem has been exacerbated by economic crisis in the past few years.

Of the other two case studies, one looked at the Fundación Construir's 2010-2013 project to reduce the high levels of femicide and violence against women in Bolivia (particularly in rural areas). The project sought to identify the key risks affecting women, to mitigate those risks, and to change community attitudes. Thus far, there are signs that there is a greater understanding of the problem. However, it is not yet clear that the program has resulted in a reduction in femicides.

The other looked at the Programa Aplicación del Enfoque del Modelo de Ocupación Humana (PAMOH) drug and alcohol treatment program in Valparaíso, Chile. Perhaps because of Chile's economic success over the last 30 years, and a generally progressive approach to social issues, the country had the highest incidence of cocaine usage among secondary school students in the Americas in 2009. Some 6.7% of Chilean secondary school students had used the drug: in the US, the second-placed country in this ranking, the corresponding figure was 4.6%. The PAMOH program had two main elements. One was the development of healthy routines, including group and individual therapy sessions, for young drug offenders. The other was vocational training in trades, through the Colegio Técnico Industrial de Valparaíso. The final outcomes of the program have yet to be determined. Nevertheless, there were clear signs of improvements in the mental and physical health of program participants.

Chart 2: Selected citizen security initiatives in Latin America			
The location	**The problem**	**The solution**	**The outcome**
Bolivia	High levels of femicide and violence against women	Fundación Construir project (2010-2013) to: identify key risks affecting women mitigate those risks and change community attitudes.	Evidence of greater public understanding of the problem. No clear evidence of a reduction in the problem.
Belo Horizonte, Brazil	Rise in homicide rate from 17 per 100,000 in 1998 to 34 per 100,000 in 2002 as a result of greater drug trading through favelas.	'Fica Vivo' program of targeted policing - seizing of weapons etc. Backed up with training and education of 12-14 year olds. Directed by community leaders rather than the police from 2004.	Reduction in homicide rates of over 50% in five communities in which the program was implemented.
Rio de Janeiro, Brazil	Soaring homicide rates in favelas as a result of the drug trade and lack of state presence.	Introduction of Unidades de Polícia Pacificadora (UPP) units from 2008. 'Community policing initiative centred on intensive police intervention… followed by a social and urban development strategy.'	65% reduction in murder rate between 2009 and 2014. Greater public investment, but with mixed social and political impacts.
Valparaíso, Chile	Rising drug use in Chile, including highest usage of cocaine among secondary school students in the Americas (including the USA)	Programa aplicación del Enfoque del Modelo de Ocupación Humana (PAMOH). A program of rehabilitation and social reinsertion for youth and young adult drug offenders from 2010.	Some improvement in mental and physical health of program participants by 2012. Overall outcomes yet to be determined.
Bogotá, Cali, Medellín and five other Colombian cities	Homicide rate soars by nearly 160% over decade to 1995.	Plan Cuadrante: more efficient community policing, supported by improved infrastructure and public services. Police forces reformed from within. Improved broader security policies.	National murder rate of 22.8 per 100,000 in 2015, down by over two thirds from 2002.
Santo Domingo, Dominican Republic	Near doubling of murder rate to 26 per 100,000 in 2002-2006 (and to over 40 in Sto. Domingo in 2005).	Plan de Seguridad Democrática (PSD). This includes reform of the criminal justice system and police, improved relations between state and society and social programs that target high risk areas. Social programs include micro-credit, scholarships and aid to repai homes.	Some evidence of improvement in real and perceived security. Some evidence of greater public confidence in criminal justice system.
San Pedro Sula, Honduras	World's highest murder rate - 187 per 100,000 in 2014	IDB-funded Peace and Citizen Coexistence program from 2003. However, the program had problems, such as a lack of accountability and proper monitoring and the inability of municipalities to improve infrastructure. In addition, there was a rapid turnover in program leaders and little community involvement.	Poor implementation and limited results.
Kingston, Jamaica	Very high murder rate in Jamaica - 126 per 100,000 in 2005.	Reaching individuals through Skills and Education (RISE) initiative - from 2003.	Improvement in education and employment outcomes, but limited impact on gang behaviour and substance abuse.
Cd. Juárez, Mexico	World's highest murder rate at 271 per 100,000 people in 2011, thanks to turf wars between Juárez and Sinaloa Cartels.	Todos Somos Juárez program, with US$380m in investments through 2011-12. Program focuses on: public security economic growth employment health education and social development.	Results are difficult to quantify, because of the end of the Cartel war and intensified government security actions in the state. However, crime and murder rates fell precipitously.
Caracas, Venezuela	World's highest murder rate in 2015, exacerbated by economic crisis. Crime fighting is complicated by the lack of exchange of data between the police forces of the five municipalities of Caracas.	Sistema integrado de Estadisticas Delictivas para el area Metropolitana de Caracas, in 2010-2012. The system includes the police in the state of Miranda. However, the system does not include the central Libertador municipality or the Policía Nacional Bolivariana.	Encouraging early indicators of improved statistics for the Caracas metropolitan area.
Source: *Igarapé Institute, Making Cities Safer: Citizen Security Innovations from Latin America.*			

Arguably the most important case study was Colombia's Plan Cuadrante, a community policing plan launched in the country's eight main cities in 2010. Implementation of the plan was helped by the experience of particular cities in preceding years. In Medellín, for instance, two mayors already had worked over the preceding decade to improve relations between the municipal authorities and the national police force, as well as focusing on improving public services and infrastructure in those parts of the city worst affected by violence. Outcomes were also helped by a crackdown on corruption within police forces in the mid-1990s and the central government's advances against the Medellín and Cali drug cartels from the early-2000s. In 2015, the murder rate across Colombia as a whole was 22.8 per 100,000 – the lowest in 30 years. In some ways, the Colombian program has provided a model for the rest of the region. Initiatives in other countries have had mixed success, although they have generally resulted in a reduction in the murder rate and/or improved perceptions of urban security situations.

Of the case studies in the report, the least effective appears to have been the Peace and Citizen Coexistence program in (and around) San Pedro Sula, the second largest city in Honduras, where there were clear problems in the way in which the program was implemented. Given the scale of the investment involved (US$380m over the two years to the end of 2012), the Todos Somos Juárez program in the notoriously violent Ciudad Juárez is the one least capable of being reproduced directly in other cities: however, it did appear to contribute substantially to a dramatic fall in the murder and crime rates.

The data published by CCSP-JP in relation to 2015 suggests that two changes over the coming three-to-five years could result in a sharp fall in overall murder (and crime rates) in the region. One of these relates to a resolution of the severe economic crisis in Venezuela, whose cities are grossly over-represented in rankings of the world's most violent cities. In 2015, the murder rate in Caracas was nearly six times that of Colombia as a whole. It is likely that any solution will also include better sharing of data among the country's disparate police forces: as the Igarapé Institute's report highlights, an important initiative to co-ordinate the various police forces operating across metropolitan Caracas needs further development.

The other change is replication (in whole or in part) of Colombia's Plan Cuadrante, or of Rio de Janeiro's UPP community policing program, in the main cities in the Northeast of Brazil, such as Fortaleza, Natal, Belém, Maceió, São Luís, Recife and João Pessoa. These are also over-represented in the CCSP-JP's ranking for 2015. Although the world's 50 most murderous cities do include some Brazilian cities outside the Northeast, the only one of the country's five largest metropolitan areas that appears in the ranking (in 43rd place) is Porto Alegre. Initiatives to boost security in São Paulo, Rio de Janeiro, Belo Horizonte and Brasilia can be duplicated elsewhere in Brazil.

POSTSCRIPT

Corporate Radar

Liverpool buys Ripley stake: Mexican department store chain Puerto de Liverpool said it had signed an agreement with the Calderón family, majority shareholders of Chile's Ripley chain, under which it would launch an IPO to acquire a 25.5% stake in the Chilean company. Ripley has a network of 69 retail outlets in Chile and Peru. Liverpool said it would pay 420 Chilean pesos per share, which would place an overall value of CLP813.14bn (US$1.23bn) on the Chilean company. If the IPO is successful, Liverpool and the Calderón family will seek to agree joint management of Ripley.

Venezuela seizes Kimberley-Clark: On 11 July the Venezuelan government said it was taking control of the local subsidiary of US personal and health

care products company Kimberley-Clark. The company, which has operated in Venezuela for over two decades, had earlier said it was shutting down production because it could not secure supplies of raw materials or access the foreign exchange it needed to operate. Labour Minister Oswaldo Vera said the takeover was to protect jobs and re-start production at the Kimberly-Clark facility in Maracay, which manufactures a range of products, including toilet paper, sanitary towels, nappies and tissues. "Kimberly-Clark will continue operating under workers' control", the minister said. Since the Venezuelan economic crisis intensified, other companies have also been seized by the State, but widespread shortages of consumer goods have continued.

Graña y Montero wins Metro deal: Graña y Montero, Peru's largest construction company, said it had won a US$410m contract to expand the Lima Metro system. Company president Gonzalo Ferraro said the contract would allow the purchase of new trains, the expansion of the total number of stations, and improvements to the electric power grid. The system currently has the capacity to carry 320,000 passengers a day, but this would increase to 500,000 with the number of operating trains to be increased from 24 to 44, he said. The new trains would be delivered in 2017-18. Ferraro said the Metro was experiencing a "crisis of success", meaning that passenger numbers had increased much faster than anyone had expected. Graña y Montero participates in a range of sectors, including real estate, infrastructure, maintenance and oil and gas. It operates mainly in Peru, Chile and Colombia, and is seeking to start up in Mexico, so as to have a presence in all four Pacific Alliance countries.

Monsanto and Microsoft target Brazilian agro-tech: The US agricultural and biotechnology company Monsanto, together with computer software giant Microsoft, said they were launching a cooperative venture in Brazilian agriculture. Monsanto will invest BRL300m (US$92m) in a Microsoft fund set up to support and assess the application of digital technologies to Brazilian farming. The fund offers up to BRL1.5m (US$459,000) at a time to support start-up farm technology projects. After three years, the start-ups can treat the money as a loan, by paying interest, or give the fund a corresponding equity stake in their venture. "We want to promote new ventures in the agricultural sector. There is a vast area for investigation and development," said Rodrigo Santos, chief executive of Monsanto Latin America.

LatinNews Daily

LatinNews Daily is an essential briefing tool for anyone with a serious interest in Latin or Central America and the Caribbean and is relied upon by thousands of LatAm professionals world-wide.

It is the definitive English language resource delivered via email at 0800 EST outlining all key developments throughout the region with expert analysis on the likely impact of each development.

LatinNews Daily costs just $1,760 USD or £1,080 GBP for the year. For a 14-day free trial register at **www.LatinNews.com**, or for further information please contact Maria Isotalo via our online form at: **www.latinnews.com/contact-us.**

LATIN AMERICAN ECONOMY & BUSINESS is published monthly (12 issues a year) by **Latin American Newsletters**, Intelligence Research Ltd., Hamilton House, Fourth Floor, Mabledon Place, Bloomsbury, London, WC1H 9BB, Tel: +44 (0)203 695 2790 Email: subs@latinnews.com or visit our website at: **http://www.latinnews.com**. Subscription rates will be sent on request. Overseas subscription sent by airmail. **CONTRIBUTORS: EILEEN GAVIN, ANDREW THOMPSON, ANDREW HUTCHINGS.** Printed by Quorum Print Services Limited, Units 3&4, Lansdown Industrial Estate, Gloucester Road, Cheltenham, Glos. GL51 8PL.

COPYRIGHT © 2016 INTELLIGENCE RESEARCH LTD. in all countries. All rights reserved. No part of this publication maybe reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, electrical, chemical, mechanical, optical, photocopying, recording or otherwise, without the prior written permission of the publishers.

Registered as a newspaper by Royal Mail. **REFERENCES:** Back references and cross-references in the current series will be made thus: EB-16-01 will indicate Economy & Business Report, 2016, issue 1.