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What is PPK's economic game plan?

Pedro Pablo Kuczynski (also known as PPK) won the second round of Peru's presidential elections on 5 June with a tiny margin (50.1% to 49.9% for his opponent, Keiko Fujimori). He takes office on 28 July. Here we look at some of the economic challenges he faces, and highlight his expected economic policy priorities.

There were no major ideological economic policy differences between PPK and Keiko Fujimori, of the conservative Fuerza Popular (FP). Both can be described as orthodox and market-friendly in their approach: in effect, the second round run-off was a contest between two centre-right candidates. What likely tipped the balance in Kuczynski's favour were concerns about the populist political heritage of *fujimorismo*, along with allegations of drug trafficking links in his rival's campaign finances. While for these reasons the Left supported PPK, Fujimori's FP still won a dominant position in the single-chamber legislature: it has 73 of the 130 seats, compared to only 18 for Kuczynski's party, Peruanos Por el Kambio (also known as PPK). The new government therefore will have to rely on FP support to get laws enacted.

However, according to Jaime Reusche, a senior analyst at ratings agency Moody's Investors Service, the similarities in the two main candidates' economic policy platforms should make it possible for the parties to reach consensus. Moody's has a positive outlook on the country, saying the incoming new government's technocratic and market friendly stance should boost confidence. It expects strengthened business and consumer confidence to offset the lingering negative effect of low commodity prices. Local economists say the economy will continue to be driven by mining (largely due to expanding output from new mines), exports, and an expected increase in the pace of infrastructure investment towards the end of this year.

As Peru has consistently achieved one of the highest growth rates in South America over the past decade, along with low inflation, the new government will maintain a number of tried and tested policies. Peru will continue pursuing export-led growth and open trade (it has a total of 17 free trade agreements, or FTAs, with 50 countries). It will remain an active member of the Pacific Alliance trade group (along with Chile, Colombia, and Mexico) and of the emerging Trans Pacific Partnership (TPP). It will continue its bid for membership of the Organisation of Economic Cooperation and Development (OECD).

Alfredo Thorne, a former JP Morgan executive and Oxford University alumnus (like PPK) has been appointed the next economy and finance minister. In a sign of continuity, Julio Valverde, the highly regarded head of the central bank (Banco Central de Reserva del Perú – BCRP) has agreed to stay on until 2021 – he has already been doing the job for nearly 10 years (since September 2006).

Real annual GDP growth was 3.3% in 2015, a slower rate than in earlier years because of the fall in international metals prices: the administration led by the outgoing President Ollanta Humala is predicting growth to rise to 4% in 2016; first quarter growth was comfortably over 4% year-on-year, as new copper reserves came on stream.

Thorne says the new government will seek to boost investment so as to lift growth up to 5% from 2017. There will be a strong emphasis on public-private partnerships (PPPs) in the infrastructure sector. Proinversión, the government's investment promotion agency, is to be reformed in an attempt to cut red tape and speed up the approvals process. Thorne says the new government will focus on 10-15 big projects worth around US$8bn. The biggest is the Gasoducto del Sur –a US$5bn gas pipeline currently being built by a consortium led by Brazil's Odebrecht. "Peru doesn't have a financing problem, we have a problem because we are not executing projects fast enough, and are lagging behind on infrastructure" says Thorne.

The emphasis on public sector investment, together with promises to reduce some tax rates to stimulate growth, is expected to lead to a moderate increase in Peru's moderate fiscal deficit. Kuczynski has proposed cutting the IGV sales tax from 18% to 15% over a two-year period, a move he says will reduce tax evasion. Cuts are also proposed to taxes applied to small and medium-sized enterprises. The London-based consultancy Capital Economics expects the 2015 fiscal deficit of 2.1% of GDP to widen to 2.9% by 2017, but then to narrow to 1% of GDP by the end of PPK's presidential term in 2021. As a result government debt as a proportion of GDP will rise, but it will do so from a low base (of just over 20%, compared to around 50% in Argentina, Mexico and Colombia, and nearly 70% in Brazil).

PPK is also expected to focus on crime and corruption, two hot topics in the country. A significant part of the electorate favours a hard line on law and order, but the signs are that the new government will try to balance punitive action with greater deterrence. A purge on corruption within the national police force has been promised. The president-elect has said his government will concentrate on the 15 or 20 local districts that are responsible for 60% of the national crime rate.

On the social side, Kuczynski is also promising to build schools and roads in rural areas notorious for drug production and trafficking, and wants to encourage farmers to drop coca production and switch to other, legal crops. PPK also puts strong emphasis on the need to reduce the very high proportion of the labour force that is informal – in other words, that operates outside the formal tax and benefits system. This is estimated at 64% – over two thirds of the total labour force. There is a link between informality and crime. For example informal mining, an activity involving over 100,000 Peruvians, is directly linked to gold smuggling by criminal groups, and has negative impacts on the environment. Kuczynski has promised to set up a miner's bank that will purchase gold from producers who can demonstrate compliance with tax and environmental protection laws.

He has also spoken of trying to increase value-added activities across the mining sector as a whole. One way this could be achieved would be by refining more metals in Peru. Significantly, PPK's first foreign visit after he takes office will be to China, where he hopes to raise that possibility. Two Chinese companies have major copper mines in Peru (Minmetals controls Las Bambas, while Chinalco Mining owns the Toromocho mine). Southern Copper, a subsidiary of Grupo Mexico, currently operates the only existing copper refinery in Peru. The country also has one zinc and one tin refinery.

REGION

Pacific Alliance and Mercosur: getting friendly?

Until recently, the two big Latin American trade alliances didn't have too much to say to each other. The Southern Common Market (Mercosur, comprising Argentina, Brazil, Paraguay, Uruguay and Venezuela; with Bolivia awaiting final accession) was older, more protectionist and more political. The Pacific Alliance (comprising Chile, Peru, Colombia, Mexico) was newer, more outward looking, pragmatic and flexible. But recent political changes may be altering the rules of engagement and the region could be on the verge of some important re-alignments in its trading relationships.

The paradigm established over the last five years of two rival trade alliances is gradually changing. Under the previous status quo, the Mercosur countries were trying to build a common market behind a relatively high common external tariff (CET). Dominated by left-wing or centre-left governments, Mercosur, first established in 1991, nevertheless had been held back by a series of political disagreements, as well as by lengthy on-off internal trade disputes, mainly between Argentina and Brazil. After 2012, all the countries in the bloc began to suffer from slower economic growth, as a decade-long commodities boom drew to a close (Brazil and Venezuela remain in deep recession).

By contrast, the newer Pacific Alliance, formally established in April 2011, was much more market friendly, flexible and light touch in its regulations. It sought to avoid politics (although several of its governments could be described as centrist or centre-right). The Pacific Alliance didn't impose a common external tariff, but all its members already had low tariffs and multiple free trade agreements (FTAs) in place. Notably, Pacific Alliance countries have recently enjoyed higher GDP growth rates and are widely considered more attractive by foreign investors.

Domestic political changes are altering the dynamic of the region's trade alliances. After over a decade of radical left wing *kirchnerismo* in Argentina, President Mauricio Macri, who took office last December, is steering the country in a less populist direction. Also, after more than a decade of centre-left *trabalhismo* in Brazil, and the suspension of President Dilma Rousseff pending the outcome of impeachment proceedings, the administration led by the interim president, Michel Temer, is also seeking more orthodox economic policies as a way of pulling the country out of recession.

On the Pacific Alliance side, the election of Pedro Pablo Kucynszki reaffirms Peru's investor-friendly economic policies and has fended off (by a very narrow margin) *fujimorismo*, a brand of politics associated with the disgraced former authoritarian president, Alberto Fujimori (1990-2000), that critics consider a form of right-wing populism.

With that political backdrop, the region's two trade alliances are beginning to take more notice, and talk to each other a bit more than they did in the past. The Chilean government led by President Michelle Bachelet is eager to act as a bridge between the two. So too is President Juan Manuel Santos of Colombia. Bachelet recently said that the Pacific Alliance "will not turn our backs on the Atlantic countries" and that talks between the two were going ahead on what she called a path of "convergence with diversity".

Argentina has been granted observer status in the Pacific Alliance. President Macri, who has been invited to attend the Pacific Alliance summit in Santiago

at the end of June, recently said, “We want to explore ways that Mercosur can interact much more with the Pacific Alliance, which has shown itself to be successful through various agreements”. Susana Malcorra, Macri’s foreign minister, also suggested Mercosur’s policy of pursuing trade agreements only by unanimity could be up for review. Earlier this year she said, “If we are not able to make progress from within Mercosur, we would examine the possibility of going out on our own.”

Key trade data - selected countries

	Mercosur (selected countries)			Pacific Alliance			
	Argentina	**Brazil**	**Venezuela**	**Colombia**	**Mexico**	**Peru**	**Chile**
Merchandise exports (US$bn)	71.977	225.101	80.47	54.795	397.506	39.326	76.675
Merchandise imports (US$bn)	65.324	239.15	44.28	64.029	411.581	42.346	72.159
Trade per capita (US$, 2012-14)	4,237	2,936	5,264	2,845	6,672	3,162	10,028
Trade to GDP ratio (2012-14 %)	29.8	24.7	38	36.6	65.6	48.2	66.3
Simple average of MFN import duties applied (%)	13.6	13.5	12.9	5.8	7.5	3.4	6
Composition of exports (% of total):							
Agricultural exports	52.6	39	0.1	13.4	6.6	20.9	29.2
Fuels and mining products	7.6	24.4	97.1	66.5	13.4	50.3	57.1
Manufactures	29.6	33.3	2.1	17.1	77.8	12.2	13.6
Destination of exports (% of total)							
First	Brazil 20.3%	EU 18.7%	n/a	US 26.4%	US 80.2%	China 18.3%	China 24.6%
Second	EU 14.2%	China 18.1%	n/a	EU 17.2%	EU 5.1%	EU 16.6%	EU 14.5%
Third	China 6.5%	US 12.1%	n/a	China 10.5%	Canada 2.7%	US 16.2%	US 12.2%
Fourth	US 5.9%	Argentina 6.3%	n/a	Panama 6.6%	China 1.5%	Switzerland 6.9%	Japan 10.0%
Fifth	Chile 4.1%	Japan 3.0%	n/a	India 5.0%	Brazil 1.2%	Canada 6.6%	South Korea 6.2%

Source: *WTO 'Trade Profiles 2015'*

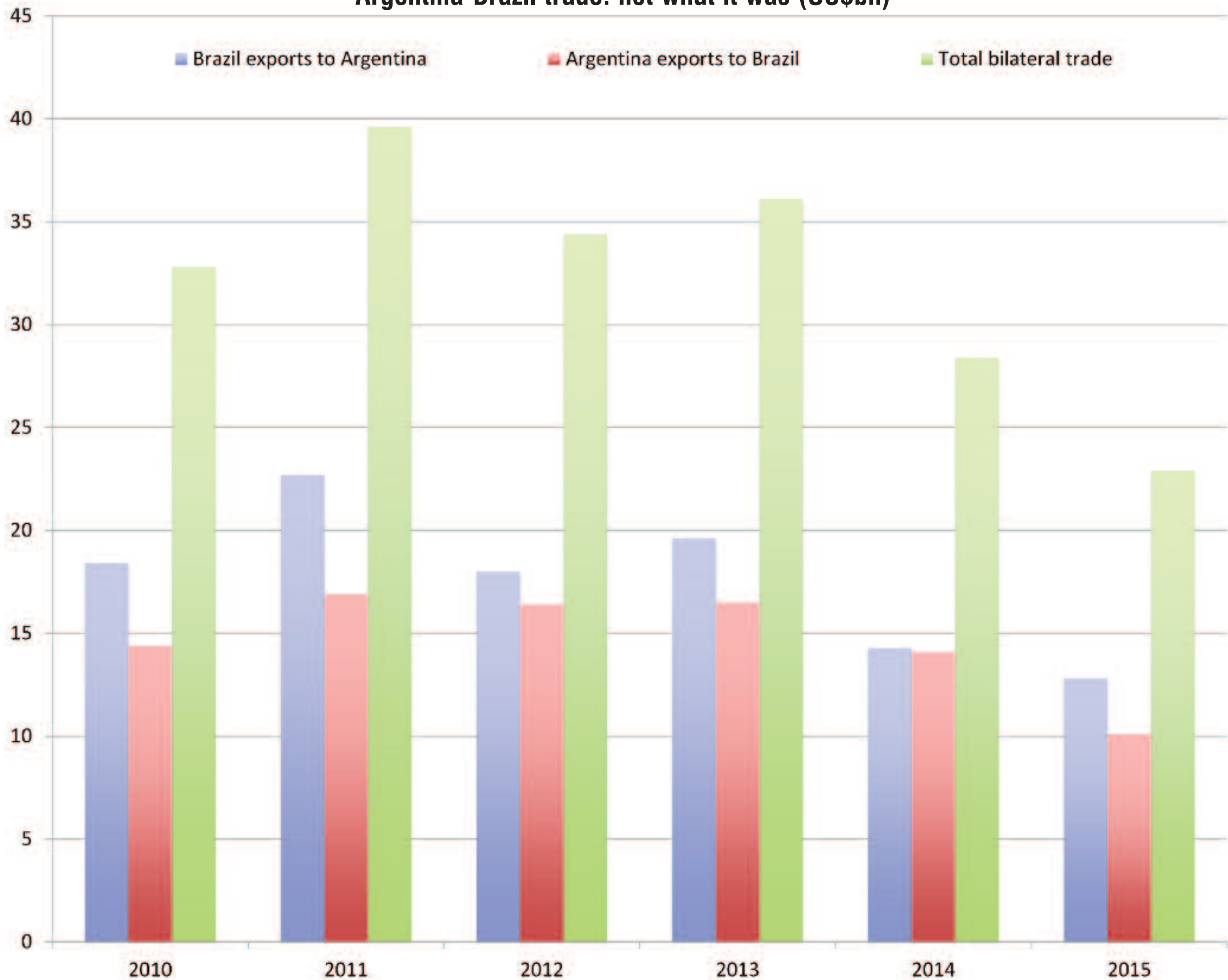
José Serra, the new Brazilian foreign minister, has taken a similar line. Speaking in June to FIESP, the São Paulo industrialists’ association, Serra was scathing over what he described as the legacy of “populist governments” in Mercosur. He claimed that a proximity to Venezuelan-style Bolivarian Socialism had, in the Brazilian case, led to a kind of “fanatical multilateralism” positioning populist governments in “the vanguard of backwardness” and de-industrialisation. “We’re not going to finish with the Mercosur common external tariff, but rather work on a transition, see the impacts, if it is convenient or not for industry; the idea is to be more flexible, and if Brazil wants to open business in another market, it can take other members along”, the minister told the country’s leading industrialists. Specifically, Serra said Brazil would seek “a more flexible Resolution 32/00” – the agreement that binds members to jointly negotiate and unanimously approve all Mercosur trade deals.

The Brazilian private sector has also signalled its interest in the Trans Pacific Partnership (TPP), the US-led, 12-country free trade initiative (which at present has three Latin American members: Chile, Peru, and Mexico, all of them also Pacific Alliance members). Thomas Zanotto of the FIESP commented that, “Since World War II there hasn’t been an agreement with

so many countries involved, from Vietnam to Singapore, Japan, the US and South America". Zanotto said the importance of TPP has induced the US to make trade concessions that had not earlier been on offer in bilateral negotiations. "That is why we recommend that Mercosur gets involved in a dispassionate and deep analysis of the TPP", he added.

Perhaps the best illustration of the crisis facing Mercosur's traditional approach is the seemingly interminable and possibly doomed attempt to negotiate a free trade agreement with the European Union (EU). Exploratory talks began in 1999, with formal negotiations commencing in 2004. Disagreements on the agriculture chapter in particular, and on compiling a tariff-free list of products within Mercosur, were responsible for years of delay. At present it seems as if additional disagreements within the EU are adding a further set of difficulties. France, Ireland, and Poland are still resisting what they see as extra competition for their farmers coming from Mercosur agricultural exports. The EU has excluded trade liberalisation for meat and ethanol from the proposed FTA, two key products for Latin American exporters. Nonetheless, the two exchanged their very first tariff offers in May. But with the UK's 23 June vote to leave the EU (BREXIT), there is renewed concern in Mercosur that talks will grind to a halt again. After 17 years of trying, it is possible that a Mercosur-EU FTA might never actually happen, or that the process might ultimately be replaced by several individual bilateral deals.

Argentina-Brazil trade: not what it was (US$bn)



Source: *Americas Society/Council of the Americas*

While new thinking is clearly underway, Mercosur's long agony and its tendency to get distracted by political disputes is not necessarily over. The current issue is the Venezuelan political crisis, and whether Mercosur should invoke the Protocol of Ushuaia, which calls for the suspension of members

who break with democratic rule. Paraguay, which was suspended on these grounds in 2012, now supports strong action against Venezuela; Uruguay opposes it; Brazil also supports action against Caracas, but along with Argentina, may want to give diplomacy a chance first. Some kind of decision is due at a meeting of Mercosur foreign ministers in July.

Behind the current attempt to reinvigorate Mercosur and re-evaluate relationships with the Pacific Alliance countries lie some deep and trade-related structural problems. In its heyday, Mercosur (now 25 years old) was driven by strong trade flows between its two largest partners, Argentina and Brazil. But the value of trade between the two has fallen by 42% since 2011. While both countries have sought to develop exports of manufactures, the decade-long commodity boom running to 2012 actually made them more reliant on raw materials and, in sharp contrast to Mexico, both countries are less integrated into global value-added manufacturing production chains. If, as many analysts believe, there will be no return anytime soon previous global commodity prices, Latin American countries will have to increase productivity and diversify their exports: the imperative to do this may begin to shake up the region's trade agreements.

BRAZIL

Which way for the economy?

The Brazilian economy remains hard to predict, still caught in recession and with high levels of political risk. But there were some positive signs in the first quarter data.

First quarter GDP data, released at the beginning of June, was less bad than feared, but cannot yet be taken as a turning point in Brazil's long recession. GDP dropped by 0.3% quarter-on-quarter (less than the 1-2% quarterly falls reported during most of 2015). On a year-on-year basis, the fall in GDP was 5.4%, a reduction on the 5.9% fall experienced in the year to Q4 15. Investment and consumer spending both remained weak (-2.7% and -1.7% q-o-q respectively). Government consumption actually rose by 1.1% q-o-q, reflecting a last-minute boost in spending as the government of Dilma Rousseff tried (unsuccessfully) to boost its popularity and head off impeachment proceedings against Rousseff. With impeachment going ahead and Michel Temer now in office as interim president, public sector spending is expected to be reduced as the new administration tries to cut back the oversized fiscal deficit (+10% of GDP). Net exports remained positive (exports up by 6.5% q-o-q, while imports contracted 5.6% on the same basis).

In short, the main reason for optimism, statistically speaking, is that the economy's overall rate of contraction has begun to slow down. Much now depends on whether the new Temer-led administration, which took office in May, can boost business confidence – bottoming out the slump in investment, and have a similar effect on consumer confidence – injecting some strength into retail sales.

The Temer team has had a shaky start on the political front (three ministers have had to step down in less than two months over ongoing corruption allegations). Opinion polls show some voters are almost as disillusioned with Temer as they were with Rousseff. But there have been some positive signs. The Fundação Getúlio Vargas (FGV) consumer confidence index rose to 71.3 in June, from 67.9 in May, reaching its highest level in the last 12 months. Despite this, FGV economist Viviane Bittencourt says the improved sentiment will take time to feed though to actual sales; "I believe we will still see consumption falling for a few quarters before it starts to grow again" she notes. And other indicators remain worrying. On the business side, a central

bank (BCB) report said that loans over 90 days in arrears rose to 5.9% of the total in May, from 5.7% in April. Company defaults continue on a rising trend.

Striking a slightly hawkish note, under its new president, Ilan Goldfajn, the BCB has raised its forecast for inflation this year to 6.9%, up from 6.6% in March and diverging from the private sector consensus, which expects inflation to fall to 5.5% by the end of the year, down from the current 9% level. At the beginning of June, the bank held the Selic reference interest rate unchanged at 14.25%. As the new government gradually begins to tighten fiscal policy, the market has been expecting a recovery-enhancing reduction in the Selic rate. But this expected monetary loosening will take longer to materialise, analysts now believe. "Earlier this year, I was thinking interest rates would fall faster" said João Pedro Brugger of brokers Leme Investimentos, but he has now shifted his position to contend that "the easing cycle could begin in the next few months"

PANAMA

Wider canal underpins growth outlook

Panama has recently experienced some short-term negatives. The 'Panama Papers' scandal in April brought attention to the use of its offshore financial centre for tax evasion and money laundering purposes. Also bad for the country's image was the announcement of US sanctions against the prominent Waked family and its network of 68 companies, suspected of involvement in money laundering. But both events should be more than offset by the boost to the country's long-term outlook signalled by the opening of the newly enlarged Panama Canal on 26 June.

The massive leak of documents from the local law firm Mossack Fonseca in April (which became known as 'the Panama Papers') and the US decision to identify members of Panama's Waked family as "specially designated narcotics traffickers" (SDNTs) have put the government of President Juan Carlos Varela on the back foot. The leaks from Mossack Fonseca have forced Panama to do more to bring its financial transparency regulations into line with international standards set by the OECD (at present it is promising to achieve that by 2018). President Varela has had to insist that, as he put it, his country's economic success has not depended on "irregular flows of money into our financial system" but on "the hard work of the Panamanian people".

Varela has also had to scramble to try and protect the 5,000-6,000 jobs in companies affiliated to Grupo WISA, the holding controlled by the Wakeds. Under US regulations, when a foreign citizen or company is listed as an SDNT or money-laundering organisation (MLO), all US citizens and corporates must cease doing business with it. So the future of many listed Panamanian companies is at risk. To protect employment, Panama's bank superintendency took over The Balboa Bank & Trust. The future of two newspapers, *La Estrella* and *El Siglo*, remains uncertain. The Felix B. Maduro department store has been transferred to a trust administered by the state-owned Banco Nacional, pending its potential sale to new owners. A similar move is being planned for Soho Mall, a brand new multi-million dollar shopping centre. And the Waked's retail beauty and duty-free chain La Riviera is experiencing some shop closures and staff reductions in both Panama and Colombia.

While these difficulties should not be underestimated, in the grand order of things they do not take away from Panama's key advantage: that it has a diversified and resilient economy, a fact that was underlined by the opening of the enlarged Panama Canal on 26 June. The US$5.25bn project, although completed behind schedule (the original in-service date had been August

2014) has involved the opening of two larger sets of locks on the Atlantic and Pacific sides, new access channels, and dredging and improved water flow along the length of the 80kms waterway. As a result longer, wider and heavier ships, known as 'neo Panamax' vessels, will be able to use the Canal, boosting traffic and revenue. Container ships with the capacity to carry up to 14,000 TEUs (twenty-foot equivalent units) can now use the canal. Demand may also increase from liquid natural gas (LNG) tankers; the enlarged Canal has triggered port expansion along the US east coast.

According to Jorge Quijano, head of the Panama Canal Authority (known as the ACP – its Spanish language acronym), "Our new transit route will have an impact on the international economy, delivering transport cost savings and enabling more profitable routes for ships which can carry three more times the volume of cargo." The ACP calculates that in the first fiscal year after enlargement revenues will grow by 40% to US$1.4bn. By 2021, it is estimated that revenues will have grown to US$2.1bn or 2.8% of GDP.

Because of the Canal expansion and other developments, Panama has a different and more diversified profile than that its more commodity-export dependent Latin American neighbours. According to the World Bank, "Panama continues to be an attractive country for foreign direct investment. The prospects of sustained high growth are also supported by emerging opportunities in transport and logistics, mining, financial services, and tourism." The Panama Pacífico new city project (currently being built on the site of the former US Clark Air Force base) has attracted a total of 140 companies, including 3M, Caterpillar, Dell, Grainger, Cable & Wireless, Avon and BASF.

Comparatively low taxes and permissive immigration laws have been used to attract innovation and new company start-ups. According to David Lewis, an investment consultant with Washington-based Manchester Trade, "Companies are realising that Panama is a very attractive location to set up America hubs, because of its multiple free-trade agreements… and with its dollarized economy, they don't have to worry about foreign exchange risk."

A favourable assessment from the IMF

The IMF's latest Article IV consultation with Panama, released on 10 June, highlighted that the economy is likely to remain one of the strongest in the region in terms of real GDP growth in 2016 and 2017. Inflation is expected to remain low, while overall macroeconomic and financial metrics are favourable. Adverse headlines surrounding the Panama Papers affair in April, and the seizure by the banking regulator of the Waked family's Balboa Bank & Trust in May, have overshadowed positive developments in Panama's financial sector.

Panama was of the largest recipients of Foreign Direct Investment (FDI) inflows in Latin America in 2015, both in absolute terms and relative to GDP. The IMF's latest forecasts (*see chart*) are encouraging. "The economy will be supported by the expected opening of the expanded Canal and lower fuel prices, which will counterbalance the effects of slowing global growth and U.S. dollar appreciation. Over the medium term, the increase in canal transit, a dynamic service sector, and investments in the energy, mining, and logistics sectors should help maintain vibrant growth", it noted.

Panama's debt burden and external accounts are also expected to move in the right direction. The IMF expects non-financial public sector debt to slip from 39% of GDP in 2015 to below 35% in the medium term. Over the same timeframe, the current account deficit is expected to drop from 6.5% to 3% of GDP, which should easily be covered by FDI inflows.

In spite of the Panama Papers' scandal and the SBPs seizure in May of Balboa Bank & Trust following the Waked family designation, recent developments in Panama's financial sector have generally been positive.

In February, the Financial Action Task Force (FATF) removed Panama from its 'Grey List' of countries with strategic deficiencies in terms of its framework for Anti-Money

Laundering and Combating the Financing of Terrorism (AML/CFT). Following the Panama Papers episode, the government created a panel of independent experts to assess practices within Panama's financial centre and propose measures to improve transparency. The government has also committed to the automatic exchange of information relating to tax matters, according to the OECD's Common Reporting Standards (CRS), by 2018.

The IMF noted that Panama's open economy is a source of vulnerability. A sharp global economic slowdown would constrain the growth of revenues from the widened Canal and probably have an impact on capital inflows. However, the banking system is well capitalised, and the government has the room to ease fiscal policy if necessary.

Panama's economy - as the IMF sees it

	2015	2016	2017
% change			
Real GDP	5.8	6.1	6.4
Ave. CPI Inflation	0.1	0.8	2.0
Private sector credit growth	11.4	2.8	7.1
% GDP			
Fiscal balance	-4.1	-3.5	-1.7
Current account	-6.5	-6.2	-5.0
External public sector debt	30.0	30.1	27.2
Source: *IMF*			

CUBA

Mixed signals on SMEs

At first sight the Cuban Communist Party's publication of a new policy towards small and medium-sized enterprises (SMEs) was taken as increased recognition of the role of the private sector, and as a sign of further liberalisation of the Cuban economy. But the timing and the detail of future changes are not clear and analysts warn that government is still unwilling to relax its tight controls over economic activity.

A new 32-page document, released in May in the wake of the Communist Party's 7th congress in mid-April, states: "Private property in certain means of production contributes to employment, economic efficiency and well-being, in a context in which socialist property relations predominate". For some, this indicates that Cuban SMEs will be given legal recognition in the relatively near future. Others warn that the process of reorganising property ownership in Cuba could still take a number of years, and that in the wake of President Barrack Obama's historic visit to Cuba in March, some members of the party are keen to slow down the speed of change and reassert their socialist credentials.

The current situation is a hybrid. Despite long-standing talk of unification, Cuba still has a dual currency system, with most of the dominant State sector operating in non-convertible domestic Cuban pesos, known as CUPs. The convertible Cuban peso, or CUC, is pegged at one-to-one with the US dollar and is used for tourism and foreign investment transactions. One CUC is equivalent to 25 CUPs.

Since 2010, individuals have been allowed to work for themselves in around 200 different types of permitted roles. These include things like mechanics, beauticians, bed-and-breakfast hosts, and even small, in-home restaurants (known as *paladares*). Cooperatives have also been allowed, for example to operate farms, taxi services and other businesses. The number of these *cuentapropistas* (people who work on their own account) has grown sharply. Labour ministry data indicates that there are some 500,000 *cuentapropistas*

registered, out of a work force of roughly 5m. Some economists believe there are at least another 500,000 who, although lacking formal *cuentapropista* permits, are illegally/informally involved in some kind of private sector activity.

What all these workers have lacked is the opportunity to set up formal companies with clearly defined legal and property rights. Such a legal framework could be used, for example, to allow such entities to deal with banks, foreign investors and State-owned companies. Most *cuentapropistas* are also currently blocked from accessing raw materials and other products at wholesale prices. (While some wholesale markets have been introduced in agriculture, they remain the exception). Neither can *cuentapropistas* import or export.

Even with these limitations, these self-employed workers have shown themselves to be resourceful and innovative. While State salaries remain extremely low in CUC terms, the combination of growing tourism and increased remittances sent back to families and friends from Cuban-Americans has meant that some Cubans have higher levels of disposable income, and they are getting used to spending it.

Writing for the *Quartz* online magazine, Ana Campoy and Jacob Templin cite a local source who quips that, "the well-off have become the neediest people in Cuba" seeking among other things accessories for pet dogs, beauty treatments, and expensive trainers. After years of the US trade embargo and domestic scarcity, consumerism is an attractive novelty: with limited Internet connectivity many keep up with US fashion and trends through *el paquete*, a weekly download of web content placed on a memory stick and brought in to Cuba by travellers. Given the ban on import-export trade, many *cuentapropistas* also use travellers to bring in essential supplies – for example skin creams and other products that are re-sold in beauty parlours. Despite continuing bureaucratic obstacles and red tape, analysts believe consumerism is a growing force to be reckoned with in modern Cuba.

THE BAHAMAS

Facing problems on two fronts

The report from the IMF's latest Article IV consultation with the government of the Bahamas highlights problems on two fronts. In the tourism sector, it is not clear who will invest the US$1bn needed to make the Baha Mar mega-resort operational. In the financial sector, the erosion of correspondent banking relationships – a problem across much of the region – has resulted in an unemployment rate of about 30%, or around twice the national average.

The IMF released the conclusions from its regular Article IV consultation with the government on 10 June. The overall picture is one of persistent stagnation. Unemployment rose to nearly 15% at the end of 2015, thanks to massive lay-offs of workers hired to build the massive Baha Mar resort project. This has contributed to softness in domestic demand, which has more or less negated the impact of a small rise in air tourism arrivals. The weakness of the economy, persistent non-performing loans (NPLs) and caution on the part of local banks, had resulted in a small fall in credit to the private sector. **(See table).**

Following its introduction at the beginning of 2015, collections of Value Added Tax (VAT) last year amounted to Bs$536m (US$536m), more than had been anticipated. This has contributed to a fall in the fiscal deficit, relative to GDP, which the IMF expects to continue. Nevertheless, the stagnation of the economy means that the overall burden of debt should continue to grow. The IMF anticipates that central government debt will rise from 64.4% of GDP in 2015 to 67.0% in 2017.

The Bahamas' economy - as the IMF sees it			
	2015	**2016**	**2017**
% change			
Real GDP	-1.7	0.5	1.0
Ave. CPI Inflation	1.9	0.9	1.2
Private sector credit growth	-1.1	0.3	0.6
% GDP			
Fiscal balance	-4.4	-3.0	-2.7
Current account	-15.3	-11.4	-10.7
Central government debt	64.4	65.9	67.0
Source: *IMF*			

How, and when, the Baha Mar mega-resort contributes to the fortunes of the Bahamas' tourism industry – one of the largest in the Caribbean – remains to be seen. The project is a 3,000 room resort and casino that is, to a certain extent, in competition with the nearby Atlantis Resort. Whereas Atlantis caters mainly to families, Baha Mar's developers envisaged that it would cater mainly to an adult clientele. When work stopped on the nearly complete project in June last year, the estimated value of the investment was more or less equivalent to 40% of the country's GDP. Construction ceased as a result of various legal disputes between China Construction of America (CCA), the main builder, China Development Bank, the Export Import Bank of China, investors and the government. The firm responsible for the development filed for bankruptcy.

Ominously, the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC) questions whether there is enough demand to support two mega-resorts in the Bahamas[1]. Atlantis, too, has had problems. Burdened with debt, it was declared bankrupt, with the result that the owner, South Africa's Kerzner International Holdings, had to transfer its interest to Canada's Brookfield Asset Management. ECLAC notes that damage to Baha Mar since construction work ceased means that new investment of US$1bn is needed to make the mega-resort operational. However, neither Kerzner International Holdings, nor Fosun Group (a Chinese company with operations in the Bahamas) or other potential investors have emerged.

In relation to the financial sector, the IMF noted that the global trend by banks towards de-risking has been a challenge. In the Bahamas, the main problem has been the erosion of correspondent banking relationships [*Latin American Economy & Business*, April 2016]. In part because of the increased regulation in relation to anti-money laundering and counter-terrorism financing (AML/CFT) and in relation to customer due diligence and know your client (CDD/KYC) concerns, and in part because of the declining profitability of correspondent banking, major international banks have been cutting their ties with numerous banks across the Caribbean. This trend appears to have hit the Bahamas harder than other countries. At a speech in late February 2016, the Minister of Financial Services CV Hope Strachan noted that unemployment in the sector had risen to 30%.

PUERTO RICO

Waiting for PROMESA

On 9 June, the US House of Representatives passed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA). This new law imposes a suspension on past and future lawsuits related to the non-payment of some of the debts of the government of Puerto Rico and its agencies. The new law also provides for the creation of a federal oversight board that will direct a restructuring of the debt. PROMESA is due to pass through the US Senate before the end of June.

[1]ECLAC, *Foreign Direct Investment in Latin America and the Caribbean 2016*, p64

In early May, the government of Puerto Rico reached an agreement with the Ad Hoc group of creditors of the Government Development Bank (GDB) of Puerto Rico, following the declaration of a moratorium on payment of most of US$422m due to be paid by the GDB at the beginning of the month. The Ad Hoc group of six fund managers collectively account for about US$900m of the GDB's US$4bn or so in bonds outstanding. The agreement involved a suspension by the Ad Hoc group of litigation against the government or the GDB, and a 53% 'haircut' on the group's investment in GDB bonds. The deal required the participation of all GDB bondholders: however, it was recognised that this would be unlikely to happen without the passage of legislation through the US Congress that would bind all bondholders.

For a long time, an apparent solution has been an amendment to Chapter 9 of the US Bankruptcy Code. This provides protection for cities and counties that get into financial difficulties, so that they can default and negotiate with their creditors in an orderly fashion. However, Puerto Rico has not been covered by Chapter 9, because it is an unincorporated US territory.

In the meantime, PROMESA appears to offer the possibility of an orderly default. At the end of June 2016, the GDB published a report[2] that highlighted the key elements of an effective restructuring regime, many of which are incorporated in PROMESA. In the first instance, there would be clearly defined rules that would allow the restructuring of all targeted debt in one co-ordinated proceeding. All litigation would be stayed, enabling the government to 'continue negotiations with its creditors without a race to the courthouse and the need to act unilaterally'. Instead, there would be a central arbiter to resolve disputes. There would be a mechanism to bind holdout creditors to deals that are agreed. Lenders would receive sufficient assurances that they could continue to provide funding for the government to maintain essential services. There would be official oversight by the federal government of Puerto Rico's fiscal situation. Finally, Puerto Rico would emerge with a 'clean slate' and obligations that are sustainable.

Over recent weeks, negotiations with creditors have not gone well. At the beginning of February 2016, the government made a proposal that envisaged total debt service through to 2051 of US$55.38bn (and no more than US$1.7bn annually). A revised deal of 11 April 2016 envisaged total debt service through to 2067 of US$89.51bn (and no more than US$1.85bn annually). The latest deal, of 14 June 2016, involves total debt service through to 2071 of US$108.09bn (and no more than US$2.05bn annually). However, even more has been demanded by holders of the government's General Obligation (GO) bonds and senior creditors of the sales tax collection agency, COFINA.

In the meantime, the creditors are resorting to litigation. Monoline insurers have sued in relation to Executive Order 2015-046, which gave the government of Puerto Rico the authority to 'claw back' certain revenues in order to pay public debts, including the GO bonds. Three separate groups of creditors have mounted lawsuits in relation to Act 21, which empowers the Governor of Puerto Rico to declare a fiscal emergency and a moratorium on the payment of certain debts. Worse, some of the GO holders are claiming that sales tax revenues earmarked for COFINA bondholders should be made available for servicing of GOs.

On Friday 24 June, Governor Alejandro García Padilla declared a suspension on payments on some debt of the Puerto Rico Infrastructure Financing Authority (PRIFA). Total payments by the government and its agencies due on 1 July amount to US$1.9bn.

Meanwhile, the latest Economic Activity Index (EAI) published by the Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA) confirmed that the island's economic situation remains grim. In April, the EAI fell by

[2] Government Development Bank of Puerto Rico, Bonistas del Patio Forum, Puerto Rico's Fiscal and Economic Crisis, 27 June 2016.

0.1% in the month and it was down 1.9% year on year. In the first ten months of the current (June 2016) fiscal year, the EAI was 1.3% lower than in the previous corresponding period. Total non-farm payroll employment in Puerto Rico was 894,300, down 1.3% year on year. Power generation was 0.9% lower than in April 2015, while cement sales were down by 13.3%. The only bright spot was the FAFAA's preliminary estimate for gasoline consumption, which was up 2.9% year on year, amid cheaper prices. Except for a brief period of stability in late 2012, the EAI has been trending downwards since mid-2005, after which the economy was hit by the expiry of Section 936 of the US Revenue Code (which provided tax breaks for companies that conducted business in Puerto Rico) and then by the global financial crisis. Back in mid 2005, the EAI had peaked at around 158 points (January 1980 = 100). It is currently down at 123.9 points.

REGIONAL BUSINESS REVIEW

REGION

FDI – downtrend to persist

According to the United Nations' Economic Commission for Latin America and The Caribbean (ECLAC), inflows of Foreign Direct Investment (FDI) dropped by 9.6% in 2015 to US179.1bn. ECLAC cautions that FDI could fall by a further 8% in 2016.

In a briefing paper[3] released on 15 June, ECLAC reported that FDI into Latin America and The Caribbean slipped to its lowest level since 2010 last year. This was partly due to the general deceleration of economic growth in much of the region – most notably in Brazil. It was also due to lower investment in the mining and hydrocarbons sectors. FDI flows last year came mainly from the US (which accounted for 25.9% of the total) followed by the Netherlands (15.9%) and Spain (11.8%). The fall in FDI to Latin America was in contrast to global trends. Worldwide, FDI flows rose by 36% to around US$1.7trn in 2015, thanks mainly to a wave of cross-border mergers and acquisitions (M&As) focused on developed countries, including the US.

Although lower in absolute terms in 2015 relative to 2014, FDI has stabilised at 3.5%-3.7% of regional GDP. ECLAC makes the point, though, that FDI varies markedly across individual economies. Last year, FDI inflows were equivalent to about 2.5% of Mexico's GDP. Conversely, the figure was nearly 10% of GDP in Chile and Panama.

As the **table** shows, Brazil remained the largest individual recipient of FDI in 2015, with an inflow of just over US$75bn, accounting for about 42% of the regional total. Nonetheless, the deterioration of the economy, and a fall in minerals prices, contributed to a 22.5% slippage in inflows to Brazil.

ECLAC also highlighted the fact that loans from foreign multinationals to subsidiaries in Brazil fell by over 50% last year. It attributes this to the early repayment of loans by local subsidiaries to their foreign parents, and noted three reasons for Brazilian companies to do so. One was the fact that access to capital in Brazil was cheaper last year than in 2014. The second was the general dearth of investment opportunities for the subsidiaries. And the third, clearly linked to the second, was the overall slump in confidence. From 2010 to 2015, earnings reinvestments by Brazil-based subsidiaries fell from US$34.9bn to US$7.15bn As the overall economic environment has deteriorated, companies have saved excess cashflows and earnings. Last year, they repaid loans from multinational parent companies, thereby reducing parent companies' exposure to Brazil.

[3] ECLAC, *Foreign Direct Investment in Latin America and the Caribbean 2016, Briefing Paper, June 2016.*

Foreign direct Investment (FDI) Inflows (US$m and percentage variation)							
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**Change**
Argentina	11,333	10,840	15,324	9,882	5,065	11,655	130.1%
Bahamas	1,148	1,533	1,073	1,111	1,596	385	-75.9%
Brazil	88,452	101,158	86,607	69,181	96,895	75,075	-22.5%
Chile	15,510	23,309	28,493	19,362	22,342	20,457	-8.4%
Colombia	6,430	14,648	15,039	16,209	16,325	12,108	-25.8%
Costa Rica	1,907	2,733	2,696	3,555	3,064	3,094	1.0%
Jamaica	2,024	2,277	3,142	1,991	2,209	2,222	0.6%
Mexico	26,431	23,649	20,437	45,855	25,675	30,285	18.0%
Panama	2,363	3,132	2,980	3,943	4,309	5,039	16.9%
Peru	8,455	7,665	11,918	9,298	7,885	6,861	-13.0%
Trinidad & T.*	519	1,831	2,453	1,995	2,488	1,214	-51.2%
Uruguay	2,289	2,504	2,536	3,032	2,188	1,647	-24.7%
Venezuela	1,574	5,740	5,973	2,680	320	1,383	332.2%
All Others	4,538	6,812	7,989	7,688	7,772	7,675	-1.2%
TOTAL	**172,973**	**207,831**	**206,660**	**195,782**	**198,133**	**179,100**	**-9.6%**
*First three quarters of 2015							
Source: *ECLAC*							

In spite of the challenging business environment and the deteriorating performance of the Brazilian economy, three of the region's five largest M&A deals involving foreign buyers last year involved Brazil-based companies. The largest single transaction was the US$10.3bn purchase of Global Village Telecom by Spain's Telefónica: however, given that the vendor was France's Vivendi: this deal did not boost FDI flows to Brazil. The purchase of Central Hidroeléctrica Jupiá e Ilha Solteira by China Three Gorges Corporation (CTGC) was worth US$3.68bn. And finally the UK's British American Tobacco (BAT) spent US$2.42bn to buy the 22% of the Brazilian cigarette maker Souza Cruz that it did not already own.

Conversely, FDI flows to Mexico in 2015 rose by 18.0% to US$30.28bn, reinforcing a general trend of gradual growth. The reinvestment of profits fell, but capital contributions and inter-company loans (i.e. from foreign parents to subsidiaries in Mexico) were substantially higher than in 2014. ECLAC also noted that outwards investment by Mexican firms increased by 62% in 2015 to US$12.1bn.

Nearly half of FDI focused on Mexico's manufacturing sector. Of that, 42% (i.e. just over 20% of total FDI) was accounted for by multinational automotive companies. Significant new investments were announced by South Korea's Hyundai (US$800m in two plants), Japan's Toyota (US$1bn in a new facility in Guanajuato that will assemble Toyota Corollas) and Ford Motor Co. (US$2.5bn in two plants, one of which will also be in Guanajuato). Elsewhere in the manufacturing sector, the US company Owens Illinois purchased the local glassmaker Vitro for US$2.15bn.

The recent telecoms and energy sector reforms in Mexico has also given rise to substantial deal-making by multinationals. Over the course of 2015, AT&T of the US finalised its acquisition of Iusacell and Nextel (for US$2.5bn and US$1.88bn respectively), and announced investments of US$3bn in infrastructure. In the energy sector, which is now opening up to foreign participation across the sector, from oil and gas to renewables, newly-announced transactions include an investment of US$470m by the Italian giant ENEL in two wind farms, and the construction of a US$84m power plant by Spain's Iberdrola, in conjunction with the chemicals group Dynasol. (These figures have yet to appear in the FDI data.)

Chile was the region's third largest recipient of inwards FDI in 2015. At US$20.46bn, the inflow was 8.4% lower than in 2014. Nevertheless, FDI was higher than it had been in 2010 and 2013. The fall in FDI relates largely to lower investment in the key mining sector – amid the fall in minerals prices – and fewer inwards M&A deals relative to 2014. However, investment in the electricity and renewable energy sectors has held up well. At the end of 2015, First Solar of the US completed the construction of Luz del Norte, the largest solar power park in Latin America, with the capacity to provide electricity to 170,000 households. Meanwhile, Spain's Acciona has begun construction of El Romero, a solar power park with 75% more capacity than Luz del Norte. Investment in the two parks is US$370m and US$343m respectively.

In 2015, there were three notable M&A deals in Chile's insurance sector involving foreign buyers. Germany's Talanx purchased Aseguradora Magellanes for US$204m. Suramericana, the insurance affiliate of Colombia's Grupo Sura, bought the Latin American business of the UK-based multinational non-life insurer RSA for US$620m: in addition to operations in Chile, this included RSA's companies in Argentina, Brazil, Mexico and Uruguay. And finally the UK-based health insurance group Bupa spent US$590m to buy the stake in Bupa Chile that it did not already own.

FDI flows into Colombia in 2015 were also hit by the softness in commodity prices, slumping by 25.8% to a five year low of US$12.1bn. This shift concealed a lot of investment in manufacturing and the broadly defined services sector. Multinationals have been upbeat about Colombia's medium-term prospects. Spain's NH Group invested US$96m in an 87% stake in Colombia's Hoteles Royal. The Chilean retail/property groups Cencosud, Falabella and Parque Arauco all added to their holdings in Colombia. APM Terminals, the port operation of Denmark's Maersk Group, said that it would invest US$200m in the Port of Cartagena, alongside the local port management company Compas SA. General Motors (GM) of the US plans to invest US$100m over the coming years in its Colombian operation. Spain's Cementos Molins and the local group Corona announced a joint investment of US$370m in cement production facilities.

The official figures for FDI into Argentina in 2015 are suppressed by the US$6bn nationalisation of the investment in the energy group Yacimientos Petrolíferos Fiscales (YPF) held by Spain's Repsol. This deal was originally announced in 2012, and counts as a divestment by a foreign company. Without this, inwards FDI in 2015 would have been similar to the US$11.66bn reported in 2014. In absolute terms, annual FDI into Argentina remained broadly constant, in spite of the challenging business environment.

Unsurprisingly, many multinationals are significantly more upbeat about opportunities in Argentina under the new government led by President Mauricio Macri. Inwards FDI in 2015 included an investment of US$941n by Spain's Telefónica to upgrade of its 3G and 4G networks. Telefónica has announced plans to invest nearly US$4bn to the end of 2018. France's Renault is looking to invest US$100m in its car factory in Córdoba.

However, these sums are dwarfed by the amounts that may be invested in Argentina's hydrocarbons and minerals sectors. At the end of 2015, Exxon Mobil said that it would invest US$229m in the development of the Vaca Muerta shale resources. If the development is successful, further investment by Exxon Mobil in coming years could reach nearly US$14bn. Trafigura, the Netherlands-based commodity trading house, has announced an investment of US$350m in port and storage infrastructure.

The recent trends in Peru have been very similar to those of neighbouring Colombia. Overall inwards FDI fell by 13.0% to US$6.86bn last year, mainly due to lower activity in the minerals sector. However, very significant deals were announced in other areas of the economy. Canada's Scotiabank

invested US$295m to acquire the Peruvian assets of Citibank. Mexico's Arca Continental, the second-largest bottler of Coca-Cola in Latin America, invested US$768m in a 48% stake in Peru's Lindley. An even bigger deal was the US$780m purchase of electricity generator Fénix Power by a consortium led by Chile's Colbún.

Elsewhere in Peru, China's Jidong Cement Company announced plans to buy the local firm Cementos Interoceánicos. As is the case in Argentina, Spain's Telefónica is looking to build on its already considerable investment in infrastructure in Peru. Likewise, Chile's Entel has been investing in the Nextel network in Peru, which it acquired in 2013. Other notable developments include the modernisation of the La Pampilla oil refinery by Repsol and the inauguration of the Cheves hydro-electric plant by Norway's Statkraft.

Finally, in line with the steady growth in the tourism sector, Peru's hotel industry anticipates investment of US$1.2bn over the three years to the end of 2018, involving the addition of 8,000 new rooms across 100 or so 3*, 4* and 5* hotels. In the period between 2010 and 2014, investment in the local hotel sector was about US$550m, so this represents sizeable new inflows into the sector.

Elsewhere in the region, FDI trends are quite varied, although it is easy to find other instances of substantial investment by foreign groups in sustainable energy projects. In Panama, for instance, inwards FDI rose by nearly 17% to a record high of US$5.04bn, partly due to investment associated with the widening of the Panama Canal. A US company, InterEnergy, began construction of a wind farm in Panama that will require investment of around US$430m. Canada's SkyPower announced the construction of a solar energy generating plant, which will require investment of US$1bn. China's Solar Power Inc. is also looking to build a new plant in Panama. In Costa Rica, where inwards FDI remained more or less unchanged at US$3.09bn, the US firm SunEdison invested US$350m to purchase Globeleq Mesoamerica Energy (GME). Other significant inflows into Costa Rica included an investment by Germany's Bosch in a local services centre, while the US retail giant Wal-Mart also announce an expansion of its operations in the country.

The hydrocarbons sector remains the main destination for FDI in both Ecuador and Bolivia, as well as in Paraguay. Notably, inwards FDI to Venezuela rose sharply from a depressed base. ECLAC attributes this to investment by Chinese firms, with the support of the Export Import Bank of China and the China Development Bank (CDB). Companies from other countries that have had interests in Venezuela's manufacturing sector have generally been writing off their investments.

Tourism projects dominated inwards FDI in Barbados, Bahamas, the Dominican Republic and Jamaica. In some countries, including Trinidad & Tobago, investment in infrastructure by telecommunications companies has also been significant.

ECLAC put FDI outflows from the region in 2015 at US$47.36bn, or 15% less than in 2014. This was attributed to a slowing in regional expansion by 'Translatinas' – groups focusing on other countries in Latin America for growth. In 2015, Chilean-based Translatinas were the largest cross-border investors in the region. However, Brazilian and Mexican companies have the largest stocks of investment across the region. The largest cross-border M&A deal within the region involving a Translatina was the acquisition by Colombia's Empresas Públicas de Medellín of a Chilean utility, Aguas de Antofagasta, for US$967m. The most acquisitive Latin American firm in 2015 was the Brazilian food giant JBS, which purchased Moy Park Holdings of the UK, the pork business held by Cargill of the US and New Zealand's Primo Group, for a combined total of a little over US$4bn. JPS also invested US$575m in the Mexican and Brazilian businesses of the US firm Tyson.

GUATEMALA

The TCQ story

Latin American countries continue to suffer serious corruption issues, often centred on the three-way crossing point between politics, public sector contracting and business. A case in point is Guatemala, where it now seems that the bribery network that led to the impeachment and imprisonment of the former president Otto Pérez Molina last September was wider and more complex than originally thought, and included major irregularities in the management of a container port, Terminal de Contenedores Quetzal, known as TCQ.

Guatemala has become notorious for the *La Línea* corruption case – a sophisticated illegal network, first uncovered in 2014, involving senior officials at the country's tax collection agency, the Superintendencia de Administración Tributaria (SAT), and implicating a string of other players, including importers, lawyers and a former intelligence agent. In exchange for paying bribes, importers benefited from fraudulent tax reductions – paying only about 40% of applicable import tax rates. An elaborate system ensured that participating customs inspectors knew which import containers to under-tax. It is believed that around 500 importers took part in this arrangement, with corrupt container inspectors each pocketing around US$1,000 a week; the scheme as a whole generated illicit revenues of around US$328,000 a week.

On a more positive note for the country, the way it investigated these crimes has set an example for others, with the United Nations'-sponsored International Commission Against Impunity in Guatemala (known by its Spanish acronym, CICIG) and the public prosecutors' office (Procuradoría General de la Nación, PGN) showing their commitment to pursue suspects right up to the top. Indeed, prosecutors in the *La Línea* case found that the trail led them all the way to the vice-president, Roxana Baldetti, and President Pérez Molina (who took office in January 2012), both of whom are now in prison awaiting trial. According to witness testimonies, the two each received a 21.25% cut of *La Línea* earnings.

What was not known at the time was that *La Línea* was only one of various corruption schemes. According to a 2 June joint press conference by the attorney general, CICIG and the interior ministry, what was involved was no less than a "macro criminal structure that had co-opted power", and which was coordinated by Pérez Molina and Baldetti. A further 25 suspected participants have been arrested, with another seven international arrest orders issued, and others being subject to preliminary investigation. Iván Velásquez, the Colombian head of CICIG, now says that Pérez Molina and Baldetti were receiving bribery payments totalling GTQ500m (around US$65.5m) relating to "commissions" on around 450 government contracts.

One of the biggest newly-uncovered corruption schemes involved TCQ. Pérez Molina and Baldetti apparently had appointed a number of associates to leading positions in a government entity responsible for Quetzal Port, in Escuintla department on the Pacific coast, and in 2012 this entity awarded a US$255m contract to TCQ, then a subsidiary of Grup Terminal de Contenedores de Barcelona (TCB), to build and operate a container terminal over a 25-year concession period. To win the contract, investigators say, TCB was initially required to pay bribes of around US$30m. The amount may have been haggled down, because prosecutors said they could only find hard evidence of two bribery payments totalling over US$12m, of which Pérez Molina and Baldetti are believed to have received US$4.2m each.

The TCQ case has multiple ramifications. One is that some of the officials who awarded the initial fraudulent contract are still working at the commissioning entity, Empresa Puerto Quetzal. A group of Guatemalan members of congress is demanding that these managers too should be prosecuted on charges of illicit association and fraud. Also complicating matters is that before the bribery was discovered, Grup TCB sold TCQ to Netherlands-based APM Terminals, which took an 85% stake, and the International Finance Corporation (IFC), which took the remaining 15%. The sale was part of a wider transaction whereby Grup TCB sold a total of 11 container terminals around the world to APM Holdings. Members of congress who have spoken to APM say the Dutch company maintains it was unaware of any irregularities committed by the previous owner, and has been considering its legal options. In early June, a local court declared the concession null and void and ordered the confiscation of TCQ assets. Talks between the current government have begun with APM Terminals to seek a negotiated settlement and to avoid international litigation.

MEXICO

Invulnerable to risk aversion

In early 2016, financial stress in Mexico reached the highest level since the global financial crisis according to one measure. This appears to have been the result of investors' general aversion to emerging markets risk. The IMF's approval, at the end of May 2016, of a new two-year US$88bn flexible credit line (FCL) should mean that any further slowing of the global economy, or future volatility in financial markets, should have limited impact on Mexico.

Since early 2009, some countries with strong track records on economic management have been eligible for FCLs from the IMF. These are essentially emergency credit facilities that governments can draw on if needed, and are normally provided for a limited and specific period of time. Mexico's first FCL was put in place on 17 April 2009. This was replaced by successor FCLs on 25 March 2010, 10 January 2011, 30 November 2012 and 26 November 2014.

The latest FCL, for an amount equal to around US$88bn, replaces its predecessor, which was worth around US$67bn. The latest FCL is valid for two years. The Mexican government has indicated that it hopes to phase out its usage of FCLs over time.

The background to the announcement is that the Mexican economy is exposed to two broad sets of risks. This is in spite of the general resilience of activity and the IMF's assessment that macroeconomic policies and policy frameworks remain very strong. One set of risks arises from the integration of Mexico with the global economy in general and the US economy in particular (including through the North American Free Trade Agreement). A measure of this is the stock of inwards foreign portfolio investment, which amounted to US$456m, or 40% of GDP, at the end of last year.

The other set of risks arises from shifts in global investor sentiment towards emerging markets. According to the Bank of International Settlements (BIS), the Mexican peso is the most actively traded emerging markets currency globally, with average daily trading volumes of US$135bn.

In spite of the fundamental strengths of the economy, Mexico's financial markets suffered badly in January and February, when global investors showed a strong aversion to emerging markets risk. The peso fell further than other emerging markets currencies and was more volatile. One measure of

composite financial conditions in Mexico compiled by the IMF rose to the highest level since the global financial crisis. Since the first two months of the year, global investors' appetite for risk has improved somewhat.

Over recent months, projections for global economic growth have been revised downwards. Given the complexity of the problems facing the largest emerging markets, but especially China, Brazil and Russia – and, indeed, many of the larger developed economies – it is quite possible that investors will again develop an aversion to emerging markets risk. Nevertheless, the new FCL means that these problems are unlikely to have a significant or lasting impact on Mexico.

REGION

Corporate Radar

Oi files for bankruptcy: Oi, the only locally controlled mobile phone operator in Brazil, filed for bankruptcy protection with debts of BRL65bn (US$19bn) on 20 June, after rescheduling talks ahead of a EUR231m bond repayment failed to produce agreement. The company has been badly affected by the Brazilian recession, but analysts say it also suffered from serious problems caused by an attempt by the previous Partido dos Trabalhadores (PT) government to turn it into a 'national champion'. Despite big ambitions and government help, the company was mismanaged (it had six chief executives in five years) and became heavily leveraged. State development banks BNDES and Caixa Económica Federal are reported to have lent BRL13bn (US$3.8bn) to the company.

Although it is a big fixed-line player, Oi is the smallest of Brazil's four main mobile operators, with an 18.6% market share, compared to Vivo (controlled by Telefónica of Spain) with 28.6%, Tim (controlled by Telecom Italia) with 25.9% and Claro (owned by Mexico-based América Móvil with 25.3%). Oi's future is now uncertain, with options including a takeover by another player (although a previously planned merger with Tim now looks off the table), restructuring, or break-up. Some analysts argue that this might be a good moment for the market to consolidate, reducing to three rather than four main players. The administration led by the interim president, Michel Temer, which is seeking to control fiscal spending and follow more business-friendly policies, has said it will not bail the company out with new loans.

Banco Galicia bets on Argentine recovery: Although there are doubts among some analysts over the speed at which the Argentina government led by President Mauricio Macri will tame inflation and build an economic recovery, Banco Galicia is confident of a positive outcome. The bank announced in June that it would double its investments in infrastructure to US$182m, in expectation of lower inflation and economic growth in 2017. General Manager Fabián Kon said 2016 would be a year of "transition" for the Argentine economy but that the outlook for 2017 was "auspicious". Kon said the bank would invest ARS2.5bn (US$182m) to open new branches, modernise its headquarters and incorporate new IT systems. As a result of the government's more market-friendly policies, the bank was expecting a "natural" expansion of credit to individuals and corporates and the emergence of new investment options. Galicia also expected inflation to begin easing down from June, which would play a key role in allowing the banks to move from very short to more longer-term lending. Bank credit is still low as a proportion of GDP, indicating that there is plenty of room for growth. Banco Galicia has round 3.3m customers, ARS107.8bn (US$7.2bn) worth of deposits, 261 branches, 5,700 employees, and net assets of ARS15bn (US$1bn).

Avianca not for sale: Colombia-based airline Avianca is talking with others about potential strategic partnerships, but is not itself up for sale, chairman Germán Efromovich told the *Caracol* radio station in mid-June. His comments followed reports that HNA Group of China had expressed an interest in acquiring Avianca Holdings and the Avianca Brasil subsidiary, both controlled by Efromovich's Synergy Group. US-based United Continental Holdings and Delta Air were also reportedly interested. But Efromovich told *Caracol*, "Avianca is not up for sale. Talks about strategic alliances go on all the time." He added that the point of them was to seek a faster rate of growth for the business. He added that the talks might lead nowhere, or might on the other hand end up "with an alliance that is very important for the future of the company". The Avianca group also includes Colombia-based freight service Tampa Cargo SA, Ecuador-based Aerolíneas Galapagos (known as Aerogal) and Grupo TACA of Central America. Avianca Holdings companies carried 28.3m passengers in 2015, and operate a network with 105 destinations in 28 countries using a fleet of 177 aircraft.

New Mexican petrol stations: For the first time in eight decades, there are now petrol stations in Mexico that are not trading under the Petróleos Mexicanos or Pemex brand, owned by the state oil company of the same name. The change is small – only three new stations in early June – but symbolically important, as it marks the introduction of competition into the downstream end of the oil and gas business, as contemplated in the 2014 energy reform. One station is now operating in Mexico City under the Hidrosina brand, while a further two in Campeche and Mérida are selling fuel under the La Gas brand. Grupo Hidrosina, set up in the early 1990s, has operated around 30 Pemex-branded stations as a concessionaire for a number of years. "With the collaboration of Pemex we signed an agreement to use a different brand and test the success that may, or not, work for the clientele", said Víctor Ruiz Iriarte, director of operations at Hidrosina. Around 20 Hidrosina-branded stations will be piloted this year, he added. More new petrol station brands are due to make their appearance: Gulf Oil of the US has said it will be opening four petrol stations in Mexico in June and July.

Legal wrangles over the Chapo name: A series of potentially costly legal disputes are looming over the media treatment of the life and times of Joaquín 'El Chapo' Loera Guzmán, the reputed leader of the Sinaloa drug-trafficking and criminal cartel, currently in a Mexican prison awaiting the outcome of extradition proceedings to the US. The disputes have been triggered by an announcement in May that the US-based Spanish television network *Univisión* and the global streaming film and TV service *Netflix* plan to co-produce a "boundary-breaking drama" series called 'El Chapo', based on his life and due to be broadcast in 2017. No so fast, said Andrés Granados, a lawyer for the real-life Chapo. According to him, *Univisión* and *Netflix* must seek his client's authorisation, something that could be available "at the right price", adding that El Chapo was also ready to provide more information to improve the proposed series. Granados has pointed out that El Chapo's family has already registered his name as a brand with the Instituto Mexicano de la Propriedad Industrial (IMPI). Potentially a further complication is that Granados is the same lawyer who negotiated on his client's behalf with the Mexican-American actress Kate del Castillo last year, giving her the rights to film a documentary on the drug lord. Mexican security forces tailed Del Castillo and the US actor Sean Penn on their way to a meeting last year with El Chapo in Mexico, who was then at large, and used some of that the information to capture him in January. Presumably *Univisión*, *Netflix* and Kate del Castillo would have to come to some kind of an agreement on film and documentary rights. According to Charles J. Glasser, Adjunct Professor

of Media Ethics at New York University, under the First Amendment journalistic accounts of newsmakers are protected from such rights claims because "otherwise bad guys could quash coverage". But those who are the subjects of fictionalised accounts, even if they happen to be criminals, do have a right to negotiate over the intellectual property rights in, for example, the use of their name. As Glasser put it, however, "*Netflix* and *Univisión* have a PR problem… how will people feel about them 'getting permission from' – and probably paying – a notorious bad guy?"

COLOMBIA

Hopes for peace and prosperity

The 23 June signature of a definitive bilateral ceasefire agreement between the government led by President Juan Manuel Santos and the Fuerzas Armadas Revolucionarias de Colombia (Farc), the main left-wing guerrilla insurgency in the country, holds out the promise of an end to over half a century of internal conflict, prompting expectations of a 'peace dividend' for the economy.

Like other Latin American economies, Colombia has been adjusting to the sharp fall in global energy and mineral prices since 2013. However, both the central bank (BanRep) and the IMF expect the economy to have a soft landing – and in the context of growth that is reasonably high in regional terms. Real annual GDP growth was 4.4% in 2014, slipping to an estimated 3.1% in 2015. In the minutes of its latest monetary policy meeting on 22 June, BanRep was expecting overall growth in 2016 of between 1.5% and 3.2%, with 2.5% the most likely outcome. A little more optimistically, the finance ministry expects real annual GDP growth of 3% this year, rising to 3.5% in 2017. Amid the fall in oil and mineral export revenues, the current account deficit was US$3.38bn (5.6% of GDP) in the first quarter of 2016; this was lower than forecast and indeed the lowest since early 2014.

The main current imbalance is inflation. Headline consumer price inflation and core inflation hit 8.2% and 6.3% respectively in the year to May. Private economists project inflation of 4.4% and 3.7% in 2016 and 2017, respectively. BanRep's inflation target is 3.0% +/- 1.0%. BanRep sees the currently elevated inflation, however, as a 'transitory' problem, because of the impact of the sharp fall last year in the peso against the US dollar and higher food prices resulting from the recent El Niño phenomenon. Nevertheless, BanRep increased its key interest rate by 0.25% to 7.50% in late June. It had already lifted the rate by 0.50% in late April and by 0.25% in May.

The IMF shares BanRep's view that the economy is on track for a soft landing, and in its latest Article 4 consultation the Fund highlighted other strengths, including fiscal discipline, given that the government has achieved its target for the structural deficit – thanks to the tax reforms approved in late 2014 and expenditure cuts. The deficit is expected to reach 3.9% in 2016, and the government's target for 2017 is 3.3% of GDP, falling to 2.7% by 2018. Meanwhile, overall public debt is expected to stabilise at around 50% of GDP this year.

Notably, the Colombian government does not expect to receive any income from oil royalties this year, according to a mid-year fiscal report published by the finance ministry on 14 June. Instead the ministry calculates that the government will have to refund a total of Col$800bn (US$268m, or 0.1% of GDP) in taxes to oil sector firms that have been operating at a loss because of the low international oil prices.

Domestic oil production this year is set to fall below the daily average of 1m barrels registered in 2015, with average output projected to dip to 921,000bpd in 2016 and 913,000bpd in 2017. Finance Minister Mauricio Cárdenas has admitted that the government does not expect dividends from the state-run oil firm, Ecopetrol, in 2017, which will oblige additional fiscal adjustments next year. According to Cárdenas, these will involve budget cuts to the tune of Col$6bn in order to ensure the targeted 2.7% of GDP deficit in 2018.

The IMF also highlighted the soundness of Colombia's financial system. Total credit to the private sector rose by 14.7% in 2014 and by 15.5% in 2015. The Fund expects credit growth to slow to 9.2% this year. Foreign Direct Investment (FDI) inflows into Colombia have held up well outside of the minerals and energy sector. Significant deals over the last year or so have included investments in retail (by Chile's Cencosud, Falabella and Parque Arauco groups, hotels (through the acquisition of Hoteles Royal by Spain's NH), manufacturing (by Spain's Cementos Molins and General Motors of the US), and infrastructure (by the Danish port operator APM Terminals).

Moreover, Colombia's own multinational groups have the scale and sophistication to undertake major cross-border investments of their own. Examples include the regional expansion by the insurance arm of Grupo Sura, Empresas Públicas de Medellín's purchase of the Chilean utility Aguas de Antofagasta, and the retail Grupo Éxito's purchase of businesses in Brazil and Argentina.

In short, the ceasefire comes at a time that economic activity is well below the cyclical peak, but where the overall business environment is improving. Colombia for some time now has already been looked upon as an attractive market opportunity, even in the absence of a definitive ceasefire between the government and rebel groups (note: a smaller radical leftist guerrilla group, Ejército de Liberación Nacional, has tentatively agreed to peace negotiations, but has yet to come to the table, amid suspected internal splits between dominant militant hardliners and a smaller moderate wing).

Strategic mining areas ruling a setback

On 9 June Colombia's Constitutional Court (CC) ruled unconstitutional three resolutions designating over 20m hectares of Colombian territory 'strategic mining areas' (SMAs, in the Spanish acronym). The SMAs comprised 516 lots rich in mineral resources, covering some 20% of the national territory, which the government expected to auction off as exploration and development concessions to interested companies. However, many of these areas were located on territories belonging to Indigenous Peoples and Afro-Colombian communities and/or in areas of important biodiversity and fragile eco systems (in the regions of Amazonia, Chocó, Orinoquía and Colombian Massif)

The CC effectively ruled that the demarcation of the SMAs required the Free, Prior, and Informed Consent (FPIC) of the affected communities, who would be directly affected. Because the government had violated this right to FPIC, which is enshrined in the 1991 Constitution, the three resolutions were considered to be invalid. Notably, the CC ruling carried what is know as 'an inter comunis effect', meaning that the protections extend not only to the 16 communities that were the plantiffs in the case, but also to populations deemed to be in a similar situation in the country.

According to a 14 June English- and Spanish-language statement issued by lawyers acting on behalf of the plaintiffs (a local NGO, Tierra Digna, in conjunction with 16 Community Councils and the Interethnic Solidarity Forum of Chocó, the ruling "is a substantial step in the democratisation of decision-making regarding the body of laws governing the territories, in that it recognises the necessary and fundamental input that indigenous and Afro-Colombian communities should have, as key actors in the formation of public policy in general, and in this case mining policy in particular".

The statement went to stress that the verdict "also represents an opportunity for the government to design mechanisms by which to consult and strengthen the participation of these populations in the adoption of decisions regarding mining policy, in order to avoid the emergence of further socio-environmental conflicts caused by arbitrary actions taken by the government. It is our belief that this ruling comes at the right time for the State to incorporate not only this holding, but several decisions that the Constitutional Court has released recently regarding mining. These rulings provide an opportunity for the government to reform its mining policy to ensure that it embodies constitutional principles and respects fundamental rights, including the rights to participation, to a healthy environment, to water, to cultural diversity, and to food. Only in this way will we be able to construct peace and development for all".

MEXICO

The curious case of Mexico's falling car exports

Following a record result in 2015, Mexican automotive exports – roughly three quarters of which are destined for the US – have fallen back in recent months, even as demand in the US economy continues to recover. In April, Mexico's total automotive exports fell by 15.6% year on year, with a 9% fall in exports to the US.

This rather incongruous result is explained by the fact that even though US demand has recovered, consumer demand in the US for light vehicles (i.e. small passenger cars) is falling.

In part, the sharp fall in petrol prices has prompted a demand shift in the US away from small cars and family saloons back towards larger pick-up trucks and sports utility vehicles (SUVs), with demand for these 'gas guzzlers' up by 11% in April. As light vehicles dominate Mexico's auto export basket, these changing demand patterns are negatively affecting locally based manufacturers. Ironically, the US recession following the 2008 financial crisis had benefitted Mexico's carmakers to a degree, as US consumers traded down to smaller vehicles.

However overall automotive sales in the US slowed in May, prompting concern that last year's record sales growth is cooling off. It is also the case that other important markets for Mexico-based manufacturers are still weak – most notably Germany in Europe and Brazil in Latin America. Sales to Germany, dominated by Volkswagen's 'Beetle' and 'Jetta' models, fell by 36.3% in the first four months of 2016, with sales to recession-hit Brazil down by over two-thirds (64.7%).

Exports typically account for about three-quarters of local production and so despite continuing strong domestic demand, the impact on the sector is heavy. Thus with export demand so low, Mexico's total auto production in the first four months was down by 5%, with the likes of Fiat-Chrysler, Ford and Mazda, all focused on smaller cars, particularly affected. The impact on the wider economy will also be felt – as auto exports account for about a quarter of the total export basket.

And there is no sign of a change in the current negative trends in the export-dependent sector. According to latest data for the month of May from Mexico's association of automotive manufacturers (Amia), total exports shrank by 7% in the first five months of the year, with total production falling by 4.6% to 1.35m units. Production has thus fallen for four consecutive months, the weakest result since 2009.

In the internal market, domestic new (passenger) car sales increased by 16.8% in the first five months of 2016, to 587,320 units, according to Amia. Of these new sales, 44% were made in Mexico and 56% abroad. Following a record year in 2015, with total sales of 1.35m units (cars and light trucks), Amia cited continued robust domestic demand, stronger price competition between manufacturers, better credit availability and continued efforts to limit the over-supply (effectively dumping) of used US cars in Mexico under the North American Free Trade Agreement. Still, this is not enough to offset the shifting winds in external markets.

AAPC-AMIA-CVMA joint statement ahead of 'Tres Amigos Summit'

On 28 June, ahead of the North American Leaders' Summit between Canada's Prime Minister Justin Trudeau and Presidents Barack Obama of the US and Enrique Peña Nieto of Mexico (also known as the 'Tres Amigos Summit'), the Canadian, US and Mexican automotive industry associations issued a joint statement urging greater integration and trade policy cooperation.

"The auto industry serves as a driving economic force in the integrated North American economy. Automotive products account for 20% of total North American trade, making automotive goods the single largest category of traded products, and this sector supports millions of American, Canadian and Mexican jobs. Together we are more competitive than we ever would be apart.

"As our leaders gather for these historic meetings, we encourage them to adopt policies that will expand economic growth and prosperity. As each of the three countries negotiate trade agreements with third parties, we urge our governments to coordinate on issues like rules of origin, including North American cumulation, and addressing non-tariff barriers to ensure that these trade agreements fortify the North American automotive supply chain and increase North American auto exports. We also call on our governments to take further steps to eliminate Customs procedures that impede efficient vehicle and auto parts commerce between our three countries. Advancing these priorities will promote the competitiveness and continued growth of the North American industry, and the millions of jobs it supports across the continent."

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