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Mexico's inflation on the rise: something to worry about?

Mexico's annual inflation rate rose to 6.17% in May, the highest in over eight years. On 18 May, before the inflation data was released, the Banco de Mexico (Banxico, central bank) had again tightened interest rates, raising the benchmark rate by 25bps to 6.75%. Analysts are divided as to whether this is part of a worrying vicious circle or whether it is no more than a passing spike in an economy that is otherwise showing signs of resilience.

There is a case to be made for concern about Mexico's inflation rate. It is now double the central bank's central target rate of 3% (within a band of 2-4%). Rising inflation comes hard on the heels of wobbly business expectations, troubled by last November's election of Donald Trump to the presidency of the US. The Trump campaign was protectionist and anti-free trade, and Trump particularly objected to the North American Free Trade Agreement (NAFTA).

Uncertainty over Trump's policies towards Mexico led to another steep depreciation of the Mexican peso in late 2016, which has been a major source of inflationary pass-through from the exchange rate in the past two years. Another factor driving the consumer price index up has been the near 20% increase in domestic fuel prices, known as the *gasolinazo*, announced in January, which has had a series of subsequent consequential effects (Mexico City bus fares, for example, were increased in April). The latest inflation data also shows food, transport and clothing prices also making a contribution to the rise in the general index.

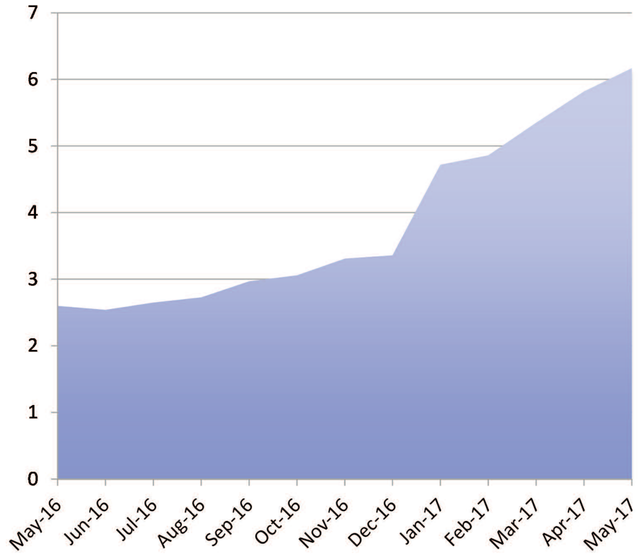
A key argument for the pessimists is that higher inflation will reduce purchasing power and therefore impair consumption's contribution to GDP. Consumer demand has been the main engine of Mexican economic growth in recent years, helping to offset the steep fall in the oil export sector, for example.

Inflation has accelerated in each of the last ten months. This consistent rise has forced Banxico to adopt a tightening monetary stance, which could slow the economy. Indeed, the minutes of the 18 May monetary policy meeting showed that the Banxico board had voted by 4-0 in favour of raising the benchmark rate to 6.75%, a hike that took most of the market by surprise. The board observed that the balance of inflationary risks had shown some deterioration, and that the possibility of additional weakness in the peso remained a vulnerability – not least amid some continuing uncertainty about Mexico's relationship with the US.

There is a more optimistic interpretation, however. Some economists argue that while both the economy and expectations wobbled in late 2016 and early 2017, that wobble is now largely over and inflation will track back down during the second half of 2017. Those taking this position cite the general

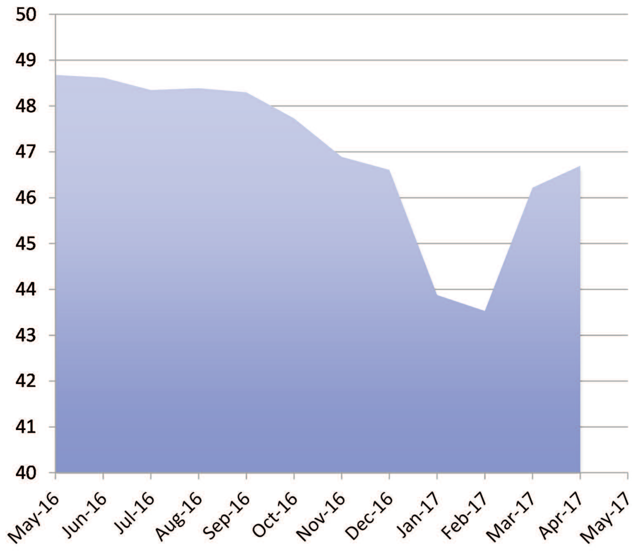
Mexican inflation rises…

12 month inflation rate



…but after a wobble, business confidence comes back

Business confidence index



Source: *Inegi*

view that the threat to the Mexican economy from the Trump administration will be a lot less damaging than feared. The feeling is that the NAFTA renegotiation will either turn out to be relatively benign, or alternatively become so drawn-out that it has a neutral impact. Those who argue this case note that since January the Mexican peso has bounced back strongly against the US dollar, appreciating by 17% to mid-May, getting it almost back to pre-election levels. (It was trading at MXN/18.4US$ on 6 June.)

Importantly, the real economy is also showing resilience. Real GDP rose by 0.7% quarter-on-quarter in the first three months of the year, better than expected, with an annual growth rate of 2.8% (up from 2.3% in Q416). The ever-cautious Banxico has lifted its growth forecast for 2017 as a whole to a range of 1.5%-2.5%, up from 1.3%-2.3% previously. Admittedly, at the same time the bank acknowledged that the general consumer price index would remain "considerably above" the upper limit of its target range. However, it did say that in 2018 it expected inflation to "revert to a trend convergent towards the objective of 3%, and to reach that level at the end of the forecast period". In a radio interview, the Banxico president Augustín Carstens stated, "we still expect that we should reach a ceiling in the rise in inflation in the next few months and… in the second half, we should see a much more downward tendency."

NAFTA renegotiation triggered

Notice of the much-heralded NAFTA renegotiation has now been formally served. In an 18 May letter to the US Congress, the now-confirmed US Trade Representative (USTR), Robert Lighthizer, served the required 90-day notice of the Donald Trump administration's intent to renegotiate the terms of the agreement with Canada and Mexico. This means that formal tripartite negotiations can begin at any point after 16 August this year. Mexico's foreign minister, Luis Videgaray, said that the government led by President Enrique Peña Nieto welcomed the announcement, adding, "We are ready to work together with both the governments of the United States and Canada to make our trade agreement better".

Since NAFTA was created in 1994, US-Mexico trade has increased by a factor of more than six, while US-Canada trade has nearly tripled. In 2016, the US had a US$55.6bn deficit in its bilateral trade with Mexico, and a US$12.5bn surplus in its trade with Canada, according to US data. The US deficit in trade with Mexico

– the subject of much adverse comment by Trump during the US election campaign last year – has remained sizeable during the first months of this year. In March, it stood at US$7.03bn, up by 30% on the same month in 2016.

Sugar drama

As this issue went to press in early June, the US and Mexico appeared close to a deal in their trade dispute over Mexican sugar exports, widely seen as one early indicator of how they intend to play the wider NAFTA negotiations. US Commerce Secretary Wilbur Ross said the 5 June deadline for reaching a deal had been extended by 24 hours. He emphasised that "the two sides have come together in quite meaningful ways, but there remain a few technical details to work out". According to some sources, a deal setting reduced quotas for Mexican sugar sales had been reached, but US sugar refiners were formulating additional demands.

REGIONAL ECONOMY REVIEW

BRAZIL

Recovery versus scandal

As has often been the case in recent months, in May there was both good and bad news for Brazil's economy: the dilemma for investors remains assessing which of the two was most significant.

The good news is that the recession looks to be over. Second quarter GDP rose by 1.0% quarter-on-quarter, ending a lengthy period of eight consecutive quarterly contractions in activity. The bad news is that President Michel Temer's administration has been swamped by a new wave of political scandal and may not complete its term. Political risk is again looming large and could, in the worst-case scenario, tip the economy back into the doldrums.

To take the good news first, there are signs of strength in overall economic activity levels at last. Not only was first quarter growth an encouraging +1.0% q-o-q, but the national statistics institute (IBGE) revised the Q4 16 data upwards, to -0.5% q-o-q (from -0.9% previously). As a result, in the rolling year to Q1 17 the Brazilian economy contracted by just 0.4%, a major improvement on the 2.5% contraction registered in the year to Q4 16. In the first three months of 2017, the biggest contribution to growth came from net exports. Exports grew by +4.8% q-o-q, while imports rose by 1.8% q-o-q. This was consistent with a recovery in commodity prices, which is helping to lift export values across a number of Latin American economies (*see previous article*).

Less encouragingly, private consumption remained weak (-0.1% q-o-q) and public sector consumption showed the impact of ongoing fiscal austerity measures (-0.6% q-o-q). The hoped-for recovery in fixed investment also failed to make itself felt (-1.6% q-o-q). Measured as a share of GDP, fixed investment was 15.6%, down from the 16.8% registered in the same year-earlier period, and still at the lowest level registered in Brazil since 1995.

By sectors, agriculture – buoyed by rising harvests and strong export prices (particularly in the case of soya) – made a strong contribution, with growth of 13.4% q-o-q, while the manufacturing sector was up by +0.9% q-o-q. The services sector remained largely flat. Moving into the second quarter, other indicators also told a relatively upbeat story. There was a record trade surplus in May (US$7.66bn, resulting from exports of US$19.79bn and imports of US$12.13bn). This suggests that the external sector will continue to play a supportive role.

Average quarterly unemployment, which had reached a record 13.7% in the three months to March, slipped back to 13.6% in the three months to May. Although this was a welcome surprise, analysts remained guarded. "The labour market has shown some incipient signs of stabilisation" said Goldman Sachs economist Alberto Ramos, cautioning, however, that further improvement will only come later this year and be dependent on the political climate. Another positive is that with inflation rates falling, the central bank (BCB) has continued its monetary easing: the latest cut in the benchmark Selic rate was announced on 31 May, with a 100bps reduction to 10.25%, the lowest rate in the last three years.

But the bad news on the political front may put a spanner in the works in the second quarter. Up until May, the consensus view among investors was that a transitional and generally unpopular government was nevertheless doing broadly the right things in terms of fiscal, tax, labour, and pension reforms. Relying on its congressional majority, the Temer administration was seen as delivering the necessary changes capable of restoring business and investor confidence ahead of the general election in October 2018. But that was before a bombshell on 17 May, when the leading newspaper *O Globo* revealed the existence of audiotapes in which the president appeared to condone bribery payments made by executives at the meatpacking giant JBS. This, coupled with other revelations, put the government on the back-foot. Temer is now the subject of a Supreme Court investigation. His centre-right congressional majority is at risk of breaking up. A long-running investigation into alleged fraud in the 2014 elections has also posed the possibility of his removal from office. A number of analysts believe Temer may have to step down before his term ends on 1 January 2019, in effect forcing Brazil to turn to yet another transitional government, with as-yet unknown economic policies, ahead of the next election. Temer has been forced to postpone a major component of his reform programme – a constitutional amendment to rein in the country's over-generous pension payments and increase the average retirement age. The central question is how this latest political uncertainty will affect business confidence and, in particular, whether it will prolong the long investment slump in the country.

The most negative implication is that Brazil may be pushed into a double-dip recession – with growth faltering again in Q2 and beyond. In fact, even without the political crisis, the economy may weaken in the second quarter this year. Finance Minister Henrique Meirelles has suggested that GDP is likely to fall again in Q2 17, but believe that Brazil will still see positive growth overall in 2017. Consultancy Capital Economics agrees that Q2 is shaping up to be weaker than Q1. This is because the recent boost from agriculture will fade, but also because latest monthly data is pointing to some additional weakness in manufacturing. It concludes that the recovery likely will be "a stop-start affair", "irrespective of the politics".

ARGENTINA

Record harvest lends a helping hand

President Mauricio Macri's efforts to stimulate economic recovery are getting a helping hand from the agricultural sector. According to Martín Moreno, director of national forecasts at the ministry for agro-industry, the 2017/18 wheat harvest could grow by over 8%, rising from 18.4m tonnes in the current 2016/17 season to an all-time record of nearly 20m tonnes in 2017/18.

The government's optimistic forecast comes despite the fact that it expects the area planted with wheat to fall to around 6m hectares, down from 6.36m in the current season. More widely, estimates of a record wheat harvest could be subject to downside risk, with meteorologists saying in May that higher rainfall and humidity in the 2017/18 season could reduce yields. But Moreno told the *Reuters* news agency that his prediction of a "nearly 20m tonne" harvest was fundamentally based on improved technology, and on the use of better seed varieties and more effective fertilisers. Private sector wheat forecasts for next season are more conservative. In April, the Bolsa de Cereales de Buenos Aires predicted a 2017/18 wheat harvest of 17.5m tonnes (there are, however, some methodological differences between the two estimates).

The outlook for the agricultural sector for next season is positive. The overall grains and oilseed harvest this season is projected at a new record of 130m tonnes, the biggest since Argentina became an independent Republic in 1810. The surge in overall output in 2016/17 was helped by a 21% rise in maize production to 48m tonnes. The soya harvest totalled 57m tonnes, roughly flat on the previous season. The sunflower harvest grew by an estimated 15%.

If this current agricultural boom can be sustained into the coming season, there are various economic implications. The first – already evident – is that Argentina's farmers are going to have a lot more disposable income. After taking office in December 2015, President Macri eliminated exchange rate controls, floated the peso (a *de facto* devaluation) and terminated almost all of the agricultural export taxes imposed by the preceding left-wing administration. The only remaining export tax – on soya shipments – will be completely phased out by 2022. Much will depend on how this extra purchasing power is spent – and how much of it is channelled into increased local investment or consumption.

The second economic effect will be to provide some help for the government's double task of boosting the country's economic recovery, while grappling to bring down the still-high rate of inflation. Based on monthly economic activity index compiled by the central bank (BCRA), Argentina's quarter-on-quarter GDP growth is estimated to have accelerated from +0.5% in Q4 16 to +1.5% in Q1 17. The acceleration in the first quarter was attributed in part to a rebound in the construction sector. Annual inflation (as measured in Buenos Aires) fell to 29.3% in April, from 34.9% in March. However, the BCRA is still wary of underlying inflationary pressures– in April it surprised the markets by raising its benchmark interest rate by 150bp to 26.25%.

Some analysts argue that a combination of a one-off fiscal income windfall from a tax amnesty last year and the strong agricultural performance has bought the government a little time in the run-up to the October mid-term elections this year. However, with the fiscal deficit currently running at an estimated 6.5% of GDP, the pressure will remain on the government – once the elections have taken place – to address the need for further economic reforms.

REGION

An export turn-around?

The end of the commodities boom, slower global growth, the oil price slump – everything seems to have conspired against Latin American and Caribbean (LAC) exporters in recent times. But the first quarter of this year may be the first indication of a turn-around. LAC merchandise exports rose by 17% year-on-year, ending four years of consecutive contraction.

According to the Inter-American Development Bank (IDB), using data from 25 countries in the region, the value of goods exports in Q1 17 rose by 17%, after a 2.9% contraction in the same year-earlier period. The bank attributes the change mainly to a rebound in commodity prices. But IDB economist Pablo Giordano warns that the improvement remains unstable and restricted to a few key economies – particularly those traditionally reliant on oil and mineral exports.

Venezuela, which is almost entirely oil dependent, led the way with a 75% increase in the value of its overseas goods shipments compared to last year. This was followed by Peru (39%), Ecuador (34%), Colombia (31%) and Brazil (24%). As a sub-group, Mexico and Central America achieved an average of 11% growth in the first quarter.

The IDB says the return to growth marks the end of the longest trade recession in the region's recent history. But export value is still below the peak level achieved in 2014. The IDB also argues that for the recovery to become sustainable, "factors that have been generating uncertainty in the global economy need to be significantly reversed". It is looking for real growth in China, the US, and Europe to sustain momentum in the second quarter and beyond. It also calls on LAC countries to promote competitiveness and regional integration, and to resist the temptation of protectionist policies.

REGION

IMF cautiously optimistic

In its latest (May 2017) Regional Economic Outlook for the Western Hemisphere, the International Monetary Fund (IMF) said it expected Latin America and the Caribbean to gradually emerge from recession in 2017, with average regional growth of 1.1%, rising to 2% in 2018. However, it also warns that growth is expected to remain subdued at about 2.6% in the medium term. Echoing ECLAC it advises that regional countries need to address infrastructure, strengthen the business environment and tackle corruption so as to ensure stronger and more inclusive growth going forward.

Economic growth in Latin America and the Caribbean in 2016 was the third-lowest in 30 years, contracting by 1% following stagnation in 2015, the IMF reports. Growth was held back by weak domestic demand, the Fund noted, amid lower commodity prices, ongoing fiscal and external adjustment in some countries, and other country-specific domestic factors.

The outlook moving forward will be shaped by global economic and policy factors, including on a positive side a modest rebound in commodity prices and external demand, thereby boosting the export performance, but on the negative side the IMF flags the risk of higher global policy uncertainty. Finally, domestic developments will continue to play a decisive role in determining growth in many economies. "With heightened policy uncertainty at the global level but low market volatility, countries in our region should focus on insuring against downside risks, while targeting strong, sustainable, and inclusive growth," Alejandro Werner, the director of the IMF's Western Hemisphere Department, stated.

Lock in the path to growth

Given a challenging external environment, the IMF stressed that many countries in the region should look to advance fiscal and external adjustments to preserve or rebuild policy buffers (for example, by improving primary balances to stabilise rising public debt).

However, "charting a course toward higher, sustainable and more equitable growth will also require domestic reforms", it stresses. These vary by country, and include the likes of: closing infrastructure gaps; improving the business environment, governance, and education outcomes; deepening regional trade integration; and encouraging female labour force participation to boost medium-term growth and foster income convergence. These policies would help raise future growth by increasing contributions from labour, capital, and productivity, it emphasises.

Regional Outlook

For **South America's** commodity exporters, the modest recovery in commodity prices will provide some relief, but not uniformly.

In **Argentina**, the Fund notes, "the recovery is under way". Its now expects real annual GDP growth of 2.25% 2017, driven by a rebound in private consumption, stronger public capital spending, and a bounce exports.

In **Brazil**, the IMF says that growth is expected to return to positive territory after two years of recession, with a real GDP result of 0.2% in 2017. This will rest on a bumper soybean crop, a one-time boost to consumption, a faster-than-expected decline in inflation, and higher iron ore prices.

In **Venezuela**, the Fund is blunt. It expects the economy "to remain in a deep recession and on a path to hyperinflation". With no sign of a shift in economic policies, real GDP is expected to fall by 7.4% in 2017.

Despite slightly better external conditions, the outlook for **Chile** remains subdued, the Fund notes, largely reflecting lingering domestic weaknesses. As such, it projects real GDP growth of 1.7% in 2017.

In **Colombia**, meanwhile, "the orderly economic slowdown continued last year, as domestic demand has been adjusting to a permanent shock to national income". While one-off factors led to a weaker-than anticipated growth in 2016, the Fund expects a mild rebound in 2017.

Peru 's economy rebounded at a decent pace in 2016. However, there is a problem in that investment continues to lag, with negative private sector sentiment exacerbated by domestic headwinds related to the Odebrecht bribery scandal. As if this wasn't enough, Peru in early 2017 suffered the worst flooding and landslides in decades, which likely will be a drag on 2017 investment and growth.

The outlook and risks for **Central America** and **Mexico** remain heavily influenced by their exposure to the US, via trade, migration, and foreign direct investment (FDI).

Mexico's real GDP growth is expected to decelerate to 1.7% in 2017, the Fund projects. Uncertainty about the future shape of the trade framework with the US in addition to higher borrowing costs, are expected to more than offset the positive effect from stronger US growth, it notes

Growth in **Central America**, **Panama**, and the **Dominican Republic** is expected to remain broadly unchanged from last year in 2017. Strong US growth will help support exports and remittances (the latter a mainstay of domestic consumption; in some countries accounting for up to a fifth of GDP).

Finally, the IMF says that prospects for the **Caribbean** are improving, "with growth in both tourism-dependent economies and commodity exporters projected to be in the 1.5-3% range for 2017 and 2018.

Priorities

The Fund identifies regional policy priorities moving forward as follows: maintaining exchange rate flexibility; easing trade-offs for monetary policy, managing corporate and financial sector risks; completing the fiscal adjustment; and finally, tackling structural bottlenecks.

Real GDP growth, % year on year, 2017-2018		
	2017	**2018**
Mexico	1.7	2.0
Argentina	2.2	2.3
Bolivia	4.0	3.7
Brazil	0.2	1.7
Chile	1.7	2.3
Colombia	2.3	3.0
Ecuador	-1.6	-0.3
Paraguay	3.3	3.7
Peru	3.5	3.7
Uruguay	1.6	2.6
Venezuela	-7.4	-4.1
Costa Rica	4.0	4.0
El Salvador	2.3	2.3
Guatemala	3.3	3.5
Honduras	3.4	3.6
Nicaragua	4.5	4.3
Panama	5.8	6.1
Dominican Republic	5.3	5.0
Haiti	1.0	3.0
Jamaica	2.0	2.4
Trinidad & Tobago	0.3	3.4
Source: *IMF*		

ECUADOR

Uncertainty over policy stance as Moreno takes the helm

After a decade at the helm, Rafael Correa stood down from the presidency in late May, when his elected successor Lenín Moreno was inaugurated. Moreno, also of the ruling left-wing Alianza Pais (AP), has indicated a likely change in style under his leadership, but questions remain about the extent to which official policy will shift under a new administration. Moreno's cabinet appointments have fuelled this speculation, with a mixture of new faces and party stalwarts.

The inauguration ceremony took place on 24 May at the national assembly, in which the AP retains a majority, with 74 of 137 seats. Immediately, the new president was at pains to gently emphasise that his governing style would be rather different to that of his predecessor, the charismatic but highly combative Rafael Correa (who critics also accused of having an autocratic bent).

Moreno immediately scrapped the president's weekly '*Enlace Ciudadano*' broadcasts on state media, which Correa regularly used to broadcast pro-government propaganda. Moreno simultaneously extended an olive branch to the media, which had suffered from an erosion of press freedom under Correa. Notably, the new president has announced plans to reform the 2013 communications law, which gave huge powers to a state-run watchdog to clamp down media coverage critical of the government.

The newly-appointed cabinet seeks to strike a balance between asserting Moreno's independence – through the appointment of a variety of new faces – while also respecting the Correa legacy, retaining a number of AP loyalists who remain close to Correa. This latter group includes the vice president, Jorge Glas, as well as María Fernanda Espinosa (foreign minister), Paola Pabón (head of political management), Fánder Falconí (education minister), Verónica Espinosa (health minister), Medardo Cadena (electricity minister), and Javier Córdova (mining minister).

Technocrats give renewed hope of change

However, the new faces include several industry professionals, including Carlos Pérez – a former international oil executive who served as Ecuador's country manager for US oil firm Halliburton – who Moreno invited to lead the energy ministry. Meanwhile, Pablo Campana, the new foreign trade minister, hails from a career in the private sector, as the president of real estate company, Millenium Partner Corporation. Other appointees to economy-related portfolios have significant private-sector experience as well, including Eva García Fabre (the new industry minister), an economist and Ecuador's former representative before the World Trade Organisation (WTO) and Enrique Ponce de León (the tourism minister), who was previously the head of Decameron Ecuador, a hotel chain with investments in tourism projects.

However, there is significant uncertainty over the extent to which economic policy orientation will actually shift under the Moreno team. The election campaign was relatively short on specific details, with Moreno talking loosely about plans to increase social spending, cut poverty and 'engage' the private sector in negotiations. Given the weak economic backdrop, with GDP stagnating in 2015 and contracting in 2016, realising these objectives might be difficult, particularly given that oil prices remain fairly low. Moreno has reportedly already held discussions with World Bank officials about how to finance his social spending plans and has also announced some down-sizing in terms of the public sector, in an effort to trim administration costs.

With the fiscal deficit already large (running at over 5% of GDP for the past few years) and large-scale borrowing under Correa lifting the public debt burden, there is little scope for Moreno to engineer a State-led recovery. As a result, boosting growth may require a significant increase in foreign investment, but in turn this will require structural improvements to the business environment, potentially including tax and labour reforms, a better competition policy, a scaling back of State dominance in key sectors and a better track record in terms of public-public partnerships (PPPs).

While Moreno seems more willing to talk to foreign investors, there is little sign of much political will in the AP for a fundamental shift in the underlying policy approach. According to the World Bank, foreign direct investment (FDI) as a share of GDP is very low, at just 1.1% in 2015 according to the latest data – below the Latin America average of 3.8% (and significantly below Ecuador's Andean neighbours Peru and Colombia). Unless the newly-appointed technocratic ministers can persuade the AP of the logic of pursuing market-oriented reforms, there appears little likelihood that this percentage will rise significantly under Moreno.

Continued appetite for bond issuance

Meanwhile, Moreno and his finance minister have signalled plans to refinance at least part of the existing external debt, given a relatively heavy repayments schedule this year, when a reported US$6bn falls due, both in scheduled bond repayments and through the country's oil-for-loans agreement with China.

Moreno has said that he will seek to push back maturities in order to ease the short-term fiscal burden of repayments, which would free up more resources for social spending. However, at the same time there is little sign of any easing up in the pace of new debt accumulation, with the brand-new administration issuing US$2bn in new bonds on 30 May, just days after taking office. This new issue comprised a US$1bn six-year bond yielding 8.75%, and a US$1bn 10-year bond yielding 9.63%. This was the latest in a string of issuances over the past year, with proceeds again likely to be used for deficit finance during 2017.

Just as there are questions over the government's policy stance, there are also uncertainties over whether the authorities will put in place any kind of fiscal adjustment. Debt and deficit levels imply the need for an adjustment, but the fresh bond issuance suggests that the authorities would rather continue accumulating debt, rather than adjust public expenditure downwards.

The spending cuts announced so far by Moreno, including a reduction in the number of ministries, are primarily symbolic, since the fiscal savings from this account for a very small share of total expenditure. All eyes will be on the 2018 budget, which will be drafted later in the year, to see if the new government's approach will be fundamentally different to that of its predecessor.

VENEZUELA

Sharp devaluation as 'new' Dicom system is launched

After a two-month delay, the Banco Central de Venezuela (BCV, central bank) has finally implemented changes to its complex exchange-rate system that essentially encompass a maxi-devaluation. The changes were initially unveiled in March and were supposed to have been launched immediately, but with massive anti-government protests spreading across the country, the government's focus has been elsewhere.

The left-wing government led by President Nicolás Maduro has retained the two-tier currency system, with one fixed rate (known as 'Dipro' and used by the public sector for imports) remaining unchanged at BsF10:US$1. The latest changes are in relation to the other rate, which is known as 'Dicom' (and also still referred as 'Simadi', as per its previous incarnation). This secondary rate is used by the private sector. The Dicom rate has devalued steadily in recent years, going from BsF170:US$1 upon its launch in February 2015 to around BsF700:US$1 in mid-May.

The 'new' aspect of the Dicom system means that the government is selling US dollars in BCV regular auctions that it hopes will occur twice-weekly (this was previously trialled in mid 2015, only to be abandoned as dollar scarcity intensified). Two auctions have so far taken place, on 30 May and 2 June, with the BCV selling US$24.1m and US$22.9m respectively, at a rate of BsF2010:US$1, implying a massive devaluation from the prior rate.

After the second sale, Vice President Tareck El-Aissami emphasised the large number of firms (776) that had received foreign currency, implying that these new auctions are primarily designed to respond to the corporate demand for US dollars, rather than to individual requests (just 3,054 individuals received funds in the second auction, of a total population of over 31m).

System will encourage corruption

However, business operating conditions will remain extremely weak. The (illegal but widely used) black-market exchange rate is around three times weaker than the newly-devalued Dicom rate. In early June, it was trading at around BsF6300:US$1, according to websites that publish the rate. This means that there is still huge scope for corruption, as anyone with access to US dollars – either at the Dipro or the Dicom rate – can make large amounts of money selling their dollars on the black market.

Secondly, the reinstated BCV auction process still lacks transparency, with little information as to how many people and businesses have requested US dollars, or how the government has made decisions as to how to allocate funds and/or for how much.

In addition, the quantities sold are tiny in comparison to the significant pent-up demand for US dollars. When the BCV last dabbled with auctions back in 2015, it made much larger amounts available (often over US$400m each time). Since then, however, foreign companies have found it very difficult to remit profits, which remain stuck in the local banking system, while other firms owe suppliers hefty amounts in for unpaid bills. Demand is therefore significant, while the supply appears paltry (despite some recovery in oil prices this year). In this context, the new auction system is unlikely to have much effect on reducing the black-market exchange rate, while the maxi-devaluation will lift inflation, which is already well into triple-digits (the Venezuelan economist Francisco Rodríguez, of the New-York based Torino Capital, estimated an annual inflation rate of 517% in April). Neither will this auction system have much impact on the widespread shortages of basic consumer goods, including food and medicines.

Debate over morality of buying Venezuelan bonds

The paltry amounts of foreign exchange available in the latest BCV auctions is a symptom of the ongoing liquidity crisis facing the Caracas government. In recent years, it has addressed these problems by tapping China for credit, as well as coming up with innovative ways of raising money – including gold swap agreements. However, with China apparently more reticent about additional lending, and the government running out of other options to secure finance, it has latterly resorted to selling off some previously-issued bonds from the state oil company, PDVSA, to the US investment bank Goldman Sachs. But the fact that the bonds were sold at a heavy discount, with the US bank paying a reported US$865m for instruments worth US$2.8bn (at full value), has generated a controversy over the morality of providing financial assistance to a government that many regard as repressive.

Goldman Sachs has defended itself by insisting that this was a secondary-market transaction by its asset management arm arranged, arranged through a broker and with no direct dealings with the Venezuelan government. However, this has not prevented an outpouring of criticism from opposition politicians within Venezuela, as well as by prominent commentators outside the country. The head of the opposition controlled National Assembly, Julio Borges, accused Goldman Sachs of trying to make "a quick buck" from the suffering Venezuelan population, while Ricardo Hausmann – a Venezuelan economist at Harvard University – said the US bank was dealing in "hunger bonds" and called on international banks to withdraw Venezuela from their bond indices.

Borges has pledged an investigation by the Venezuelan legislature and also urged the US Congress to investigate the Goldman Sachs purchase. In reality, there is little to suggest that the US bank has broken any law in purchasing the bonds. Investors routinely trade debt instruments from governments deemed not-entirely-democratic, with so-called 'exotic debt' from high-risk issuers now constituting an asset class in its own right. Moreover, Goldman Sachs is not the only international financial institution holding Venezuelan debt. Many of the large international asset management firms also hold bonds issued either by the sovereign or PDVSA. The high yields for Venezuelan debt, which range from 20% for 20-year bonds to nearly 50% for 1-year instruments, make Venezuela an attractive market for investors prepared to take on the considerable risk of default.

The transaction helped stem the steep slide in the BCV's international reserves, at least temporarily. Reserve levels had fallen from US$11bn at the start of the year to US$10.1bn in mid- to late-May, before recovering to US$10.6bn in early June. It remains unclear whether the authorities will manage to stabilise reserves, but the fact that oil prices remain well above year-earlier levels will help. Venezuela's average oil export price stood at US$44.8/b in the first quarter, compared with US$24.7/b in January-March 2016, with prices remaining at around US$42-44/b since then. Combined with a likely continued compression in import spending, on current trends the government looks to be in a position to continue servicing its debt during the remainder of 2017.

REGIONAL BUSINESS REVIEW

REGION

Inequality down but not out

For many years, very unequal income distribution has been one of the major economic problems affecting Latin America and the Caribbean (LAC). During the most decade-long recent commodities boom (2003-2013), a combination of strong growth and redistributive social programmes helped reduce inequality. But, according to the latest (2016) 'Social Panorama of Latin America', published in late May by the Economic Commission for Latin America and the Caribbean (ECLAC), the move towards a more equal distribution of income is losing pace, and various types of inequality, acting through "multiple vicious circuits" continue to hold back regional economies.

The latest Social Panorama report says that income inequality fell across the LAC region in 2008-2015. However, it notes that the pace of improvement slowed in the period 2012-2015. Current levels of inequality are still adjudged to be too high and incompatible with sustainable development. "Inequality is a historical and structural characteristic of Latin American and Caribbean societies, which manifests itself via multiple vicious circuits. Advancing toward its significant reduction is one of the goals of the 2030 Agenda for Sustainable Development, signed by all the countries of the region in 2015. This agenda advocates for leaving no one behind," Alicia Bárcena, ECLAC's executive secretary, stated upon the launch of the report.

Inequality of income is usually measured through the Gini coefficient, a scale of zero to 1.0, where zero represents theoretical equality and 1.0 represents absolute inequality of income distribution. Based on survey data from 17 LAC countries, ECLAC found that the region's Gini coefficient in 2015 was 0.469, a level still considered high compared to international standards. By comparison, Denmark's latest available Gini score was 0.291, signifying a country with high levels of income equality, while in the US it was 0.411.

The regional index for the LAC fell by an average of 1.2% a year in the period 2008-2012 (signifying a move towards greater income equality), but thereafter the rate of improvement halved, with the index improving by a milder 0.6% per annum in the period 2012-2015. The year 2012 was an important turning point. It is no coincidence that this was when the global commodities boom began to fade, with negative economic repercussions for much of the region.

Factors reducing inequality

Among the factors reducing inequality, ECLAC cites rising employment, higher minimum wages, generally rising earnings for lower-income workers, monetary transfers, and policies to reduce informality in the labour market. The end of the commodities boom clearly made it difficult to maintain these trends. However, ECLAC stresses that governments must try to find ways to continue pushing through progressive structural reforms capable of generating high quality jobs (with rights and social protection), along with measures to boost productivity and sustain wage growth.

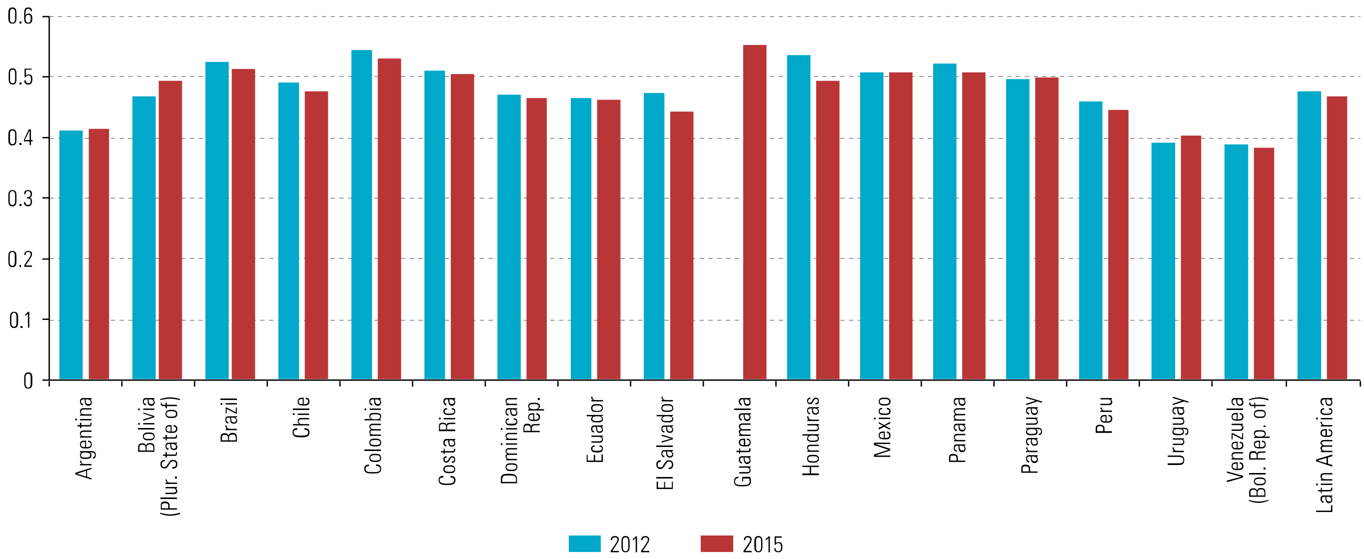
Another way of measuring inequality is to compare the average per capita income of the top one-fifth of households (Quintile V) with those in the bottom one-fifth (Quintile I). For 14 countries in the region, the ratio fell from 14.7 to 12.2 in 2008-2015, or by 16.8%. While this too indicates an improvement, it highlights the continuing scale of inequality. For example, for every 100-currency units received by those in the bottom quintile in 2015, those in the top quintile received 1,220.

Whether measured by quintiles or by the Gini coefficient, the report identifies Guatemala, Colombia, Brazil, Mexico, Panama and Paraguay as those countries with the most unequal distribution of income. Argentina, Uruguay, and Venezuela appear as countries with the least unequal distribution of income in the region (although there will are questions as to the reliability of the Venezuela data in the context of incomplete statistics and recent hyper-inflation).

Income distribution becomes (a little) less unequal

Gini coefficient in Latin America 2012-2015

B. Around 2012 and 2015



Source: *ECLAC*

One reason for concern is that the increase in social spending – which was one of the main driving factors behind the reduction in inequality – now appears to have gone into reverse, reflecting fiscal austerity in the post-commodities boom era. Social spending reached a highpoint of 14.5% of regional GDP in 2015 (within that, central government social spending amounted to 10.5% of GDP). By type of spending, the largest items included social protection (5% of GDP), education (4.6%), and health (3.4%). Yet ECLAC says that in 2016 and 2017, budgets for social spending are "contracting in the majority of countries" against a background of below-trend economic growth.

Other types of inequality

The reports looks beyond income to various other related types of inequality, including a continuing marked inequality between sexes in Latin America.

Women are over-represented in the bottom quintile by income: in fact, the overrepresentation of women aged 20-59 in Quintile V is around 40%. In addition, ECLAC calculates that women's "total work time" (a combination of paid employment and unpaid work carried out in households) is significantly greater than that of men. Women are found to dedicate up to one-third of their time to domestic and care work, while for men the proportion is a much lower 10%. The total value of unpaid work carried out at home, which is not captured in official statistics, is said to be equivalent to about one fifth of GDP. The report notes that there is evidence to show that greater economic participation by women in the formal labour force makes a significant contribution to reducing broad poverty and income inequality. In the absence of this, the current status quo is that "a large group of women face deprivation and inequity".

ECLAC also analyses the racial and ethnic components of inequality. There are about 130m Afro-descendent people in Latin America and the Caribbean, about one fifth (21%) of the total population. The Afro-descendent community is particularly large in countries like Brazil and Cuba, but is present throughout the entire region. Yet in only 14 countries (i.e. less than half) have governments created institutions and programmes to promote racial equality. The Afro-descendent community also suffers other indicators of inequality, such as higher than-average rates of infant mortality, teenage pregnancies, unemployment and lower-than-average earnings.

True to the norm in other parts of the world, inequalities of income tend to co-exist with sharper inequalities of wealth. Taking the case of Mexico, ECLAC points out that in 2003-2014 the Mexican economy grew at an annual rate of 2.6%, but wealth grew by a much higher average of 7.9%. Total wealth doubled over that period. In terms of physical assets, the Mexican data shows that 10% of the country's companies own 93% of the physical assets, a Gini coefficient of 0.93 (which compares to Mexico's much lower Gini coefficient of around 0.5 for income distribution). The largest share of total assets, 37%, is held by private families (other categories of ownership include the government, with 23% of total assets; and private companies, with 19%). Within this, 1% of the wealthiest Mexican families hold over one-third of these assets. By family, the Gini coefficient of total asset distribution, both physical and financial, is a very high 0.79.

REGION

Latin American women struggle to break the glass ceiling

Despite surpassing men in tertiary educational attainment, and becoming ever more present in the ranks of professional, middle and senior managerial positions, few Latin American women have advanced into executive positions. Breaking the glass ceiling is a challenge facing not only Latin American women, but women generally across the world. A new report from the International Labour Organization (ILO) examines the position of female executives in Latin America and the Caribbean.

As we reported in April, recent studies suggest a plateauing of the general female participation rate in the labour market in Latin America, with a lot of women stuck in low productivity sectors. A March 2017 report from the Gender Equality Observatory at the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC)[1] noted that while regional labour market indicators have demonstrated a positive trend over the past decade, the female labour market participation rate for women has stagnated at around 53%, while over three quarters of women who are employed (78.1%) work in 'low productivity sectors', where the pay is worse, social security coverage is low, and there is less exposure to technology and innovation. The report called for the creation of quality jobs that recognise women's abilities, levels of instruction and productivity.

[1]*Notes for Equality N°22: Women: the most harmed by unemployment*, 3 March 2017, UN Gender Equality Observatory for Latin America and the Caribbean. http://oig.cepal.org/en

In a press release marking Women' Day, ECLAC's executive secretary, Alicia Bárcena, noted that labour indicators for the region "continue to show large gender gaps between men and women with regard to access to opportunities and rights", which she also related to systemic social inequalities. These structural factors, she continued, "pose an obstacle to overcoming poverty and inequality in the region, as well as to women's attainment of economic autonomy – even more so if one considers the current context of economic contraction".

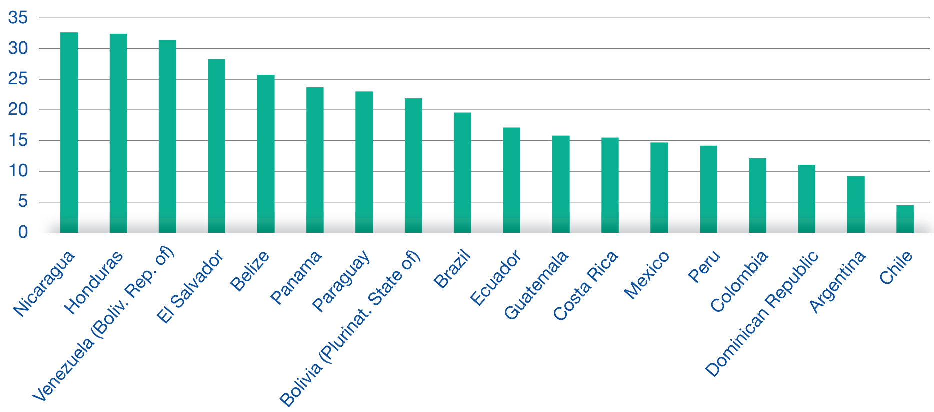
For ECLAC, employment policies "should be capable of modifying the current structure of inequality, confronting the existing gender bias in the labour market". It also calls for "the recognition and redistribution of time spent on unpaid labour", so that the responsibility of caring for children, dependent persons and older adults does not fall exclusively on women.

This plateau – or as the ILO calls it, the problem of 'glass walls' – extends all the way up to executive level, when it becomes a glass ceiling. According to the new (May 2017) ILO report[2], entitled '*Women in business and management: Gaining momentum in Latin America and the Caribbean*', few women in the region have advanced into the highest levels of management as chief executive officers (CEOs) and/or board members.

In the past two decades, the report notes in its executive summary, the growing numbers of Latin American women surpassing their male counterparts at university level have gone on to swell the ranks of professional, middle and senior managerial jobs. These factors signify that the female talent pool is "extensive and well developed", it emphasises. Indeed, according to the ILO, Latin America and the Caribbean, together with Europe, are leading regions in increasing the share of women in management positions and in several regional countries, more managers are women than men.

Yet at the same time, it continues, most global company surveys show Latin America and the Caribbean lagging behind other regions in the number of female CEOs – at only 4.2% – while nearly half of executive boards in the region are entirely male. Despite the evident talent, managerial experience and know-how of women, barriers to the career advancement of women (i.e. the glass ceiling) remain firmly entrenched, it observes.

Enterprises with at least one top female manager as a share of total enterprises (percentage), selected Latin American countries, latest available year



Note: Latest surveys conducted for most countries in 2010 except for Brazil (2009) and El Salvador (2016). Top managers are defined as the highest ranking executives with titles such as chairman/chairwoman, CEO, managing director, president, executive director and executive vice-president, among others.

Source: World Bank, 2017.

Similarly to ECLAC, the ILO believes that these barriers are "rooted in gender inequalities in the labour market at all levels". The report emphasises

[2] http://www.ilo.org/public/english/dialogue/actemp/downloads/events/2017/lima_conf/wibm_fullreport_2017.pdf

Company boards with at least one women member as share of total boards (percentage) by region, 2016	
Regions	
Eastern Europe and Russia	27
Africa	25
Australia and New Zealand	23
Western Europe	19
Middle East	18
North America	17
Asia	14
Central and South America	12
Note: Regional classification by Spencer Stuart, Women Corporate Directors Foundation.	
Source: *Spencer Stuart and Women Corporate Directors Foundation, 2016.*	

that "overcoming these obstacles is essential for economic and business growth". Noting the strong research link between gender equality and increased GDP, as well as the link between gender diversity in top management teams and improved business outcomes, the report stresses that measures to reconcile work and family responsibilities are central not only to talent uptake, but also to retention and promotion to senior level, and not only for women but also for men, in both the public and private sectors.

The leaking pipeline of female talent, Latin America and the Caribbean and the world, share of total companies (percentage), 2013

Level of management	Proportion of positions filled by women	Companies in Latin America and the Caribbean	Global companies
Supervisory or junior level of management	No women	33	10
	Less than 30% women	57	61
	Women are 41–50%	9	13
Middle management level	No women	20	10
	Less than 30% women	54	62
	Women are 41–50%	14	15
Senior management level	No women	14	21
	Less than 30% women	56	71
	Women are 41–50%	15	10
Top executive level	No women	32	34
	Less than 30% women	57	74
	Women are 41–50%	7	8

Note: Latin America and the Caribbean data include responses of 63 companies in Argentina, Costa Rica, Ecuador, Honduras, Jamaica, Nicaragua, Paraguay, Uruguay and the Bolivarian Republic of Venezuela. Global data include responses of over 1,300 companies in 39 countries.

Source: *ILO Company Survey, 2013.*

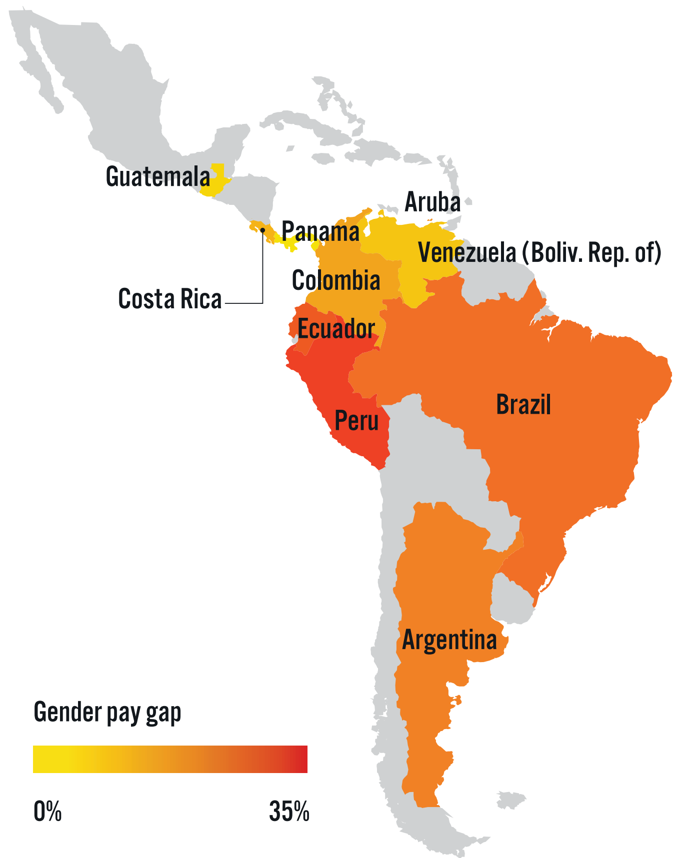
From the ILO's perspective, the overall outlook for the region is in fact quite optimistic, on the grounds that "it appears poised to become a world leader in the next decade" in terms of progress towards gender parity in the workplace. Compared to other regions, it notes, "more women in Latin American and the Caribbean are moving into strategic business areas such as profit and loss, research and product development".

"Women managers in all regions of the world have more commonly filled managerial support functions such as human resources and financial administration. By moving into strategic business areas, women managers in Latin America and the Caribbean will be better positioned for advancement to the highest levels of management".

The report also points to the fact that initiatives are underway in the region "to challenge gender stereotypes and corporate cultures that are disempowering for women". "In some cases, women and men's career paths diverge at an early stage in ways that prevent women from obtaining executive-level positions", it notes. Research efforts are underway to explore this problem, and to develop policies "to ensure that men and women have equal opportunities and treatment in recruitment, career development and promotion", while some companies have taken steps to promote gender balance and capitalise on women's talent.

The report notes that in December 2016, Chile launched the first Gender Parity Initiative in the region, supported by the IDB and the World Economic Forum. The main goals are to ensure more and better participation of women in the labour force, reduce the gender pay gap and boost the number of women in leadership roles. Chile's president, Michele Bachelet, was the founding executive director of UN Women, and is leading global advocated for women's rights.

Gender pay gap in monthly nominal salaries of managers, selected Latin American countries (%, latest years)



Source: ILO, 2017. Note: Latest years are as follows: Aruba and Venezuela (2010), Panama (2012), Costa Rica, Ecuador, Guatemala and Peru (2013), Argentina (2014), Colombia (2015), Brazil (2016). Data for Argentina refers to urban areas only.

This is the first in a series of ILO-backed initiatives in Latin America and the Caribbean. An important element of the initiative in Chile is to generate evidence on the benefits that companies can obtain from increasing women's participation. It is anticipated that this first model will be a reference point, and be replicated and adapted by other regional countries.

The gender pay gap

These is one sour note, and again it is a global problem. Even when women knock down glass walls and shatter glass ceilings, they have to suffer yet another indignity – they are awarded less pay than male counterparts in the same roles.

Globally, women earn 77% of what men earn. According to the ILO, without targeted action, at the current rate pay equity between women and men won't be achieved before 2086. And strikingly, the ILO has found that the gender pay gap is not only larger among the highest- paid occupational categories, but actually increases at the top end of the wage distribution. In a study of 22 European countries, for example, the gender pay gap among CEOs was approximately 40%, twice as high as the overall gender pay gap.

Unsurprisingly, the situation in Latin America is no different. Peru had a 20% pay gap among all employees, but among managers this rose to a sharp 34%. Ecuador had a 3% overall gender pay gap, rising to 30% among managers. On the other hand, the gender pay gap at managerial level in Argentina was less – at 25% – than the average 33% pay gap for all employees.

REGION

Assessing the climate change challenge

The announcement by Donald Trump that he intends to pull the US out of the Paris climate change agreement reached in December 2015 has been widely criticised by other signatories. Countries from Latin America and the Caribbean (LAC) have been broadly supportive of the need for action to mitigate the effects of climate change. The US decision, and shifts in energy usage, may have far-reaching effects on the region.

Two interventions at a recent international symposium in London underline the climate change challenge facing the LAC countries. The inaugural Green Financial Summit (GFI), held on 31 May-1 June, was well-attended by Latin American delegates, particularly from Brazil and Argentina. It focused on the development and funding of renewable energy projects via mechanisms such as green bonds. One of the interventions came from Sir David King, formerly the UK government's chief scientific advisor and special representative for climate change.

King's analysis of the state of play on the Paris agreement (also known as the COP21 agreement) was stark. The core agreement, signed by 197 countries, was that signatories should take steps to limit global warming to no more than 2 degrees centigrade (and if possible to hit the lower target of 1.5 degrees) above pre-industrial revolution levels by 2100. This was to be achieved by voluntary government-by-government action plans, known as nationally determined contributions (NDCs). The COP21 also envisaged a review process in 2018-2020 that would allow adjustments to NDCs to further reduce carbon emissions to get back onto the 2-degree track. Legally, US withdrawal would not happen until 2019, however the Trump administration suggested that the US would no longer be taking the voluntary steps envisaged in the agreement. Led by California and New York, US states, cities and corporations have pledged to make take their own steps to comply with the Paris agreement, independently of US federal government policy decisions. Nonetheless, the White House move was seen as a very heavy blow, not least because it abrogates US leadership on climate change and sends a negative message to developing countries struggling to grow their economies sustainably.

King pointed out that the sum of the existing NDCs doesn't limit global warming to 2 degrees centigrade by the end of this century, but points instead to a 3-4 degree increase in average temperatures. Given that the US is the world's main polluter, the Trump administration's decision to abandon the Paris commitments could make that gap wider.

Limiting the global temperature rise to no more than 2 degrees would require the world achieving a target of zero net greenhouse gas emissions by 2055. At the time of the agreement in 2015, actuarial studies indicated that on the current trajectory, by 2060 the world would already be exposed to sharply rising risks from extreme weather events and weather-related natural disasters. Melting ice caps may raise sea levels anywhere from six to 10 metres, increasing the possibility of what King described as "a potential disaster of extraordinary proportions". Among the US cities most vulnerable to rising sea waters are New York, Boston, New Orleans and, somewhat ironically, Miami – which President Trump has his 'second office'.

If temperatures rise by 1.5 degrees, the chances of this kind of epic disaster are believed "low", but if temperatures rise by 2.0 degrees, the probability rises to 1%-5%, which King suggested was too high a risk. Above that, the probability becomes even higher. King's core message was that the world needs to shift dramatically – and quickly – to the greater use of renewable energy. On a positive note, he believes that a whole range of commercially viable technologies to make that shift are now beginning to emerge.

Another speaker questioned the way in which the transition to renewables may actually happen. 'Peak oil' and other theories have traditionally held that global hydrocarbon reserves are becoming scarce, and that prices, although still volatile, are therefore inexorably moving up. For this school of thought, the commercial viability of renewable energy sources such as wind and solar power will be judged in a world where oil prices are set at US$100

US still no.1 investor

The US remains the largest investor in Latin America and the Caribbean, albeit its stock as of 2015 – US$244bn – is largely unchanged from 2010 levels (US$243bn). Spain lies in second place with a stock of US$165 in 2015, which is down from US$199bn in 2010.

a barrel or more. But Dieter Helm, Professor of Energy Policy at Oxford University, takes a contrary view. Speaking at the conference, he argued that the end-game for fossil fuels will play out against a background of relative hydrocarbons plenty, not of scarcity: and that the long-term trend will be for the oil price to fall further from its current level of around US$50 per barrel.

In fact, measured at present-day values, the long-term average oil price in the 100 years to 1970 was US$36 a barrel. Despite subsequent spikes caused by the Arab-Israeli war, the Iranian revolution, and the expansion of the Chinese economy, Helm expects that the trend going forward will be for prices to remain at below US$50. This will be a function of new discoveries, the shale oil and gas revolution, and technological change. Although renewable energy will therefore face stronger competition from hydrocarbons, he believes the renewable revolution will still advance, and that decarbonisation is inevitable. The digitalisation of production processes (the so-called Fourth Industrial Revolution), and revolutionary changes in transport (including autonomous vehicles) will pave the way to a more energy-efficient and zero net-emissions future, with electricity playing a key role. Electricity markets will be organised less on calculations of marginal costs and the operation of wholesale markets as they are now, and more on the sheer expansion of capacity.

The views of both King and Helm may or may not be correct, but taken together they sketch out a very different and striking international context for the LAC countries. One conclusion is that the region's first moves to reduce its dependency on hydrocarbons will need to be deepened and accelerated. Targets for the renewables share of total electricity generation under COP21 have been set as follows – Argentina has pledged that 20% of its electricity output will come from renewables by 2025, Mexico has pledged a higher share of 35% by 2024, and Brazil has set a target of 86% by 2023 (the latter reflecting Brazil's very large hydro resources). These targets almost certainly will need to be reviewed upwards.

Another conclusion is that global and LAC geopolitics are likely to shift. The shale revolution is making the US much less dependent on oil imports, and on it strategic relations with the Middle East. Traditional global oil exporters like Saudi Arabia, Russia and Venezuela could face long-term decline and sharpened economic challenges.

Those capable of best adapting to the electric and digital world (possibly the US and the European Union at a global level, and those LAC countries that are able to invest in broadband, education, and innovation) will do best in the regional context.

CARIBBEAN

Coastal flooding emerges as major threat

The danger of coastal flooding induced by climate change is far from theoretical for the Caribbean, according to a new study published by the Inter-American Development Bank (IDB). It says that up to 4.2m people in Small Island Developing States (SIDS) in both the Caribbean and the Pacific are living in areas prone to flooding due to rising sea levels.

It may be of increasing relevance to know whether you live in a LECZ, the acronym for Low-Elevation Coastal Zone. The IDB defines a LECZ as any coastal area with an elevation of less than 10 metres above current sea levels.

According to some projections of global warming trends (*see previous article*), sea levels could rise by up to 10 metres by the end of this century; and part or all of your LECZ could end up under salt water. The IDB report sets out to investigate what this might mean for small islands and what can be done in response.

The report estimates that a total of 4.2m people, or one of every five inhabitants of small island states, are eventually at risk of flooding. One of the most extreme cases is the Bahamas, where over 80% of the population lives in low-lying coastal areas. Coasts will be eroded and there will be negative impacts on economic output, inflation, employment and government debt. Although no definitive estimate is suggested, the cost of dealing with rising sea levels in small islands by the end of this century is described as being "enormous" in relation to GDP. The IDB also cites an academic study which estimates that by 2050 the cost of dealing with rising sea levels in the Caricom countries alone will range from US$3.9bn to US$6.1bn. A further insight into potential costs is given by another study, which estimates that a 1-metre rise in sea level would damage 49%-60% of tourist resort properties across the Caribbean.

The Caribbean is at the forefront of climate change, according to Michael G. Donovan, one of the authors of the report. He is calling for action to improve the resilience of cities in coastal zones. The IDB notes that over the last 20 years a total of US$55.6bn has flowed into the SIDS in the shape of aid and private sector funding, and that at least part of this money has involved strengthening coastal city resilience. Around US$800m in green climate funding has also taken note of the so-called 'Blue Urban Agenda', a programme to heighten preparedness.

Michelle Mycoo of the University of West Indies (UWI), another of the report authors, observes that "the challenge facing SIDS government officials is investing in protection of their highly vulnerable coastal cities before the damage occurs."

Recommended measures include improving coastal planning, land reclamation, enforcement of building codes, 'climate proofing' infrastructure, mangrove reforestation and coastal monitoring. Some internationally-funded preparedness projects are already underway in Bridgetown (Barbados). Kingston (Jamaica), Nassau (Bahamas) and Port-au-Prince (Haiti). Ultimately, however, not all threats can be avoided. The report suggests a broad three-point strategy described as "protection, accommodation, and retreat" which recognises that these small islands, which themselves have a very small carbon footprint, ultimately lack the ability to halt rising sea levels caused by other countries' larger emissions.

REGION

FDI flows to LAC drop for fifth straight year

Foreign Direct Investment (FDI) flows to Latin America and the Caribbean fell by 14% to US$142bn in 2016, the fifth consecutive year of decline, according to the latest World Investment Report from the United Nations' Commission for Trade and Development (UNCTAD), released on 7 June.

Total global FDI flows fell by 2% to US$1.75trn last year, which the UN Secretary General. The Latin American figure matched the 14% drop in overall FDI to emerging economies António Guterres described as troubling. However, flows to advanced economies rose by 5% to US$1trn, with the US taking US$391bn of that. Advanced economies took a hefty 59% of global FDI in 2016, the highest level since 2016.

With FDI yet to return to pre-2008 levels (international cross-border investments peaked in 2007), and with investors favouring the US and advanced economies over developing markets, even turning away from the likes of China and Asia, there are concerns about the implications for the global economic recovery. FDI flows to emerging Asian market contracted last year for the first time in half a decade, falling 15% to US$443bn. Investment in China (mainland) accounted for US$134bn of that – but that was a drop of US$2bn from 2015.

Quoted by the UK's *Financial Times*, James Zhan, lead author of the UCTAD report, expressed concern about the weak FDI in developing economies, noting that it remained 'by far the largest external source of financing for the world's developing economies, accounting for almost 50% of the US$1.4tn in external financial flows to developing economies last year'. That figure, however, was down from over US$2tn in 2010 and 'well below the level needed to achieve the poverty reduction and other sustainable development goals agreed by the UN in 2015'. Adding to the concern, Zhan also pointed out several one-off 'mega deals' had underpinned FDI activity in advanced economies last year.

The latest fall in FDI flows to Latin America reflected continued commodity price weakness, meaning continued sharp falls in investment in South America in particular, which took in US$101bn in new investment last year – an annualised drop of 14%. Notably though, FDI flows to all the Latin America sub-regions –South and North (meaning Mexico and Central America) – fell in 2016. In 2015 FDI flows to the North grew, while those in the South continued to contract

Reflecting its ongoing recession, flows to Brazil, Latin America's largest economy and principal recipient of FDI, fell by 9% per cent to US$59bn in 2016, from US$64bn in 2015, which the World Investment Report attributed to a sharp decline in the services sector in particular. FDI also fell in the sub-regional commodity exporters Bolivia, Chile, Ecuador and Peru. Chile took US$11bn in FDI, from US$16bn in 2015, while Peru registered an inflow of US$6.9bn, from US$8bn the previous year.

Breaking the pattern was Colombia, which took in US$14bn last year, up 17% from US$12bn in 2015, with investor sentiment towards the country warming on the prospect of a resolution to the country's long-running internal conflict with a left-wing guerrilla insurgency. While peace is not yet guaranteed in Colombia, the prospect of important new opportunities in sectors including agriculture, hydrocarbons, electricity, telecommunications, construction, mining, plus related services (and consumer sectors), is piquing foreign interest in the Andean country.

The Colombian finance ministry (Minhacienda) recently reported that the country received FDI flows of US$2.4bn in the first four months of this year, down 16.7% in the same-period of 2016 and only 21.5% of its FDI inflow target for the year. However, Minhacienda said that discounting the US$1bn paid by the Canadian investment fund Brookfield Asset Management to acquire the government's 57% share in the energy company Isagén in April 2016, then FDI inflows to date this year showed a 27.4% increase. Nonetheless, Minhacienda now projects about US$11bn in FDI this year, a notable drop on last year's reported US$14bn.

In the US-facing Central America, meanwhile, inflows fell by 14% to US$38bn, on slower gross fixed capital formation and export trade volumes, UCTAD reported.

Mexico takes a hit

Significantly, FDI flows to Mexico fell a sharp 19% per cent to US$27bn, from US$33bn in 2015, as investment in the services sector declined. "Flows to most of Mexico's manufacturing industry also retreated, especially in automotive manufacturing", the report noted. Inevitably, there will be concern that the election of a 'disruptive' and unpredictable US president in the form of Donald Trump weighed on investment decisions in Mexico.

Mexico's stock of inward FDI amounted to US$473bn in nominal terms in 2016. That's the equivalent of 45.3% of GDP, compared to 12% in 1995, the year after the tripartite North American Free Trade Agreement (Nafta, comprising Canada, the US and Mexico) took effect (on 1 January 1994). The US Trump administration, having initially threatened to kill Nafta, now appears more agreeable to its renegotiation.

Finally, flows to the Caribbean (exclusive of financial centres), fell by 9% to US$3bn, albeit this was not uniform. UNCTAD observes that a 9% rise in FDI flows to the Dominican Republic (to US$2bn) did not offset declines in Jamaica and Trinidad & Tobago.

UNCTAD says that FDI prospects for Latin America and the Caribbean in 2017 "remain muted". This owes the fact that economic growth is expected to remain well below the rates associated with higher inflows in previous years. Investment in the region's extractive sector is "likely to remain modest". The report notes that greenfield FDI project announcements for the primary sector (agriculture and extractives) in 2016 amounted to only US$4bn, "as operators continue to strengthen their balance sheets and restructure their capital expenditure plans". "FDI to the region is also likely to be affected by uncertainties about economic policymaking in the United States", it notes.

Multilatinas sitting on their hands too

It is also worth noting that FDI outflows by the region's multinational enterprises (multilatinas) fell by a colossal 98% to US$751m in 2016. "This was due to strong changes in intra-company lending flows that pushed overall outward investment into net divestment of foreign assets in Brazil and Mexico", according to the report. It added that intra-group financing flows "were also strongly impacted by a large increase in reverse investment in debt instruments, as foreign affiliates funnelled capital raised in corporate debt markets back to their Latin American parents".

Financing

While the IMF, the World Bank and others are a little more optimistic about global growth rates in 2017-2018, the problem of insufficient financing for and investment in and by developing economies remains a key red flag. The Organisation for Economic Cooperation and Development (OECD) says that a general lack of investment is a critical problem not only for international trade, but also for productivity (and real wages), which in turn threatens future potential growth.

From its perspective, the World Bank calls for increased public-private financing. This is echoed by the UN Commission for Latin America and the Caribbean (ECLAC), which also persistently beats the drum of structural reform to regional governments (who pay polite, if somewhat non-committal, heed).

Corporate Radar

Albemarle completes second lithium plant

The US-owned Albemarle has completed La Negra II, its second lithium carbonate plant in Chile. Construction took three years, with total investment of US$450m. The company has reached an agreement with Corfo, Chile's economic development agency, to build a third plant, which could come on-stream in 2020, requiring around US$600m in additional investment. Corfo has announced a call for Chilean and international companies to express interest in manufacturing lithium products, such as battery cathodes and electrolytes. The companies selected will be guaranteed up to 25% of Albemarle's locally mined lithium output at the lowest costs available in the market.

Albemarle is now one of only two lithium miners operating in Chile (the other is Sociedad Química y Minera de Chile (SQM). Chile is the world leader in lithium, with around 40% of global production. Last year, Chile exported 80,000 tonnes of lithium carbonate equivalent (LCE) worth US$589m. Exports are projected to increase to 300,000LCE a year by 2035. Lithium in the Salar de Atacama slat flats is believed to be the world's easiest and cheapest to extract. The company expects lithium demand to grow strongly, driven by increasing use of electric vehicles.

Citibanamex seeks upgrade

Jane Fraser, head of Citigroup Latin America, told the *Reuters* news agency that the company is overhauling Citibanamex, its Mexican unit, with a view to improving customer service. The 133-year old bank was reported to be lagging behind its competitors in terms of technology, profitability, market share and customer satisfaction. The bank reportedly is reorganising its branches and adding 2,500 ATMs to its existing network of 7,600. It is also looking for a range of partnerships to improve customer experience.

One initiative has been the launch of Saldazo, a deposit and money transfers card distributed through the OXXO chain of convenience stores. Executives recognise that Citibanamex was slow to modernise, but note that this may not be an entirely bad thing. "Most banks in Mexico updated their core technology platforms seven, eight, nine years ago. We're doing it now, but the technology now available is very different" noted Edgardo Rincón, general manager for consumer banking, which may give the bank a competitive advantage. Although Citibanamex in many ways has lost its competitive edge, it is still estimated to deliver nearly 10% of Citigroup's global profits and a 15% return on equity (roe), better than the group average. The bank is also seeking to restore its corporate reputation after its 2014 involvement in a US$500m loan fraud, a money-laundering investigation, and bad loans to housing companies.

New hostilities break out in pisco war

Chile and Peru are again battling over the exclusive rights to use of the 'pisco' denomination. 'Pisco' is a type of spirit made by distilling fermented grape juices. It was originally produced by Spanish settlers in the 16th century, as a local alternative to Spanish brandy, and ever since has been celebrated and enjoyed in both Chile and Peru. The current dispute was triggered in the run up to the Concours Mondial de Bruxelles (CMB), an international wine and spirits competition due to be held in Chile on 22-24 August. The CMB organisers have accepted Chile's contention that only its entries can properly be described as 'pisco', while Peru's equivalents are to be described instead as "Peruvian grape-distilled drink, or aguardiente".

In response, the association of Peruvian exporters (Adex) has suggested that the country should consider boycotting the competition. "I suggest that Peru should not participate" said Adex president Juan Varillas, complaining, "this contest will enable the Chilean drink to take all the pisco category medals." The Peruvian pisco camp has noted that British singer Ed Sheeran recently described Peruvian pisco as one of his top drinks. Peru's competition and intellectual property agency, Indecopi, has supported the idea of a CMB boycott.

Industry sources note that Chilean legislation recognises only locally-distilled drinks as 'pisco'. Despite this, around 35% of Peru's pisco exports are shipped to Chile; to comply with Chilean law, when they cross the border they are re-labelled as Peruvian 'aguardiente'.

Kuntur Wasi loses Chinchero airport deal

The Peruvian government and the Kuntur Wasi private consortium (whose members include Argentina's Corporación América and Peru's Andino Investment Holding) have agreed by mutual consent to cancel a troubled US$520m contract to build a new airport at Chinchero in Cusco, one of Peru's top tourist destinations.

Allegations of improprieties in the 2014 public-private partnership (PPP) agreement, which was modified earlier this year to provide additional government guarantees, have dogged the administration of President Pedro Pablo Kuczynski and forced the transport minister, Martín Vizcarra, to quit his post (he remains as elected first vice president). It was left to his ministerial successor, Bruno Giuffra, to announce that the two parties would hold talks about the level compensation due to the consortium for the preparatory work done to date. Giuffra said that the government on its own would continue with the first phase of the works, clearing and levelling the airport site, which is expected to take 18 to 24 months. During this period, it will consider the best contractual model for building and operating the new terminal (officials have hinted that one option might be to go ahead with a 100% publicly-owned project). Meanwhile, the political repercussions continued, with the finance minister, Alfredo Thorne, denying allegations that he had improperly pressured the comptroller general office to green-light the Chinchero contract.

Low cost air travel takes off in Peru

On 9 May, Peru's first low cost airline, Viva Air Perú, formally began operations. The company is owned by Irish holding firm Irelandia Aviation, the parent company of Ryanair, and will operate nine different domestic routes in Peru, with two more added next year.

The company aims to carry 700,000 passengers in its first year. Peru's tourism ministry expects internal tourism to increase by 10% in 2017, creating an ideal environment for Viva Air Perú to grow its business. The transport ministry has already reported a 5% year on year increase in domestic air passengers in the first quarter of this year. Between 2009 and 2016, the number of domestic passengers more than doubled, going from 4.3m to 10.9m.

Viva Air Perú is the latest in Irelandia Aviation's expansion into Latin America following the launch of Viva Colombia in 2012. Viva Colombia's CEO, William Shaw, estimates that the airline's lauch in Peru arrival will result in a 50%-70% price reduction in airfare costs.

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