CANNING HOUSE EDITION

latin american economy & business

July 2018 - EB-18-07

ISSN 0960-8702

CONTENTS

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

Getting ready for the trade war

A global trade war may, or may not, be around the corner. US moves to slap protective tariffs on imports of aluminium and steel caused an initial ripple of global concern. Further tariffs on imports from China, and Chinese countermeasures, have also worried the markets. Meanwhile, the future of the North American Free Trade Agreement (Nafta) still hangs in the balance. The election of a populist president in Mexico may increase uncertainty over trade. Whether a real storm is on the way, or whether it will end up being nothing more than a passing squall, it is still worth asking how Latin America would cope in a much more protectionist world.

The first question, whether a trade war will actually happen, is difficult to answer. There are some worrying milestones already in place. US President Donald Trump, a populist and a mercantilist, clearly sees political gains to be made by protecting US industries. On 1 June his government imposed a 10% extra tariff on aluminium imports and a 25% one on steel imports from Mexico, Canada and the European Union, in the name of protecting national security. That in turn led to counter-measures. The EU applied countervailing tariffs to a range of US products, including blue jeans and Harley-Davidson motorcycles. Mexico responded by increasing duties on US-produced flat steel, pork, foodstuffs and other products. It has also started proceedings against the US in the World Trade Organisation (WTO).

Meanwhile the US and China have squared off. The US made the first move, applying tariffs to around US$50bn worth of imports from China, citing unfair trade practices and violation of intellectual property. China responded by imposing tariffs on 128 US products, including soya beans. Trump has threatened further escalation that would target up to US$200bn worth of trade with China. A generalised trade war would have serious consequences. Michelle Meyer, an economist from Bank of America, has commented, "Our work and the literature suggest a major global trade confrontation would likely push the USA and the rest of the world to the brink of a recession."

But a recession-inducing global trade war is by no means inevitable at this stage, for at least two reasons. First, the extra tariff costs imposed so far are only a small proportion of a single percentage point of the GDP of giant economies like the US, China, and the EU. They are a negative factor, but one that might be offset by other sources of economic stimulus (for example productivity gains from new technology). The global economy is still growing. Second, the US president – currently the main instigator of protectionist measures – is unpredictable and may be using threats solely as a negotiating strategy. According to Alberto Pfeifer, coordinator of international affairs at the University of Sao Paulo, the aluminium and steel tariffs were "yet another messy policy move by Trump – shoot first and see who falls down". César Rojas of the University of Santiago (Usach) in Chile says, “So far, we’ve seen a war of missives and declarations between the United States and China, rather than a trade war. Trump doesn’t always achieve what he sets out to, but he’s a major source of uncertainty for global trade.”

Whether a trade war does develop, or the main protagonists instead reach a less harmful point of equilibrium, it is useful to try and assess the potential costs and benefits for the Latin American economies, as well as investigating what some of their policy options might be. According to Alfredo Coutiño, Latin American director for Moody’s Analytics, the swing towards protectionism may cut the region’s GDP growth rate to 1.8%, down from the 2.2% he was predicting previously. In other words, the Latin American recovery of 2017 might weaken, rather than strengthen, in 2018. Coutiño believes there may be an unfortunate coincidence of the negative impact of global protectionism with the high election-related political risk in the region’s two major economies, Brazil and Mexico. Argentina will also experience slower growth because of its recent currency difficulties (although IMF support will help stabilise the country’s economy next year). Taken together, Brazil, Mexico, and Argentina account for nearly two-thirds of regional GDP, ensuring that growth will be below par.

Marcos Casarín, Latin American head of Oxford Economics, agrees that the tariff escalation on trade flows between the US, China, Europe, Canada, and Mexico “makes it very difficult for growth to accelerate among the Latin American economies”. He thinks increased protectionism will shave around 0.3 percentage points of the annualised regional growth rate in the second half of this year, bringing it down to 1.8%. But he also notes that some countries will buck the trend. Among them he cites Colombia, poised to benefit from recovering oil prices and a new, recently elected market-friendly president. He also mentions Chile, which he believes, unlike other commodity exporters subject to earnings volatility, will be “protected” by relatively firm copper prices.

Consultancy Capital Economics says a rise in US protectionism would hit some Latin American countries harder than others. Those most exposed would be the countries with the greatest dependency on US trade: Mexico and various Central American republics including Nicaragua, Honduras, and Costa Rica. Exports to the US represent nearly 30% of Mexico’s total GDP: it also has a large surplus in its bilateral trade with the US, making it liable to be targeted for specific US tariff measures. Exports to the US represent 20%-25% of GDP in Nicaragua and Honduras, and 5%-10% of GDP in Ecuador, Venezuela, El Salvador, Guatemala, and Costa Rica. By industry sector, those most likely to be targeted by US tariffs include automobiles (Mexico), aeronautics (Brazil), copper (Chile), renewable energy (Argentina), fruit (Chile, Peru, Costa Rica), and clothing (El Salvador, Nicaragua, Guatemala, and Honduras).

One early example of how Latin America-based companies may have to react to rising protectionism is given by Mexico’s steel sector. Máximo Vedoya, president of the Cámara Nacional de la Industria del Hierro y del Acero (Canacero), says the new US steel tariffs will cause US$2bn in losses for the Mexican industry. In response, the sector has developed an action plan. Broadly, it envisages absorbing some of the extra tariff costs in an attempt to remain competitively priced in the US steel market. At the same time Mexican steel companies hope to step up their exports to other countries, particularly those with which Mexico has free trade agreements in Central America, the Andean region, and Europe.

Vedoya, who is also chief executive of steel company Ternium, makes the point that last year Mexican steel consumption was 30.8m tonnes: 16.1m tonnes came from local mills; 14.7m tonnes were imported. Separately, Mexican steel companies exported 5.1m tonnes. Canacero’s aim will therefore be to change those numbers going forward with Mexican producers supplying a greater proportion of domestic steel demand, at the same time as they try to maintain

Table 1: Top Export Products to the US (2017)

Country	Products	US$bn (% of GDP)
Argentina	Biofuels	0.8 (0.1)
	Aluminium	0.6 (0.2)
Brazil	Oil	4.6 (0.2)
	Iron & steel	3.0 (0.1)
	Aircraft	2.6 (0.1)
Bolivia	Gold	0.5 (1.4)
	Tin	0.1 (0.4)
Chile	Copper	3.0 (1.2)
	Fruit (mostly grapes)	2.3 (1.0)
Colombia	Oil	8.0 (2.3)
	Gold	1.2 (0.4)
	Coffee	1.1 (0.4)
Costa Rica	Medical equip.	1.8 (3.1)
	Fruit	1.2 (2.0)
Ecuador	Oil	4.1 (4.3)
	Fish (mostly shellfish)	0.7 (0.7)
	Fruit (mostly bananas)	0.5 (0.5)
El Salvador	Knitted clothing	1.7 (6.2)
	Non-knitted clothing	0.3(1.1)
Guatemala	Fruit (mostly bananas)	1.5 (2.1)
	Knitted clothing	1.1 (1.6)
Honduras	Knitted clothing	2.1 (9.2)
	Electrical wiring	0.6 (2.6)
	Non-knitted clothing	0.5 (2.2)
Mexico	Passenger cars	30.6 (2.7)
	Passenger car parts	23.0 (2.0)
	Goods vehicles	22.9 (2.0)
Nicaragua	Knitted clothing	1.1 (8.0)
	Electrical wiring	0.5 (3.0)
Panama	Fish	0.1 (0.2)
Peru	Gold & silver	2.1 (1.2)
	Oil	1.0 (0.6)
	Fruit	0.9 (0.6)
Uruguay	Beef	0.2 (0.3)
Venezuela	Oil	12.0 (5.6)

Sources: Intracen, Capital Economics

exports. Of course if the steel industry in every country tries to be more self-sufficient in this way the net effect will be a fall in global steel trade volumes with consequent loss of efficiencies and economies of scale. Vedoya also makes the point that tariffs are indiscriminate: "What the US did with these tariffs is not only to attack countries with unfair trading practices, but to attack all countries, including Mexico and Canada, who should never have been involved: this is going to create big global trade distortions," he says.

While those Latin American countries and industries that trade most intensely with the US are most exposed to protectionist US moves in any future trade war, others may be caught up in the indirect effects. This is because they are involved in global value chains, which may also ultimately link to the US market. Capital Economics says the important measure is each country's share of value added in US imports. The bigger this is, the more they are exposed to any punitive US tariffs. The Mexican share of US import value added is equivalent to 16% of Mexican GDP; for Colombia the number is just under 5% of GDP. Yet countries that export to China are also at risk, because some of that value is then incorporated into manufactured products exported by China to the US. Exports to China represent 5%-7% of GDP for Chile and Peru, and 2% for Brazil. In a trade war, those exports could be at risk in two ways. First, a US-China trade confrontation could ripple through global supply chains to impact the Latin American suppliers lower down the chain. Capital Economics believes Chile is at most risk from this indirect effect. Second, the Chinese economy could slow down, either because of a trade war or for internal, more structural reasons. Of course, shifting trade flows also create some opportunities: Chinese tariffs on soya shipments from the US might provide an opportunity for rival exporters in Argentina, Brazil, and Paraguay to gain more market share.

Latin America's policy options in a global trade war are limited, but how governments react will still be important. One perhaps obvious point is that a patient, measured and carefully calibrated response to trade restrictions is likely to be more successful in the long term. In fact, although proceedings have been incredibly long and drawn-out, the region has positive experience in this regard. Within Nafta, Mexico was involved in a long dispute over trucking when the US refused to honour a commitment to let Mexican truckers operate north of the border. Mexico took three years before formally invoking a disputes procedure; when it obtained a favourable ruling from a Nafta disputes panel it took almost another 10 years before imposing carefully chosen countervailing tariffs, targeting items produced in politically sensitive US constituencies. This finally did the trick, with the US authorities agreeing a resolution within two further years.

A similar story can be told over Brazilian objections to US cotton subsidies. Brazil made a formal complaint within the WTO in 2002; two years later the WTO ruled in its favour. But the US did not comply with the ruling. Brazil secured WTO approval for countermeasures in 2009. Finally, Brazil threatened countermeasures, including the suspension of US intellectual property rights in the country; in the face of the threat alone (rather than actual implementation) the US then accepted a settlement in October 2014. Another, more macroeconomic point is that countries with floating currencies (the majority of Latin America at the moment) are better placed to react flexibly to the trade disruptions caused by the sudden imposition of tariffs or non-tariff restrictions.

REGION

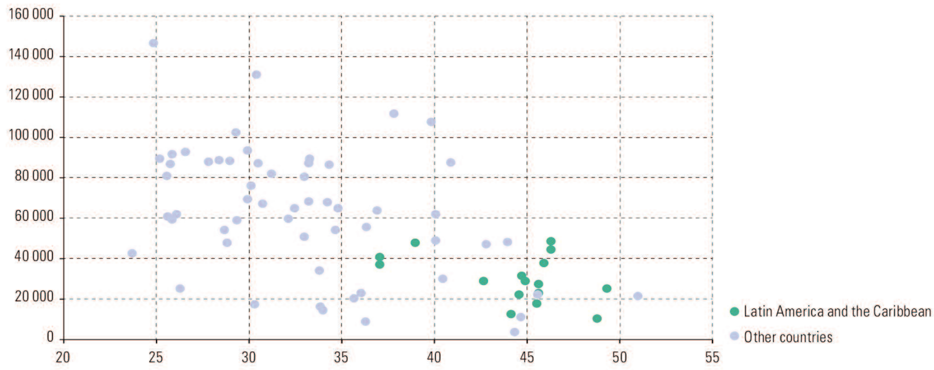
Alternatives to trickle down

When Latin American countries face economic crises, austerity is often proposed as the solution. Austerity, in turn, frequently means that the poor are called on to make the greatest sacrifices. The rich, on the other hand, are seen as having to be encouraged to save and invest, for that is what will get the economy moving again. The belief is that those benefits will eventually 'trickle down' to the poor. But this thinking, says the UN's Economic Commission for Latin America and the Caribbean (Eclac) in a new report, is outdated and wrong.

The report, titled 'The Inefficiency of Inequality', was published in May. It points out that for many years conventional economic theory has held that efficiency and equality have been at odds with each other. Significantly, in 1975 one economist, Arthur Okun, described the relationship between the two as "the big trade off". It was through that greater equality could only be achieved by accepting inefficiencies and lower economic growth. Conversely, policy makers who wanted higher efficiency and growth would have to accept lower equality. At the centre of this view was the thought that the concentration of resources in the hands of the few would raise their capacity to save, and consequently, to invest.

But Eclac says these ideas have been replaced by an emerging new consensus that inequality is in fact a barrier to development. This new consensus takes a long term view and seeks to include social, cultural, and political factors. It holds that equality can improve the efficiency of an economic system, increasing the pace at which innovations can be made, those generated in other parts of the world can be absorbed, technology gaps can be reduced, productivity can be increased, and new areas for investment can be established. Eclac recognises that the interaction between equality and productivity is complex. Nevertheless looking at a broad spectrum of countries and using output per employee (measured in 2011) as an indicator of productivity, and the Gini Index as a measure of equality, shows that the more equal countries tend to be the more productive (the lower the Gini score on a 0%-100% scale, the more equal a country is judged to be). The exercise also shows that Latin American countries are clustered at the high inequality/low productivity end of the spectrum

Productivity and Gini index, 2014
(Purchasing power parity (PPP) dollars and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of University of Groningen, Penn World Table [online database] https://www.rug.nl/ggdc/productivity/pwt/, and Harvard University, Standardized World Income Inequality Database (SWIID) [online database] https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/11992.

Note: The Gini index is expressed in percentage terms. Productivity is expressed in output per employee in 2011 PPP dollars.

The Eclac report argues that pro-equality policies are beneficial in social terms, but also create an economic system that facilitates learning, innovation, higher productivity, and environmental protection. Eclac's Executive Secretary, the Mexican economist Alicia Bárcena, commented, "The political economy of highly unequal societies and the culture of privilege are obstacles to progress in development with equality. The region still bears the colonial vestiges of a culture of privilege that normalises social hierarchies and highly unequal access to the fruits of progress, political participation and production assets. We must consolidate a culture of equal rights, which is the direct opposite of the culture of privilege." The core argument of the report is that more inclusive and meritocratic institutions are better for increasing productivity, and create positive externalities. One example is that the benefits of the internet-based digital revolution will be greater if the highest possible proportion of the population enjoys broadband connectivity.

The report highlights the extent of the challenge facing Latin America and the Caribbean (LAC). The LAC region is the most unequal in the world, with a Gini coefficient of 0.5, compared with 0.45 for Sub Saharan Africa, 0.4 for East Asia and the Pacific, and 0.3 for the developed countries in the OECD. Tax evasion in LAC is 6.7% of GDP (the number refers only to income tax and VAT). There are also big gaps in access to education, a high rate of teenage motherhood, and indications of racial discrimination. Inequalities also show up in life expectancy, infant mortality, and access to drinking water. These divisions are accentuated by an economic model based on the extraction of natural resources and suffering the effects of low quality infrastructure and climate change. The response, Eclac argues, should be for regional governments to seek sustainable development in social, economic and environmental terms, by revitalising investment, fully inserting the region in the digital revolution, and focusing on decarbonisation of economic growth. The report does not provide an alternative to short-term austerity policies, but it does make the case for long-term development.

MEXICO

Critical five months start now

The 1 July election of Andrés Manuel López Obrador (AMLO) as Mexico's next president was widely expected. Now that it has happened, one element of economic uncertainty has been taken out of the picture. But from an investor's point of view there are still many other unknowns, which they are hoping will be clarified over the next five months – the period between the elections and 1 December, when the new president takes office.

There is a Mexican tradition that economic upheaval is more likely to fall in the transition year between sexenios – the six-year presidential terms in office. And if something is going to go wrong, it is likely to do so in the five-month transition period between elections and inauguration day. Mexico defaulted on its foreign debt in August 1982, in the transition point between the presidencies of José López Portillo (1976-1982) and Miguel de la Madrid (1982-1988). Again, those same dangerous five months between the presidencies of Carlos Salinas de Gortari (1988-1994) and Ernesto Zedillo (1994-2000) saw the unfolding of the 'tequila crisis', a run on the currency and the banks that eventually led to a massive devaluation in December 1994.

Of course, it does not follow that there will be a crisis in the next five months of 2018. Other six-yearly transitions have been trouble-free. But there are reasons to believe that markets will be particularly sensitive to any signs of trouble, not least because it is still not entirely clear what kind of president AMLO will be. From the investor's point of there are two possible views of AMLO: dangerous radical or responsible reformer. The next five months will help reveal what point on the spectrum between those two caricatures is to be occupied by the 'real AMLO'.

Sticking for the moment with the caricature, the 'dangerous' AMLO is seen as the man who has talked about rolling back the energy sector reforms; who has antagonised top entrepreneurs; who has threatened to cancel the project to build a new Mexico City airport; and who could, as a populist mirror image of US President Donald Trump, take Mexico impetuously out of the North American Free Trade Agreement (Nafta). Those who anticipate a responsible reformer point to the candidate's many moves to reassure the private sector, his promise to respect the independence of the central bank, and his ability to make alliances with the centre and even with some parts of the right of the political spectrum. On the energy reforms, the airport, and Nafta, AMLO and his advisers have softened their position. Supporters also point out that voter dissatisfaction with the political establishment is at record levels, particularly over issues like crime and corruption: paradoxically, a self-professed outsider like AMLO may be best qualified to bring renewal and stability.

Although the markets have had bouts of nervousness, by June an AMLO victory had been pretty much priced in to the valuation of the Mexican peso. Up until April the currency had appreciated against the US dollar, gaining 8.6% relative to its value at the beginning of the year. Then, as election nerves took their toll, by 15 June the peso had weakened to 20.86 to the US dollar, down by 5.9% on its value at the beginning of the year. On 21 June Banxico, the central bank, pushed up its benchmark interest rate to 7.75%, the second increase this year, citing higher risks to inflation. Analysts believe the central bank was also motivated by uncertainty over Nafta and the elections. After the Banxico move, the currency strengthened, reaching 19.9 to the US dollar by 29 June, the last working day before the elections. This brought the peso back to almost where it had been at the start of the year.

It is clear that over the next five months AMLO will be subject to intense market scrutiny. The president-elect will be watched for his pronunciations and appointments in three key areas. On fiscal policy he is expected to increase spending and widen the deficit, perhaps from the current 2% to 4% of GDP: plans that imply a bigger deficit will be badly received by the markets, who will want to see public sector debt being kept under control. On energy policy, the private sector believes any rollback of the 2014 energy reform, which opened the oil and gas sector to foreign investment, will delay the long-hoped for recovery in local production, which has been falling for the last decade. The third area of scrutiny is trade policy, and particularly bilateral relations with the US including the fate of Nafta negotiations. The business community wants to see signs that AMLO is committed to renegotiating a favourable Nafta agreement. One of the big unknowns is how a populist of the right (Donald Trump) and a populist of the left (AMLO) may affect US-Mexico trade, which is of central importance to the future growth of the Mexican economy.

As might be expected, analysts are split into optimistic and pessimistic camps over prospects for the Mexican economy. Michael Roche of Seaport Global Holdings suggests that post-election, the peso will be under further pressure. Rafael Elias of Exotix Capital suggests the peso could fall as low as 27 to the US dollar by 1 December. On the other hand Shamaila Khan, director of emerging market debt at Alliance Bernstein, says AMLO's presidency could be similar to the initial period of Luiz Inácio Lula da Silva's presidency in Brazil. Lula came to office in 2003 on a left-wing reformist platform, but surprised many with a raft of business-friendly policies. Mauro Roca of TCW Group said he expects Mexican assets to weaken after the elections, but then rally when investors realise that the country's fundamentals remain strong. "We're talking about changes in the margin. Mexico is not going to lose its investment grade," he said.

ARGENTINA

Not out of the woods yet

Despite the announcement of a US$50bn financial support package from the IMF, Argentina's financial markets remain turbulent. The Buenos Aires stock market suffered a 'black Wednesday' on 27 June when the Merval index fell 8.9%, one of the biggest single one-day drops since the 1990s. By the following Friday, 29 June, there had been another steep fall in the value of the peso, which touched 30 to the US dollar.

It seemed clear at the beginning of July that the major package of IMF financial support, confirmed the previous month, had not been enough to prevent ongoing waves of speculation against the peso and Argentine assets in general. Argentine sovereign bond prices have plummeted. Nor, apparently, did the government's appointment of Luis Caputo, previously the finance minister, as a new hawkish president of the central bank (Banco Central de la República Argentina – BCRA) on 14 June, halt the panic. Caputo replaced Federico Sturzeneger. On 26 June the new BCRA team had said it was holding the benchmark interest rate at the eye-wateringly high level of 40%, where it had been since May, and where it would continue until there were signs that domestic inflation was beginning to fall to the adjusted target range (26% by the end of this year and 17% by the end of 2019).

Analysts have been seeking to explain why there have been repeated runs on the peso despite the government's stabilisation efforts. Economist Germán Fermo argued that notwithstanding the IMF deal the twin current account and fiscal deficits have continued to make Argentina particularly vulnerable, and international currency traders have sensed there is money to be made by betting against the peso. "I imagine the market is testing Caputo to see how he will react," he said, adding, "The reality is that our economy has a pile of problems and the IMF's US$50bn is being seen as a blank cheque and nothing more." Fermo's recommendation was bleak and politically difficult to deliver: he thought Argentina needed "five years of sacrifice" to eliminate the fiscal deficit, and that until that was done there could be no sustainable economic recovery.

Analyst Jimena Blanco of Verisk Maplecroft highlighted the heavy debt loads that have been incurred during the Macri government. She commented, "After two years of unpalatable government measures focused on the removal of utility tariffs and other long-standing subsidies, the fiscal deficit is still structurally too high, and public debt has risen exponentially, both external bond debt and internal debt including central bank deficit financing."

Certainly all the latest economic statistics suggest that the economy is turning for the worse, showing the accumulated impact of continued turbulence over

Upgrade amid the bad news

On 21 June MSCI, the global financial data company said its Argentina Index would be reclassified to Emerging Market status, up from the previous Frontier Market status. The change would take effect from May 2019, when the MSCI Argentina Index would represent around 0.4% of the global MSCI Emerging Markets Index. The upgrade is significant because many global asset funds can only invest in stocks and shares with Emerging Market status, and are prevented by internal rules from investing in Frontier Markets, which are seen as riskier and more volatile. In a statement, MSCI said, "While Argentina's most recent economic woes demonstrate its prospective challenges, international consensus remains sufficiently confident in Argentina's long-term commitments to boosting market access and facilitating international investment." Argentina had previously enjoyed Emerging Market status, but had been downgraded to Frontier Market in 2009. MSCI said that this time the restored Emerging Markets status will apply only to foreign listings of Argentine companies, since these enjoyed better liquidity.

the last three months (April-June). Things have not been helped by a drought which has cost the country an estimated US$5.9bn in lost agricultural exports, according to the grain producers' association, Bolsa de Cereales de Buenos Aires. Retail sales by small and medium-sized companies, a sector particularly hard-hit by the crisis, fell 2.8% in the first half of the year. Large retailers were also in trouble: Carsa and Santiago Saenz, citing falling sales, filed for protective bankruptcy while kitchenware retailer Longvie had its credit rating cut. Industrial output was down by 1.2% year-on-year in May. Construction activity in the same month fell by 5.8% on last year. Overall economic activity fell by 0.9% year-on-year in April, the steepest decline since President Mauricio Macri took office in December 2015. It was also the first contraction in 14 months. On a month-on-month basis the fall was 2.7%. "It is almost certain that Argentina will fall into recession. We won't see the recovery until the end of the year," said Fausto Spotorno of consultancy Orlando J. Ferreres & Asociados. The government itself has cut the official GDP growth forecast for this year from the original 3% to "around 1%".

A potential consolation for the government was that, at least up until the end of June, the consensus among economists appeared to be that the coming recession would be relatively short. The BCRA spoke of a "temporary deceleration" of growth in 2018. Its latest survey of independent economists showed GDP contractions are now expected for the second and third quarters, which were previously predicted to be either flat or in positive territory. Daniel Artana at think tank FIEL said "It will be a mild recession," although he added it could get worse if there is a global financial tightening and an exodus from emerging market assets: "It depends on what happens in the rest of the world in the months ahead, not just in Argentina."

CUBA

Economic growth deemed "acceptable" in the first half

The first deputy minister for Economy & Planning, Alejandro Gil, described the economy's performance as "acceptable" in the first half of 2018 in a presentation to the Council of Ministers in mid-June. This came despite significant external and domestic headwinds, including the impact of import restrictions, a sharp drop in the sugarcane harvest and – although he did not mention it specifically – ongoing reductions in cheap oil import from Venezuela.

There were fewer concrete statistics made available by the authorities following the presentation to the Council of Ministers. The government has usually, in the past, provided an estimate of first-half GDP growth at the time of the official discussion, but this time the economy minister gave little indication of the likely pace of GDP growth. This is possibly explained by the fact that in recent years, growth has tended to be stronger in the first half of the year, raising expectations for the trajectory during the following six months, with full-year results subsequently disappointing. In June 2016, the economy minister stated that GDP growth came in at an estimated 1.1% during the first half, with full-year results subsequently revealing growth of just 0.5%. In June 2017, the authorities announced that first-half growth was in line with the official 2% target, with full-year growth then disappointing, at 1.6%.

Sugar harvest likely to register a century's low

The government has retained the 2% growth target for 2018, but Minister Gil's imprecise comments about an "acceptable" rate of growth imply that the economy is expanding at a more moderate (although not disastrous) pace. This is likely to be a reasonable result given the range of domestic and external headwinds facing the economy. Domestically, reports emerged in mid-June that the impact of Hurricane Irma in September 2017 and subsequent erratic weather (unseasonably wet weather in early 2018, followed by severe flooding in May) has devastated the sugar harvest. The crop season runs from November-May, but hurricane damage forced mills to close in November-December, which has meant that the unusually heavy rains experienced in early 2018 had a severe impact on this crop year's results. After producing 1.8m tonnes of sugarcane in the 2016/2017 crop year, Azcuba (the state sugar company) was targeting output of 1.6m tonnes, on the basis that drought last year affected growing conditions. However, recent reports indicated that the 2017/018 harvest is reported to have fallen to 1.1m – the lowest in over a century. Planting is also reported to have been delayed for the 2018/2019 season owing to recent heavy rain. Meanwhile, an ongoing lack of investment continues to contribute to high levels of inefficiency, with processing facilities in particular hit by power cuts.

Sugar accounts for a relatively small share of GDP. The data are not disaggregated into such detail, but sugar accounts for the lion's share of overall agricultural production, which in turn accounts for under 5% of GDP. As such, the impact on GDP growth will not be as catastrophic as the headline sugar production data indicate. That said, the industry is still a significant rural employer and export earnings provide an important source of foreign exchange. Although around 600,000-700,000 tonnes of total sugar production is retained for domestic consumption, the remainder is exported, mainly to China.

Export earnings under pressure

During the presentation to the National Assembly, Minister Gil also referenced the loose "non-compliance with (expected) revenues" as a result of weaker export earnings, which is likely to partly reflect lower sugar exports. It is also likely to reflect lower exports of medical services, which are dominated by a doctors-for-oil swap with Venezuela. Lower oil shipments from Venezuela, however, are likely to have prompted a fall in medical services exports from Cuba. In the press releases following the National Assembly meeting, no specific mention was made of Venezuela, but it is little secret that the latter's severe economic and political problems are having significant reverberations on the Cuban economy. This will be particularly true given the steady increase in global oil prices this year, which will place strain on Cuba's external accounts given relatively low levels of estimated reserves.

There has been little indication of pressures on Cuba's public finances, but deteriorating external conditions (higher oil prices, in particular) have in the past lifted the fiscal deficit significantly. During the Council of Ministers meeting, officials discussed the outturn from 2017, with the deficit coming in below official projections as a result of above-budget revenue and below-budget expenditure. Although there was no formal recognition, the authorities will struggle to shrink the deficit further this year. Reflecting these concerns, President Miguel Díaz-Canel reinforced that government oversight of the budget must increase, with more regular discussions at the Council of Ministers about the year-to-date figures. This implies that the government may be willing to make further spending cuts later in the year in order to prevent a sharp widening of the fiscal deficit.

Government pins hopes on tourism

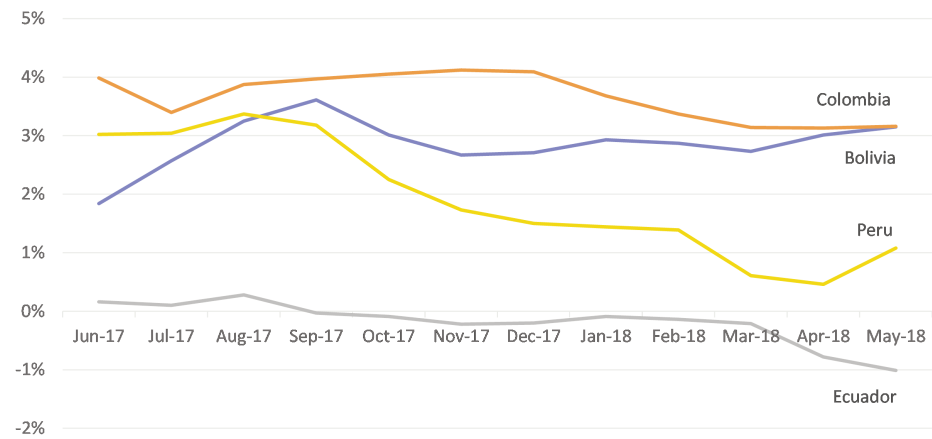
One of the only positive developments outlined at the Council of Ministers meeting was a strong performance by the tourism sector, but even here the actual outturn is likely to be weaker than the rhetoric suggests. Minister Gil highlighted the fact that tourist arrivals exceeded 2m in the first half of 2018, but they have done so for the past two years. Detailed data from the first quarter of the year showed that tourist arrivals actually fell by 7%, so even if arrivals surpassed the 2m mark in the first half, they could still have registered a decline. The government continues to project full-year tourist arrivals of a record 5m, up from 4.7m in 2017. However, even if the island does manage to reach this goal, it is unclear whether this will be sufficient to offset the various other negative economic developments in recent months.

ECONOMIC HIGHLIGHTS

ANDEAN COUNTRIES

Andean Countries: Inflation rate (%)

Percentage variation (year-on-year)



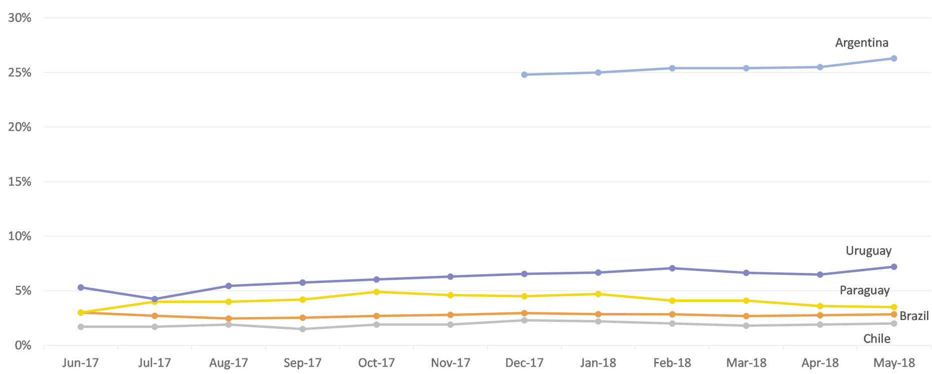
Source: *Local central banks. No reliable data available for Venezuela.*

Andean Countries: GDP growth									
Quarterly figures are year-on-year growth									
GDP	**end 2017***	**2018 forecast****	**Q3 2016**	**Q4 2016**	**Q1 2017**	**Q2 2017**	**Q3 2017**	**Q4 2017**	**Q1 2018**
Bolivia	3.9	4	4.7	4.2	3.8	3.9	-	-	-
Colombia	1.8	2.6	1.2	1.6	1.2	1.3	2	1.6	2.2
Ecuador	1	1.3	-1.6	1.5	2.2	3.3	3.8	3.0	-
Peru	2.5	3.5	4.5	3	2.1	2.4	2.5	2.2	3.2
Venezuela	-9.5	-5.5	-	-	-	-	-	-	-
**Figures from the United Nations Economic Commission for Latin America & Caribbean December 2017*									
***Figures from the United Nations Economic Commission for Latin America & Caribbean April 2018*									
Quarterly growth based on figures from the local central banks. Bolivia has ceased providing quarterly y-o-y GDP data.									

BRAZIL & SOUTHERN CONE

Brazil & Southern Cone: Inflation rate (%)

Percentage variation (year-on-year)



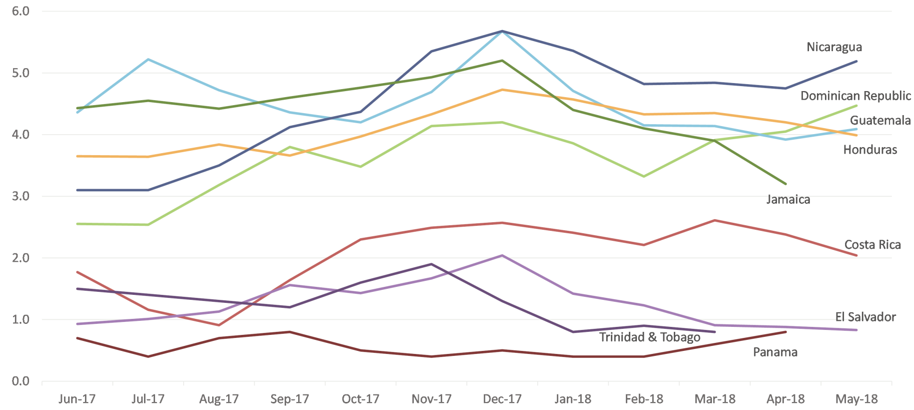
GDP growth (%)						
	End 2017*	**2018 forecast****	**Q2 2017**	**Q3 2017**	**Q4 2017**	**Q1 2018**
Argentina	-1.30%	2.20%	3.00%	3.80%	3.90%	3.60%
Brazil	-0.90%	2.00%	-1.21%	-0.17%	0.99%	1.29%
Chile	1.50%	2.80%	0.50%	2.50%	3.30%	4.2%
Paraguay	4.00%	4.50%	1.50%	3.10%	4.50%	-
Uruguay	3.00%	3.20%	2.80%	2.20%	2.00%	2.20%
Annualised quarterly growth based on figures from local central banks.						

ECONOMIC HIGHLIGHTS

CENTRAL AMERICA & CARIBBEAN

Central America & Caribbean: Inflation Rate

Percentage variation (year-on-year, selected countries, latest available data)

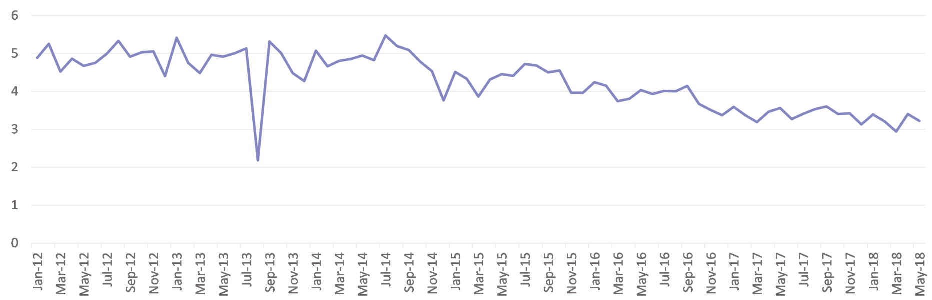


Central America & Caribbean, selected countries: GDP growth							
Quarterly figures are year-on-year growth							
GDP	**end 2017***	**2018 forecast***	**Q4 2016**	**Q1 2017**	**Q2 2017**	**Q3 2017**	**Q4 2017**
Costa Rica	3.9	4.1	4.1	2.9	2.7	2.8	3.2
Dominican Republic	4.9	5.1	5.9	5.3	3	3	6.5
El Salvador	2.4	2.5	2.6	2.3	2.3	2.4	2.4
Guatemala	3.2	3.5	3	3	2.3	2.7	2.9
Honduras	3.9	3.9	4.4	5.9	4.5	6.5	3.6
Nicaragua	4.9	5	3.8	6.6	4.3	3.2	4.3-
Panama	5.3	5.5	4.5	6.2	5.4	5.4	4.9
Jamaica	1.2	1.3	1.4	0.1	-0.1	range of 0.5%-1.5%	range of 1.0%-2.0%
Trinidad & Tobago	-2.3	0.5	-6.9	-6.9	-3.2	3.1	-
**Figures from the United Nations Economic Commission for Latin America & Caribbean Dec 2017*							
Quarterly growth based on figures from the local central banks							

MEXICO & NAFTA

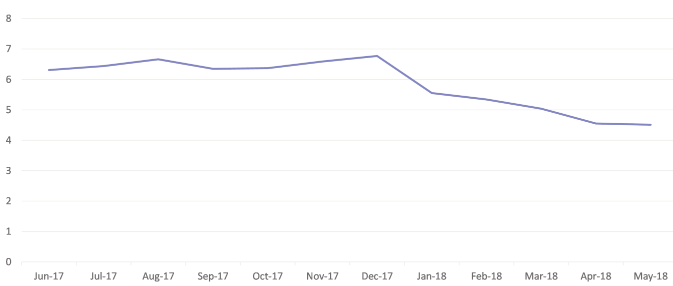
Mexico's unemployment rate

Economically active population



Mexico's inflation rate

Percentage variation (year-on-year)



Mexico's GPD

Percentage variation (year-on-year)

Source (all Mexico Highlights data): *National Statistics Institute (Inegi)*

Barbados enters selective default

It has been a baptism of fire for the government led by Mia Motley, elected on 24 May. Although the incoming administration knew it faced economic challenges, a reassessment of the public debt burden – which put liabilities at 175% of GDP, higher than the previously estimated 135% of GDP – prompted the government to suspend external debt payments from early-June.

The government faced little choice in announcing a selective default, after discovering the additional liabilities, as well as large amounts of money that was either overdue or falling due in June. This includes a US$100m repayment on a Credit Suisse loan taken out in 2013, as well as a number of unpaid bills and transfers (to the University of West Indies, state owned companies and other wire transfers), totalling B$1.3bn (around US$660m). In a press briefing a week after taking office, Prime Minister Motley detailed a number of other financial pressures, including B$345m owed by the Revenue Authority to taxpayers, as well as a number of loss-making state companies.

The prime minister announced that external debt repayments would be suspended with immediate effect. The government would endeavour to make interest payments to domestic creditors, but she requested that creditors agree to roll over principal maturities while the authorities negotiate a debt restructuring. For this, Barbados has turned to the International Monetary Fund (IMF), with Prime Minister Motley speaking with the Fund's Managing Director, Christine Lagarde, at the beginning of June to seek balance-of-payments assistance.

The IMF sends an emergency mission

An IMF mission arrived in the capital, Bridgetown, on 5 June, and held discussions with the prime minister, as well as the central bank governor, other ministers, and representatives from the private sector. At the end of the emergency visit, on 7 June, the IMF released a statement that echoed the government's alarm, stating that central government debt was "unsustainable" and that the overall economic position was "precarious". A second mission was scheduled for early July, with the government stating that it hoped to reach a formal lending agreement upon the completion of the visit on 12 July. Meanwhile, on 7 June, the credit ratings agency Standard & Poor's downgraded Barbados' long-term foreign currency rating to selective default (SD), from CCC+ previously, as well as the long-term local currency rating to CCC, from CC.

IMF requirements under a new lending package are likely to include a reduction of the fiscal deficit (which stood at 4% of GDP in the 2017/2018 financial year), mainly through efforts to reduce expenditure since the IMF has already noted that tax revenues are already high. Keeping the public sector wage bill and reforming pensions are likely to be priorities, alongside efforts to improve the financial position of state-owned companies (and potentially divesture of some government stakes). Given that international reserves have fallen to just US$220m (representing less than two months of import cover), efforts will be designed to bolster the external accounts and prevent a further run-down of reserves.

ECUADOR

Deflation begins to weigh on economy

At a time when many countries in the region are facing the prospect of a rise in inflation, as recent sharp local-currency depreciation feeds through to higher import prices and the knock-on effect of higher retail prices, Ecuador is experiencing deflation. The consumer price index registered a 0.18% month-on-month fall in May, following a 0.14% decline in April. In year-on-year terms, inflation has been negative since last September, but May's result (-1%) was the lowest in this string of data.

It is the prices of many goods, rather than services, that is driving the recent bout of deflation. Food and non-alcoholic beverages (which account for the largest share of the consumer price index, at 22.5%) fell by 3.2% year on year in May, following a 3.3% decline in April. Clothing prices fell by 4% year on year in both April and May, while housing goods & equipment fell by 1.6% and 1.4% respectively in these months. Alcoholic beverage prices rose very marginally in May (0.1% year on year) but followed several months of deflation previously. Services prices generally came in higher, although in most areas they still remained low by historical comparison. Utilities prices increased by 1.3% year on year in both April and May, while healthcare price inflation came in at 1.1% and 1.4% respectively. Hotels, cafés and restaurants (a proxy for tourism) registered annual inflation of 0.4% and 0.9% respectively in April and May.

US dollar appreciation holds down import prices

Deflation among goods-related sectors is explained by the appreciation of the US dollar so far this year, which has reduced import prices. This, in turn, is likely to have been passed onto the consumer via lower retail prices, particularly because underlying economic growth remains relatively weak (spurring retailers to cut prices in order to attract customers). Weak domestic demand is also likely to have been a factor behind the low inflation results in services-related areas of the consumer price index, also encouraging cuts in retail prices in an effort to boost interest. Given Ecuador's status as a net oil exporter, the consumer price index has been less affected by rises in global oil prices than net oil importers; indeed, the transportation sub-sector of the consumer price index fell by 0.3% month on month in May, and by 0.6% year on year.

The problem with deflation is that it can become a vicious circle, with the public delaying purchases because prices are falling, but then not only does weaker private consumption undermine GDP growth, but retailers often feel pressurised into further price cuts and employers cut wages, deepening the deflationary cycle. Japan is perhaps the classic example of a long-run, problematic cycle of deflation and extremely weak economic growth. Although there is little indication that deflation will take hold in Ecuador in the same way as it did in Japan, it is likely to hamper growth in domestic demand this year in Ecuador.

REGIONAL BUSINESS REVIEW

REGION

Mobile getting more competitive

The big boom in Latin American mobile telephony, which saw the emergence of one or two dominant players in the key markets, may be entering a different and more competitive stage. New entrants are helping keep down mobile tariffs.

The big story in the Mexican mobile phone market last year was the arrival of US giant AT&T to fight incumbents Telcel (part of Carlos Slim's América Móvil) and Movistar (owned by Telefónica of Spain). In terms of mobile revenues, AT&T pushed up into second rank, bypassing Movistar, but still behind Telcel. In terms of paid-up subscribers, however, AT&T remained in the number three slot behind Movistar. The Mexican market is still dominated by pay-as-you-go or pre-paid subscribers (82.1% of the total) but the proportion of post-paid and smart phone customers is excepted to grow, and it is in this segment that AT&T is particularly well positioned. The telecoms reform law of 2014, which forced dominant players to grant infrastructure network access to new entrants, has facilitated the move away from a duopoly in Mexico.

Jorge Negrete of consultancy Mediatelecom Policy & Law says AT&T was the "big winner" in Mexico last year, with stronger growth in subscribers and revenues than its competitors. It has invested intensely in developing its network, and is still seen as a new brand. AT&T's way into the Mexican market was by buying two small operators, Iusacell and Nextel, and making them grow. It has also benefited from the fact that it is developing a North American network (for a customer base in Mexico, Canada, and the US). Because of the focus on a single technical standard for this larger market it is able to invest more extensively in Mexico than a single-country operator might be able to. Radamés Camargo of The Competitive Intelligence Unit (CIU) say new market entrants like AT&T are making Latin American telecoms markets more competitive.

Mexico has also seen a lot of small new entrants, including those using virtual mobile networks (known as Operadores Móviles Virtuales or OMVs). Kristian Kuhn, chief executive of Simplii, an OMV, says there is space for them in the market because consumers are often unhappy with the service they get from the dominant companies. He notes that according the office of the federal prosecutor for consumers (Procuradoría Federal del Consumidor, Profeco), roughly 50% of mobile phone users are unhappy with their operating companies. Admittedly, there are 16 Mexican OMVs and between them they control only 1.2% of the market. In Colombia, however, Virgin Mobile, also an OMV, has achieved a 4% share. This success has been attributed, among other factors, to the company's innovative approach – it is the first to introduce charging by the second, rather than by the minute.

A similar story of new entrants challenging the incumbents is being told in Peru. Last year two new operators, Entel of Chile and Bitel of Vietnam, made major inroads. According to Ospitel, the telecoms market regulator, Entel raised its market share to 16.3% of subscribers, while the share achieved by Bitel was 13.5%. Market leader Movistar saw its share drop by 6.5 percentage points to 38%. Claro (owned by Mexico's América Móvil) was the number two with 32%. Negrete says there is a pattern playing out across Peru, Colombia, and Mexico. Gone are the days in which a dominant operator could hold a 40%-50% market share. Consumers are shopping around much more, and many are migrating away from the dominant players. AT&T is one of the big winners taking market share away from América Móvil and Telefónica. The Spanish company has so far managed to limit the impact on its bottom line by improving its internal cost control. But a number of analysts warn that it now needs to raise its game

The newcomers in Peru are sharpening their marketing strategy. Chief executive Phan Hoang Viet of Bitel says his company is focusing on the high-speed data services that key customers are demanding, and ensuring that the network can provide the necessary technical quality. Entel also focuses on data and on special offers and promotions such as two-for-one cinema tickets. Together, Entel and Bitel had successfully shaken the two Peruvian incumbents “out of their comfort zone”.

Camargo of CIU says Entel has benefited from techniques it has developed in its home market in Chile: although comparatively small, in his opinion competition in the Chilean mobile telephony market is almost as intense as it is in the United States. That doesn’t mean there aren’t any opportunities. Chris Bannister of WOM, the number four operator in Chile, says local tariffs per gigabyte have been high for data services of fairly low quality, so his company is seeking to come up with a better value proposition.

At a pan-regional level all mobile telephony providers face some shared challenges. As the business becomes more competitive, tariffs have fallen, putting pressure on profitability. One aspect of this is the fall in average revenues per user (ARPUs). This has reflected lower economic growth and the maturing of the market, as mobile phone ownership extends to cover most of the population. According to mobile phone company association GSM, Latin American ARPUs measured in US dollars fell by an annual average of 2.6% from 2010-2015 and were expected to continue dropping by 2.8% a year until 2020. As growth in subscribers levels off and tariffs fall, overall revenue growth, measured in US dollars, is unlikely to exceed 1% per annum until 2020, GSM predicts. This compares with 4% over the last five years. Another analyst, Roberto Baltra of Baltra Consultores, says that in response to these financial pressures, companies will have to invest to meet changing customer needs, such as data transmission. He notes that the number of data-heavy videos transmitted by WhatsApp quadrupled between 2016 and 2017. UK based analysts Ovum says the big challenge for Latin American mobile operators is to catch up with the necessary 4G investments to upgrade networks so as to cope with the data boom. Market penetration of 4G networks is 80% in the United States, over 50% in Europe, and only 19% in Latin America. Operators in the more developed economies are already preparing for 5G. For some, the big investments required to upgrade network speeds and data handling capacity may give the larger Latin American operators a route to re-establishing lost market share.

Brazil goes for smartphones

According to a survey by Pew Research Centre, 54% of Brazilian adults now own smartphones, up from 15% five years ago. Smartphone ownership appears to be leading to greater use of the internet, particularly among the young. Pew found that 90% of 18-36 year olds “occasionally” access the internet, compared with a lower 57% for people aged 37 years or older. Mobile telephony now represents 43.5% of total telecom company earnings. As in other countries the industry is seeing a major shift from voice to data, marked by increasing use of social media apps such as WhatsApp and Snapchat. Although the market remains highly concentrated, mobile phone operators have had to cut fees and tariffs to try to preserve market share. Investment spending has been squeezed, leading to lower quality and speeds of internet access. Brazil is now ranked 79th in the world by speed of internet access, at 7.2 Mbps (South Korea has an average speed of 28.6Mbps, while neighbouring Uruguay achieves 9.6 Mbps).

VENEZUELA

Oil production nosedives

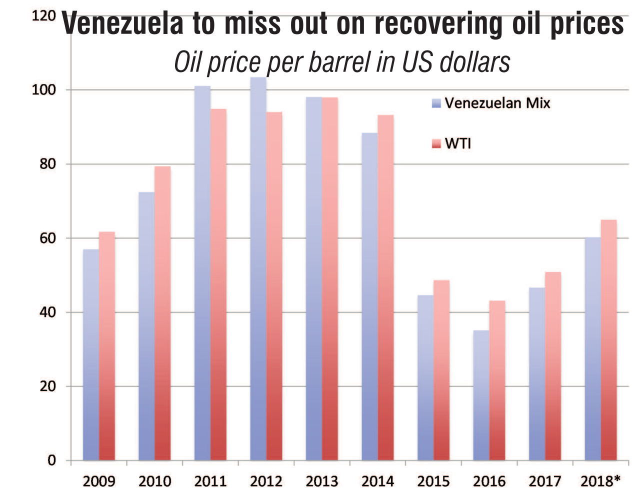
Prices are finally picking up after a long slump in the international oil market. So far this year Venezuela’s mix of heavy and light crudes has sold for an average of US$60.25 a barrel, 29% higher than the average for last year. This

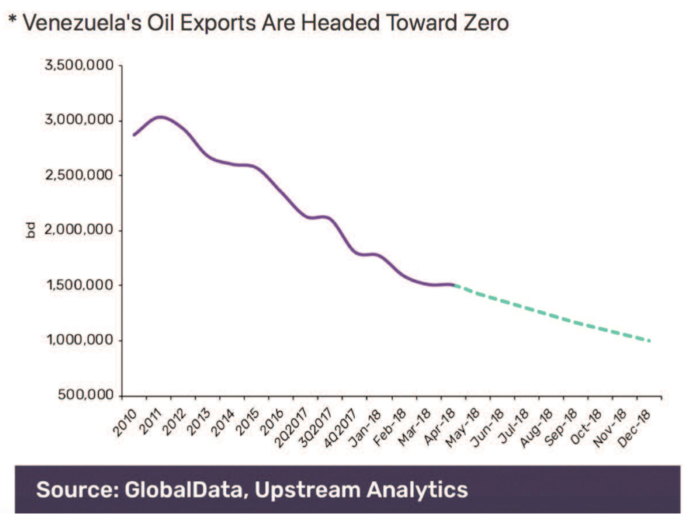
would be good news for the Venezuelan government if not for one dramatic fact: Venezuelan crude oil production is collapsing at an alarming rate.

The Venezuelan government does not publish reliable crude oil production data (although it does share figures with the Organisation of Petroleum Exporting Countries, Opec). However, no one denies that production has been falling steeply from a peak of around 3m barrels per day (bpd) in 2011, down to somewhere around 1.5m bpd in June this year. Adrian Lara, an oil and gas analyst at GlobalData, says, "Crude oil production in Venezuela is practically falling at an average of 10% every quarter, and has been since mid-2017. A scenario with oil production in the country losing at least another 500,000 barrels per day by the end of the year is not unrealistic."

In May the Intentional Energy Authority (IEA) commented, "In Venezuela, the pace of decline of oil production is accelerating and by the end of this year output could have fallen by several hundred thousand barrels per day." Francisco Monaldi, a Venezuelan oil expert at the Baker Institute in Houston, says, "It is better for the Venezuelan government that oil prices should go up, rather than go down. But the average price increase so far this year has not been enough to compensate for the fall in output. In net terms, Venezuela's oil income is down this year."

Prices up, production down





Source: *Venezuelan goverenment, Statista*

Venezuelan oil minister Manuel Quevedo, attending an Opec meeting in Vienna, responded with a degree of bluster. On 20 June he said his country had "a lot" of capacity to increase production, given that it had the world's largest oil reserves and a "historic" oil and gas industry. He did admit however that the target demanded by President Nicolas Maduro – to add 1m barrels per day of extra output by the end of this year – would be "challenging". International oil analysts on the other hand see absolutely no chance of that objective being met.

The reality is that Venezuela's oil and gas industry is in a mess that will take years to resolve. The steep fall in output is attributed to a range of factors, principally a lack of investment, mismanagement, and corruption. Experienced and qualified oil engineers have been fleeing the country for years, creating a brain drain that has relentlessly weakened the state oil company. In November last year Quevedo, an army general with no oil industry experience, was put in charge of both PDVSA and the energy ministry and ordered to restructure the entire sector. He has attributed the lack of investment to the operation of "mafias" within the company. At the end of June, 11 PDVSA managers were arrested, accused of "premeditated negligence" and "serious errors" in the handling of shipments, which in two incidents caused the loss of over 2m barrels of crude and petrol. Since August 2017, a total of 90 PDVSA employees have been arrested on corruption charges: the list includes 23 senior managers, a former oil minister, and a former PDVSA president.

To make matters worse a combination of transport and supply difficulties are complicating the flow of products to the downstream sector. US major Conoco Phillips has been seeking to seize PDVSA assets on several Caribbean islands to enforce an arbitration decision in its favour. This has affected PDVSA's ability to use its storage facilities on the islands of Bonaire, Curaçao, and Aruba, which are crucial for serving very large crude carriers (VLCCs) and for storing and blending Venezuelan crude. PDVSA then sought to increase its use of Venezuelan ports, but these are in very poor state: as a result there have been big bottlenecks, with up to 70 tankers waiting off the Venezuelan coast to load. Another work-around is to increase ship-to-ship-loadings, but these are more expensive. As a result of all these factors industry analysts say PDVSA is delivering less than it has promised to its customers. *Reuters* estimated that in April Venezuela shipped 1.49m bpd, or 665,000bpd below what it was legally contracted to deliver.

The situation is unlikely to improve quickly. Monaldi estimates that simply to maintain output at current levels, replacing exhausted oil fields with new ones, Venezuela would need to be deploying around 55 drilling rigs. But according to US oil services company Baker Hughes there are only 36 rigs operating in the country. Many of PDVSA's contractors have not been paid. The US government has imposed sanctions that affect the oil industry (for example they prevent PDVSA from issuing bonds to raise loans in capital markets).

Another big problem is that the proportion of oil production that actually generates cash flow for the country has fallen significantly. Of the roughly 1.5m bpd currently produced, 400,000bpd cover domestic consumption (sold in Venezuela at heavily subsidised prices). Various hundreds of thousands of barrels per day are shipped to China, Russia, and Cuba as part of barter deals or to pay interest in kind on earlier financial loans. As a result only 450,000 to 650,000bpd – less than half total production – generates foreign currency earnings for the country. This proportion could fall further if China does not extend an initial interest-free period on some of its loans. To make matters worse, Venezuela also needs to import between 120,000 and 200,000bpd of lighter crudes to mix with its heavier ones.

BRAZIL

New battle over privatisation

Although by now considered something of a lame duck administration, the government of President Michel Temer, which has six months left in office, is still trying to press ahead with plans to privatise state companies. To do so it will need to navigate a new legal challenge coming from the supreme court.

On 27 June Supreme Court Justice Ricardo Lewandowski ruled that congress must individually approve the full or partial sale of state-controlled companies, including their subsidiaries. The ruling has yet to be confirmed by the full supreme court, but it has important implications for the asset-selling programmes followed by giant state-owned companies such as Petrobras (oil and gas) and Eletrobras (the power utility formally known as Centrais Eléctricas Brasileiras). The ruling came in response to a bank workers' union legal challenge relating to a November 2016 law, which they suggested was unconstitutional. That law, passed after a wave of corruption scandals, required state companies to create risk management committees, put in place internal controls, and publish codes of conduct. Asked to rule on how it dealt with the matter of privatisations, Lewandowski said that because the text does not specifically say that congressional authorisation for divestments is not needed, then it must be assumed that the authorisation is needed, on a case-by-case basis.

The government said it would mount a legal appeal against Lewandowski's interpretation and that it hoped the plenum of the supreme court would in any case reverse it. Mining minister Moreira Franco said he hoped "common sense" would prevail, and that would mean allowing privatisations to go ahead without further legislative authorisation. At issue is the proposed sale of six Eletrobras power distribution companies, scheduled for 26 July. The minister said the financial difficulties and poor quality of transmission infrastructure operated by the six was increasing costs and forcing higher-than-necessary electricity tariffs around the country. The privatisation process required private sector bidders for these companies to meet investment and modernisation targets, meaning that the ultimate result would be lower electricity charges for the population. Moreira Franco added that the closing date for the tender should not be altered. However, analysts believe the legal battle is far from over.

On 2 July the government signalled its desire to press ahead by announcing it was adding 14 new assets to its privatisation programme. The list included more power transmission companies, highways, railway services, and oil and gas concessions. Together they were estimated to be worth around BRL100bn (US$25.57bn). A total of ten transmission companies between them accounted for 4,807km of power lines across 11 of Brazil's 27 states. Also up for sale were 515km of highways in the state of Santa Catarina. The government added in four pre-salt deepwater 35-year oil and gas concessions, in effect creating a fifth round of pre-salt auctions. Also on the block was a 53km passenger and freight rail line in São Paulo state and a centre-west rail link in Mato Grosso state.

The government says that in all, it has around 80 concession projects underway, valued at BRL136bn (UD$35bn). It aims to complete them by 1 January 2019, Temer's last day in office. If, however, these divestments require individual congressional approval, the sale programme is likely to be severely curtailed: what happens after that will depend on the political colour of the new government taking office at the beginning of next year.

Truckers' strike casts a long shadow

The government is still trying to unravel some of the consequences of the 10-day truckers' strike at the end of May. The strike, which seriously disrupted the economy, ended when government officials made a range of concessions and promises. Implementing them is proving a complicated affair. The strikers wanted an end to market-based fuel pricing by state oil company Petrobras. While government officials seemed to be moving in that direction (causing the chief executive of Petrobras to resign) in the end they did not change the status quo, instead offering the truckers a BRL0.46 per litre reduction on the price of diesel – a subsidy thought to cost around BRL9.6bn (US$2.45bn). The government also agreed on 30 May to publish a reference table for minimum freight prices. But dozens of haulage companies have now filed legal challenges against the table, which they say is an illegal form of price control – an issue that has joined the long list of cases pending consideration by the supreme court.

Separately, on 20 June the Chamber of Deputies approved a government bill intended to make good on a long list of other promises made to the truckers. It states that independent truckers cannot be considered employees of haulage companies.

Nevertheless, it allows individual or collective bargaining agreements covering issues such as losses and damage, payment dates and methods, and subcontracting. Even if cargoes have been stolen, it establishes that truckers have the right to payment in full. Safety requirements are tightened (including mandatory travel insurance). Truck drivers are given special leniency for traffic infractions. Brazil operates a points system, with three points being awarded for minor traffic infractions, up to seven for very serious infractions. If drivers accumulate more than 20 points in a given year they lose their licence. But the bill raises the threshold for truck drivers to double that – 40 points.

On 28 June Brazil's central bank (BCB) cut back its GDP growth estimate for this year to 1.6%, down from 2.6%, largely because of the impact of the truckers' strike, which it said had "direct and indirect" effects on the economy. The bank added that the impact of the strike was likely to have spilled over into June "affecting the growth dynamic of the second quarter and influencing the downward revision to annual growth". The strike is also cited as a factor in slightly higher projections for inflation this year, up to 4.2% from 3.8% in the BCB's March outlook. A number of economists have been reflecting on whether Brazil is excessively reliant on rail transport. Two-thirds of the country's freight is carried by road, and if crude oil and iron ore are excluded (mainly carried by pipelines and rail), dependence on the roads goes up to 90%. An auto-parts shipper told freight website JOC.com "It is insane. To be held to ransom like this by one truckers' union is not how a market economy is supposed to work. Successive governments have failed to address the imbalance between road, railroad, and sea/navigable waterways. In Brazil, who screams loudest wins."

REGION

Corporate Radar

Armoured cars – a Mexican growth sector. Concern over crime and insecurity in Mexico has at least one upside for the automobile industry – growing demand for armoured cars. Arturo Ávila, himself a victim of various attacks and thefts in Mexico City, told *Reuters* news agency that sales of these vehicles by his company Share y Asociados were growing well. "One of the crimes we are concerned about is kidnapping, it is what we fear most," he said. "Driving an armoured vehicle in certain parts of the city gives me peace of mind so that I can concentrate on my work." According to the country's armoured vehicle association (Asociación Mexicana de Blindadores de Automóviles, AMBA) production this year will rise by 10% to exceed the record of 3,284 units registered in 2012. There also seems to be plenty of room to grow. Of around 1.5m passenger vehicles sold in the country in 2017 only 0.19% were armoured. Prices are not cheap – after buying the vehicle a Mexican customer can pay around US$35,000 to armour plate it against small arms fire: this is a lot more than would be paid by an equivalent customer in Brazil. Because of this AMBA is looking at lease or rental options. AMBA president Ernesto Mizrahi (who is also head of Blindajes Epel) says paying a monthly tax-deductible leasing fee is a lot more affordable than having to pay one million pesos (US$48,700) up front to buy the vehicle, followed by another 1m to have it armoured up to a high standard. While much of the sector is made up of small shops that armour commercially available four-wheel drives and SUVs, some big-name automobile manufacturers are also displaying interest. In 2017 Germany's Audi began assembling an armoured version of its Q5 range in Mexico, from where some are exported to Brazil and Argentina. BMW, Jeep, and Mercedes-Benz are also offering armoured versions of some of their models.

Fiat-Chrysler to invest US$3.7bn. At a time when global automobile companies are debating the pros and cons of off shoring versus re-shoring, Fiat-Chrysler's Latin American division, based in Brazil, has announced plans to invest US$3.7bn in the region between now and 2022. Antonio Filosa, the chief executive of Fiat-Chrysler Latin America, said the money would go into producing new more profitable models for the company. The aim was to produce over 1m vehicles in Latin America by 2022, up from 700,000 now. Investment would go principally to the Fiat, Jeep and RAM marques. But Filosa said, "What we least need are new factories. We are going to invest in product, in improving the efficiency of existing factories by automating and digitising operations there."

Volaris sees zero-tolerance opportunity. Whether companies should become involved in political issues is open to debate, but Mexican low-cost airline Volaris appears to have decided it is worth the risk. Following the uproar over the US "zero tolerance" immigration policy, which in certain circumstances led to the forcible separation of parents from their young children, Volaris offered to reunite families at no cost. In a statement the airline said, "Our hearts are heavy to see these youngsters separated from their parents and we believe it is our vocation to reunite them." The airline added, "Volaris is ready to work with the authorities in the US, in Mexico, and in those countries in Central America where we operate, to reunite boys and girls with their families as may be required." Some US airlines also took a public position on the issue. American, United, and Frontier asked the US government not to use them to transport any children separated from their parents against their will. ON 20 June US President Donald Trump indicated that the authorities would review the policy.

Walmart buy-out approved. Cade, Brazil's competition watchdog, gave its approval for the sale of 80% of Walmart's Brazilian operation to Advent International, a global investment fund. The sale came as the US retailer recognised that after 23 years in the country it had failed to make a success of the local business. The price paid for the 80% stake was not revealed but Walmart said it was taking a roughly US$4.5bn non-cash charge to partially exit its Brazilian operation. Advent plans a change of approach. It will seek to convert unprofitable hypermarkets into cash-and-carry wholesale stores, and to expand some subsidiary brands developed by Walmart in the country such as Maxxi and Todo Dia. Walmart has been wildly successful globally, but could not replicate that in Brazil. Retail analysts say this was for a number of reasons. Walmart Brazil stores had comparatively poor locations, they were inefficient, they suffered from labour disputes, and the company had no less than five chief executives in the years after 2008. But perhaps a key failing was that Walmart could not deliver its critical success factor in other markets: low prices. At its peak Walmart Brazil had 540 outlets, four times less than market leader Pão de Açucar (owned by Casino Guichard-Perrachon of France). This meant it lacked the negotiating power top secure big discounts from its suppliers.

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. **EDITOR: ANTON DITTNER. CONTRIBUTORS: ANDREW THOMPSON, KATE PARKER.** Printed by Quorum Print Services Limited, Units 3&4, Lansdown Industrial Estate, Gloucester Road, Cheltenham, Glos. GL51 8PL.

REFERENCES: Back references and cross-references in the current series will be made thus: EB-18-01 will indicate Economy & Business Report, 2018, issue 1.