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Latin American Newsletters since 1967

Chinese lending – a lifejacket for Latin America

China continues to lend in excess of US$20bn a year to Latin America and The Caribbean. Since 2005, Beijing has invested over US$141bn in the region.

The Inter-American Dialogue's China and Latin America Program and Boston University's Global Economic Governance Initiative published their latest annual report on Chinese lending to Latin America & The Caribbean on 23 February.

The report[1] estimates that the China Development Bank (CDB) and The Export-Import Bank of China (China Eximbank) issued about US$21bn in new lending to governments and state-owned companies in the region in 2016. This was down a little from US$24.6bn in 2015, which was the highest since 2010, when Chinese funding peaked at a whopping US$35.6bn. (In 2014, the figure was put at US$10bn).

According to the report summary:

- Last year was the third highest on record for Chinese State-to-State finance in Latin America (after 2010 and 2015).

- In 2016, Chinese finance to Latin America surpassed the World Bank's and the Inter-American Development Bank's lending to the region, estimated at US$8.2bn and US$11.6bn respectively. (This was also the case in 2015).

- China continues to be an important source of finance for those regional countries with more limited access to global capital markets (for example, Venezuela and Ecuador).

- Brazil, Ecuador and Venezuela accounted for 92% of China's total lending to the region in 2016, with approximately 72% – or US$15.2bn – issued to Brazil alone, and Ecuador and Venezuela getting US$2.2bn each. Brazil's state controlled oil company Petrobras took the vast majority of the lending to Brazil, in exchange for oil shipments. This was in spite of the massive ongoing corruption scandal in Brazil linked to Petrobras.

- Bolivia also remains an important recipient of Chinese lending. In 2015, China announced a US$7bn credit line to Bolivia, which in 2016 was extended to US$10bn. On an October 2016 visit to the country, China's foreign minister, Wang Yi, promised an additional US$4.8bn (mostly for infrastructure projects). China is now helping to funding the stalled El Mutún iron ore mine (previously abandoned by India's Steel & Power), as well as the Rosita hydroelectric plant.

- Argentina received no Chinese funding in 2016. While there might be an assumption that this was linked to the change of government in

Buenos Aires in late 2015 from the radical left-wing administration led by President Cristina Fernández (2007-2015) to a new centre-right government under President Mauricio Macri, the report notes that "relations with Brazil and Argentina remain strong, despite recent changes in leadership". It observes that Argentina's President Macri "made some modifications to previously negotiated Chinese loans when he took of office", but that his new administration "continues to engage Chinese lenders. In May 2016, "Argentina announced possible Chinese support for an ambitious, US$100bn infrastructure plan over the next four years".

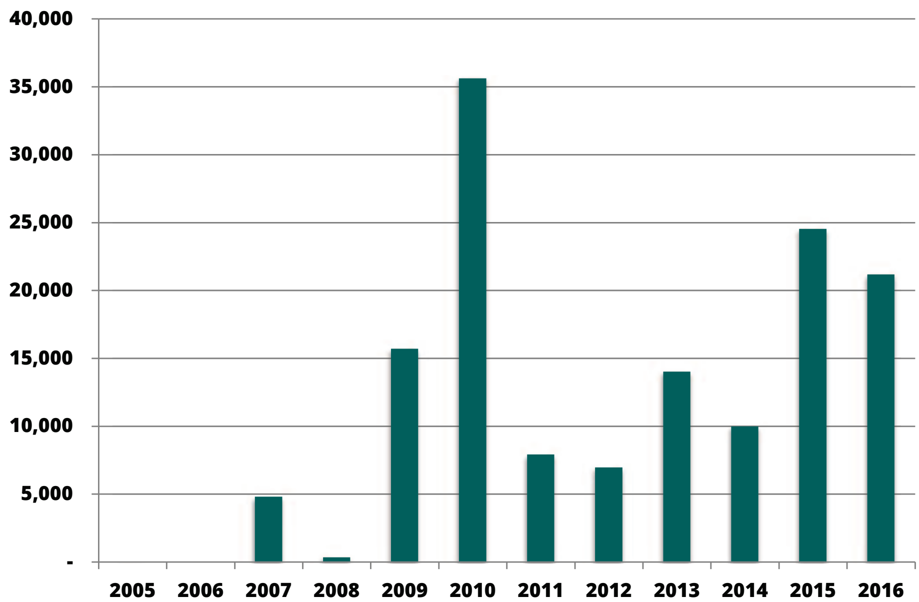
- Chinese banks continue to focus heavily on the region's extractive and infrastructure sectors. Between 2005 and 2016, Chinese policy banks financed US$24bn in infrastructure projects, plus an estimated US$100bn in energy projects, some of which included energy infrastructure development.

- The report notes that "Chinese banks still refrain from imposing policy conditions on loan recipients, although finance is often contingent on the use of Chinese construction firms and equipment. Major Chinese companies such as China National Petroleum Corporation (CNPC), Sinohydro, China Three Gorges Corporation, and Sinosteel were linked to China's 2016 State-to-State loans to LAC".

- The authors point out that as China's financial sector grows, a wider range of lenders is now issuing finance in the region: "In addition to policy bank lending, China's commercial banks are increasingly active in Latin America and other regions, often in cooperation with other international banks".

- Whereas Chinese funds and commercial banks are seeking to diversify their activity in Latin America, the report posits that "Chinese policy bank lending is likely to remain focused on a handful of countries – notably Brazil, Ecuador, and Venezuela, Argentina, and Bolivia – and sectors. This is because "these countries are rich in natural resources, have been relatively open to the idea of large-scale, China-backed infrastructure projects, and/or have large domestic markets". They are also in relative need of Chinese capital and willing to partner with CDB and Eximbank to attract it, it emphasises.

China – lending to LAC by year, US$m, 2005-2016



Source: *Gallagher, Kevin P. and Margaret Myers (2016), "China-Latin America Finance Database," Washington, DC: Inter-American Dialogue.*

[1]Chinese Finance to Latin America and the Caribbean in 2016, Margaret Myers and Kevin Gallagher, Inter-American Dialogue – China and Latin America Program; Boston University – Global Economic Governance Initiative.
http://www.thedialogue.org/wp-content/uploads/2017/02/Chinese-Finance-to-LAC-in-2016-Web-and-email-res.pdf

China – lending to LAC by country, US$bn , 2005-2016	
Venezuela	62.2
Brazil	36.8
Ecuador	17.4
Argentina	15.3
Bolivia	3.5
Trinidad & Tobago	2.6
Jamaica	1.8
Mexico	1.0
Costa Rica	0.40
Guyana	0.13
Bahamas	0.10
Peru	0.05
TOTAL	**141.3**
Source: *China-Latin America Finance Database, compiled by The Inter-American Dialogue's China and Latin America Program and Boston University's Global Economic Governance Initiative.*	

The question of sustainability

In conclusion, the report calls for China's regional financing to focus more on sustainability. It notes that while Chinese loans are an important source of capital for the region, "they carry risk for both lender and borrower". In 2016, for example, most Chinese finance for the region was destined for "troubled" governments and companies, "suggesting continued tolerance…of potentially risky ventures with possible long-term pay-offs". It is also the case that Chinese finance remains heavily focused on sectors like mining and energy, which "could lock in the resource curse" that has long held back the region, and which also are very susceptible to social and environmental conflict.

Moving forward, the authors conclude, "the challenge for Latin American governments will be to propose deals that are both attractive to Chinese partners and economically and environmentally sustainable".

REGIONAL ECONOMY REVIEW

MEXICO

Getting ready for the NAFTA negotiations

In the second month of the new US administration led by Donald Trump, the prospective renegotiation (or termination) of the North American Free Trade Agreement (NAFTA) is still looming large. The latest developments include noticeably tougher talk from Mexico, further speculation about what a US border tax might look like, and some statistical oddities. Covering what happens to NAFTA – one of the world's largest free trade agreements – remains vital because of its importance to business. But with no real clarity on the timetable for negotiations, coming months will remain uncertain.

At this stage, two things are clear. The Trump presidency has said it wants to renegotiate or terminate NAFTA. And Canada and Mexico, the two other signatories of the 23-year old trade deal, have indicated their willingness, however guardedly, to enter negotiations. There has been some early shadow-boxing, with all parties talking in general terms about what they might want to see in a renegotiation. But what the timetable might look like remains very unclear.

The Mexican government initiated a 90-day consultation period with its domestic private sector in January, and officials have been reported saying they expect formal negotiations to begin in June. On the US side, any substantial NAFTA renegotiation would require President Trump to request trade promotion authority (TPA) from Congress, a request which must be submitted with 90 days' notice (and at the time of writing had not been filed). While NAFTA rules establish that any signatory can give six months' notice of withdrawal, many analysts believe that renegotiation is more likely than termination, and that renegotiation will be a long and politically complex process, involving a lot of lobbying within the US itself. Warren Maruyama, former legal counsel at the Office of the US Trade Representative (and now a partner in the Hogan Lovells law firm) recently said he could envisage a renegotiation process taking two to four years before the US Congress might be in a position to vote it through.

In the past month (February), Mexican officials have started talking tougher as they seek to position themselves in preparation for formal talks. Speaking in a session in the federal senate, Foreign Minister Luis Videgaray said Mexico would reject the imposition of any tariffs or quotas, and if necessary would walk away from the talks. "The executive branch, via the economy ministry, will not accept any modification that implies damage or doesn't benefit the national economy" he said, noting also that Mexico was ready to strengthen its trading relationship with US trade rival China. Economy Minister Idelfonso Guajardo was also on-message, telling journalists, "the moment they start talking about a 20% tariff on automobiles I will get up and leave the negotiating table".

At a round table discussion organised by the Council of the Americas in Washington, Kenneth Smith Ramos, director of the NAFTA office in the Mexican embassy, also sounded a warning note over the politics. As he put it, President Trump's protectionism and anti-Mexican rhetoric risked eliciting an equivalent nationalist and anti-free market reaction in Mexico. "Senators from opposition parties have presented an initiative calling for expedited agreements with Brazil and Argentina to buy agricultural products from them, and to close down access from the US," he warned, adding, "We as a government do not want to see a situation where we close down access from our number one partner, because we know the impact it would have on us, but these are some of the realities we are facing."

President Trump has long complained that Mexico has unfairly benefited from NAFTA because it has a large surplus in bilateral trade. On current US data, that surplus in Mexico's favour totals around US$60bn. The White House is reportedly considering changing the way US trade statistics are reported, in a way that would make Mexico's surplus in bilateral trade look roughly double its current level, rising to US$120bn. This would be achieved by excluding re-exports – goods that enter the US in transit on their way to other countries, including Mexico. Politically, that makes the perceived mercantilist problem look much bigger. But Mexico itself has already been using that reporting standard for years (goods imported to Mexico via the US are recorded as an import from their original country of origin). The difference between the two measurements has grown because of the development of manufacturing in locations in northern Mexico, where it makes greater economic sense to ship inputs in through nearby US ports. The counter argument to mercantilism is that both Mexico and the US have benefited from trade, which boosts comparative advantage and economic growth despite imbalances.

Much of the recent discussion in the US has focused on the feasibility of imposing a 'border tax or a 'border adjustment tax'. Various different versions have been mooted. President Trump has expressed interest, but has not yet endorsed any detailed plan. The broad idea is that a 20% import levy would be applied to goods coming in across the border from Mexico; at the same time US companies would get corporate tax exemptions for their exports. In some versions, these changes would be part of a much broader and deeper reform of US corporate taxation, reducing the main corporate income tax rate from 35% to 20%. There is much in these ideas that may appeal to some of Trump's constituency, and to Wall Street; but it is also looking like a potentially politically dangerous cocktail. The *Financial Times* has commented that early skirmishes on the proposals "have shattered Republican Unity, left lawmakers skittish about their party's plan, and given the Trump administration reason to keep it at arms' length."

There are indeed some signs that the border adjustment tax may be splitting the US business community down the middle. The country's largest retail chain, Wal Mart Stores Inc, opposes the border adjustment tax on the grounds that it would lead to a sharp increase in the cost of imported products. Wal Mart is a member of Americans for Affordable Products, a coalition that also includes large retailers such as Costco, Gap, Macy's, Nike and Target. A spokesman for Republican Senator Tom Cotton (Arkansas), who opposes border adjustment, focused on its effect on prices and described it as "a new tax on working class Americans". In the opposing corner is another lobby group, the American Made Coalition, whose supporters include Boeing, Caterpillar, Dow Chemical and General Electric among others. Chief executives of 16 corporations on that side of the divide wrote to members of Congress saying border adjustment would make US manufactured products more competitive abroad and at home.

These signs of controversy within the US may hearten Mexican officials, who oppose border adjustment as a protectionist move against the free trade spirit of NAFTA. They believe that the controversy may bog things down and delay any new protectionist measures.

The issue for Mexico remains the impact on the domestic economy. The London-based consultancy, Capital Economics, has sought to assess the importance of the NAFTA negotiations for Mexico. It describes the stakes as "big but not overwhelming". Total trade with the US, at US$380bn, represents 45% of GDP, and includes the significant trade balance in Mexico's favour. However, the trade surplus is concentrated in a relatively few sectors: automobiles, electrical components, TV and computer screens, and medical equipment. The US has a surplus in refinery output, plastics and maize. NAFTA has not affected large swathes of the Mexican countryside – meaning regional inequalities and low productivity growth continue to be ongoing issues. In this situation, Capital Economics notes, "there is scope to change NAFTA without substantial economic damage to Mexico (for instance by tightening some rules of origin)." It also suggests that President Trump might eventually accept the arguments of those who maintain that Mexico-US trade is not a win-lose game, but a win-win one. The consultancy also suggests that the White House might also at some point accept that "supply chain linkages mean the US and Mexico are on the same side to a large extent".

That said, Capital Economics accepts there could also be a range of more damaging scenarios. Near-term disruption to the Mexican economy could be significant, because of an extended period of uncertainty during which the NAFTA outcome remains unknown and investors take fright. During that time, the Mexican peso will act as safety valve, although to some extent there is a correcting mechanism since peso weakness helps maintain export competitiveness. In the short term, Capital Economics argues that some protectionism is probably priced in, but the peso could fall further if the US takes more draconian measures. The consultancy's conclusion is that in the long term, "because NAFTA has failed to boost Mexican productivity growth over the past 20 years, it follows that even its collapse is unlikely to change the underlying outlook of the economy." More important to Mexico's future, it suggests, will be the progress of the major structural economic reforms initiated by the current government of President Enrique Peña Nieto, which include the opening up of the energy and telecoms sectors to greater competition.

The Alfonso Romo option

President Trump's attacks on NAFTA and migrants are widely seen as boosting a Mexican nationalist backlash, and raising the chances of a victory in the 2018 presidential elections for left-winger and perceived populist Andrés Manuel López Obrador, known by his initials as AMLO, the leader of the Movimiento de Renovación Nacional (Morena). AMLO is leading most of the early opinion polls on the 2018 race. It is early days, but understandably there is a sharpening focus on what AMLO's economic policies might look like. He has been a strong opponent of the Peña Nieto government's energy reforms, which opened up the oil and gas sector to foreign investment. Many think he may also move away from Mexico's commitment to free trade.

Yet the candidate is clearly reviewing his policy positions. He is also currently reported to be working closely with Alfonso Romo Garza, a Monterrey-based businessman with interests in insurance, stock-broking and biotechnology among other sectors. Romo was an outspoken supporter of Vicente Fox, of the right wing Partido de Acción Nacional (PAN), in the 2000 elections of 2000, in which Fox was catapaulted into the presidency. So, his new alliance with AMLO, at the other end of the political spectrum, looks somewhat surprising. In a recent interview with the Spanish newspaper *El País*, Romo gave some interesting hints of the policy discussions he is having with AMLO.

Romo said the top priorities for Mexico should be to tackle corruption, cut back wasteful government spending, and strengthen the independence of the Central Bank (Banxico). He quoted AMLO to the effect that wiping the country of corruption, like cleaning a staircase, has to start at the top. He stressed the critical need to win over and reassure what he describes as "the dynamic sector of the Mexican business community" to a programme of reform.

Mexico is growing at an average of around 2% per annum, but the North grows much faster than the South: future governments must therefore focus on developing the forgotten south, he argued. Asked about his support for, and AMLO's opposition to privatisation, Romo said that the candidate was not opposed to privatisations *per se*, only to the way in which previous asset sales have been carried out, to favour vested interests.

On the subject of the energy reforms, he suggested that a debate within Morena was still in progress. "We are talking about it now. The devil will be in the detail. What should be the private sector's role, what resources can we count on…we have to be very intelligent in managing this" he told the newspaper. Asked about relations with the US, Romo said things looked negative in the short term but that in the longer term he was more optimistic: the way forward was to build the economic relationship. As for whether he and AMLO would agree on all policy matters, he said, "Let's see. I'm not too worried. If we disagree on 20% of the issues, it doesn't matter. Agreeing on 80% is ok. I want the boat to get underway and start sailing."

CENTRAL AMERICA

Looking good, but what lies beneath?

From the broad macro-economic perspective, the sub-region of Central America and the Dominican Republic (referred to as CADR) is doing rather well. A new report from the Inter-American Development Bank (IDB) forecasts overall regional GDP growth of 3.9% this year, along with low inflation and a healthy banking system. That seems to be a lot better than what either Mexico to the north, or much of South America to the south, will be able to muster this year, in GDP terms. But the report warns that on closer examination, not enough is being done to get the regional economies in shape for tougher times.

At the 31st meeting of IDB governors from Central America and the Dominican Republic, the IDB president, Luis Alberto Moreno, had an upbeat message to deliver, telling officials from Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua and Panama. "Advances in macroeconomic stability, the reduction of poverty, and integration, together with a young and growing population, allow us to be optimistic about the potential of these countries to transform the future", he stated. While that certainly reflected part of a new IDB report, the report's title '*Running out of tailwinds – opportunities to foster inclusive growth in Central America and the Dominican Republic*' also sounded something of a warning note, as did the main body of the text.

The report expects real annual GDP growth in the CADR sub-region to rise from 3.7% in 2016 to 3.9% in 2017. But it makes clear that the region has been helped along by US economic growth, low oil prices, and by the stimulation of private consumption and exports, all of which have helped to keep inflation and interest rates low and stable. Inflation averaged 2.4% in 2016, well below the historical average of 1980-2015. This fairly benign environment may not continue. Global demand may weaken. The US Federal Reserve appears to have begun a monetary policy tightening cycle. Uncertainties over foreign trade policies in the developed economies are increasing.

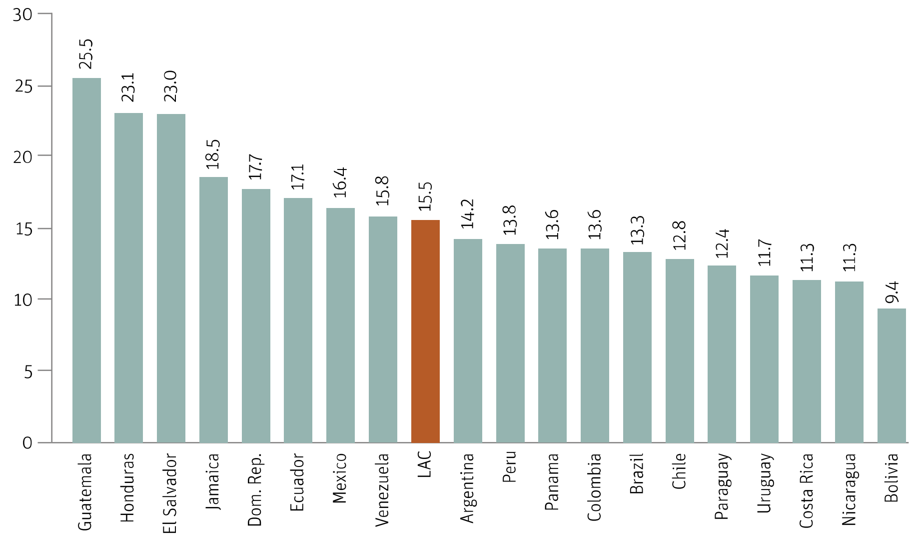
One cause for concern is that the CADR countries do not seem to have used these relatively good times to improve their fiscal position. Both fiscal revenues (at 19.6% of GDP) and expenditures (at 22.9%) have remained broadly constant, with the net deficit stuck at 3.3% of GDP and therefore continuing to drive an increase in the total level of public debt. Despite improvements in the balance of trade in oil, a deterioration in the non-oil balance means that the combined current account deficit remains at just above 5% of GDP. These two deficits make the sub-region highly reliant on external funds. Public debt has grown to 47.2% of GDP, which the IDB says is "increasing vulnerability to less sunny skies".

Demographic bonus requires investment

The region is still enjoying a demographic bonus from a young and growing population, which means that the ratio of those of working age to dependents (those under 15 or over 65) is favourable. The working age population, expressed as a proportion of the total population, has grown from 50.6% in 1964 to 63.9% in 2015. According to UN population forecasts, this growth will

15-24 Year-Olds Who Neither Study Nor Work, 2014

(% of population between 15 and 24)



Source: *CID/IDB Staff using data from Duryea and Robles (2016).*
Note: *Bolivia, Chile and Venezuela data correspond to 2013, and that of Jamaica and Nicaragua to 2012*

continue until the working age population reaches a peak of 66.1% of the total in 2040, and then begins to decline. There will be variations between countries, with the decline beginning earlier in Panama and Costa Rica, and later in Belize, Guatemala and Honduras. Between 2040 and 2060, CADR will have the largest share of working age to total population in the world. This gives the region a major economic advantage, but it runs the risk of failing to capture it. Figures show that the proportion of 15-24 year olds who are neither in work nor studying (known as 'ninis', from the phrase 'ni estudia, ni trabaja') is highest in countries like Guatemala, Honduras, and El Salvador (which, coincidentally, have some of the most serious problems of gang violence and youth crime). The report concludes that the demographic transition presents a window of opportunity for the sub region, which should be maximised through investment in human capital (education and training).

Energy savings need to be passed on

Nor have the CADR countries done enough, in the IDB's opinion, to take advantage of low international prices to overhaul their energy subsidies and achieve a better allocation of resources and improved competitiveness. The report notes that electricity tariffs in regional countries have remained fairly stable, even though electricity generation costs have dropped amid lower international prices. According to IDB calculations, improving the pass-though of lower international energy prices to the final consumers could boost GDP growth rates by 0.5 percentage points across the sub-region after one year. It suggests that pricing and subsidy reforms should be addressed to ensure better pass-through, to take advantage of economies available through the regional electricity market (Mercado de Electricidad Regional – MER) and to investigate innovations like subsidies that are self-financing through the lifetime of the energy price cycle.

Potential shocks

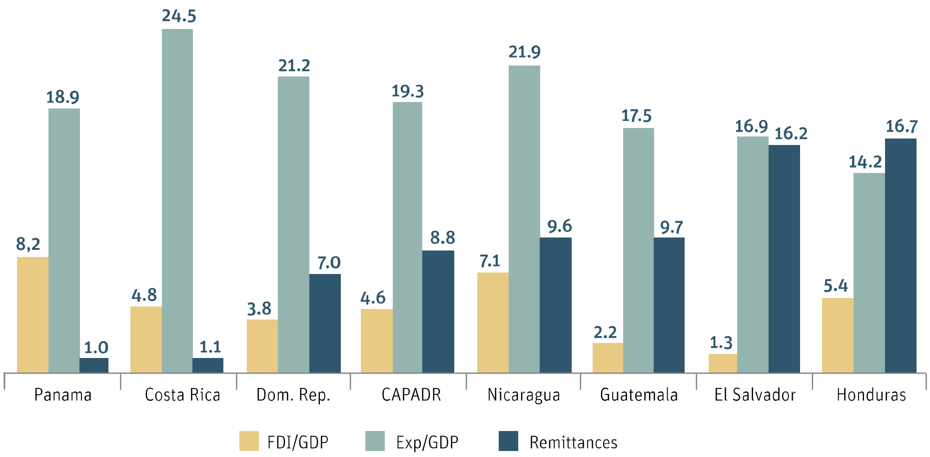
One of the most interesting sections of the report looks at some of the potential economic shocks that the CADR sub-region could face in the near future, and tries to model what kind of an impact they might have. It identifies the strongest transmission channels for external shocks as trade and foreign remittances, but says transmission via financial links is less of a risk factor.

Trade with the US is particularly important. On average, 35% of all CADR exports go the US. Export products remain concentrated in primary commodities whose prices are set internationally: principally coffee, bananas and sugar (averaging 17.6% of the total); followed by fruit, palm oil and shrimp (9.7%); medium technology products (7.3%) and gold (4.4%). Remittances from expatriate workers averaged 9% of GDP in 2011-2015, but range much higher for some countries (nearly 17% of GDP for Honduras in the same period). Foreign Direct Investment (FDI) has averaged 4.6% of GDP – less than remittances, but still important to cover part of the current account deficit.

The IDB's conclusion is that US growth is the single external variable that has greatest impact on the CADR sub-region. A 1.0 percentage drop in the US growth rate would have an almost immediate and equivalent effect on the CADR and take two years to dissipate. Oil prices are also important: a rise in the international price per barrel of crude from US$50 to US$70 could slow CADR growth by 0.4 percentage points. Global risk aversion – as measured through the Global Volatility Index (VIX) – would have a relatively limited effect. A 30% increase in VIX (equivalent to the Euro crisis experienced in Q3 2015) would slow CADR GDP by 0.25 percentage points.

On the positive side, some current trends could have an upwards impact on growth, such as a gradual depreciation of local currencies and recovering international coffee prices. The report says that a sustained 10% currency deprecation could boost GDP by 0.2 percentage points. A 20% increase in international coffee prices could add 0.5 percentage points to GDP.

Remittances, Exports and FDI (2011-2015 Average as % of GDP)



Source: *CID/IDB Staff using data from Central Banks of Central America and the Dominican Republic.*

The report also looks at the implications of a possible increase in US import tariffs – relevant since this is a policy option currently being discussed by the new Trump administration. According to the WTO, the current average weighted tariff in the US is 2.2%. If the average tariff on goods imported into the US from CADR were to rise to 20% (the level suggested in some US discussions), there would be a negative effect on regional GDP of 4.4 percentage points: enough, in other words, to trigger a major recession. This result, however, depends on assumptions about US import price elasticity – if demand is relatively less elastic the negative effect will be lower. On the other hand, unlike some of the other, more temporary shocks, the effects of an increase in US tariffs would continue over the medium to long term.

BRAZIL

Inflation and interest rates head south

Brazilian inflation is falling, and the central bank (BCB)'s main policy rate, the Selic, seems to be following it on the way down. Retail inflation peaked at an annual rate of 10.7% in January 2016, and one year later, by January 2017, had fallen to 5.4%. The BCB has reacted. The latest 75bps Selic cut, announced on 20 February, took it down to 12.25%.

Marcelo Carvalho, chief Latin American economist at BNP Paribas, says that to hold back inflation the Selic has traditionally been held at around five percentage points higher than retail price growth, although the current gap is more like seven points. "In terms of real interest rates, there is a lot of room for cuts," he says, arguing that inflation could slow to as little as 4% by the end of this year. If that happens, in order to boost an economic recovery the Selic might in turn need to be cut to 8% by year-end, he says.

Other analysts have slightly different numbers (many are forecasting an end-year Selic of 9%), but agree that the trend has to be downward. Minutes from BCB's latest monetary policy committee meeting indicated that further cuts will depend on inflationary expectations and the performance of the economy. The context is that two years plus of deep recession have sharply reduced inflationary pressures. The BCB's measure of core inflation (excluding energy and volatile food items) has already plunged to 5.6%. At this rate of reduction, actual inflation is expected to come close to the BCB's target of 4.5% by the end of this year. There is speculation that by the middle of this year the authorities will consider lowering the target rate for future years.

The good news is that lower rates will contribute to the hoped-for recovery. The not-so good news is that the transmission mechanism is not terribly efficient. Brazil is widely seen as having structurally higher interest rates than many other emerging markets, because the country has a lower savings rate and other entrenched imbalances, including its large and persistent fiscal deficit. Should the government led by President Michel Temer get more reforms approved in Congress (such as pension reform), reductions in the 'equilibrium' Selic rate could move lower.

In the meantime, however, questions are being asked about the banking system, which so far has been slow to pass on the benefits of a lower Selic to borrowers. The spread charged on top of Selic to a range of customers is hefty. In December, for example, when the Selic stood at 13.0%, banks were charging a massive 59.2% annual interest rate on consumer lending, and 16.9% on corporate loans. The justification for this is that the banks remain cautious over poor loan quality. While acknowledging that non-performing loans now account for 5.7% of total lending, critics argue that this does still not justify such large spreads.

One official closely monitoring rates is the BCB's president, Ilan Goldfjan. He was recently asked in an interview with *Euromoney* whether high commercial bank profitability – returns on equity rates that have remained consistently high through the recession at round 20% – was a good or a bad thing. His careful answer was, "It is good to have liquid banks, that can provide credit as part of the recovery and that can be resilient within a recession. So that part is good. The part we are working on is having banking spreads fall." Achieving that, he acknowledged, meant looking at things like the current levels of taxes and statutory reserves, but "also, a requirement for a little bit of competition enhancement".

ARGENTINA

Dujovne sets out fiscal plan

Amid a continuing debate over the Argentine government's 'gradualist' approach to fiscal reform and monetary stabilisation, Finance Minister Nicolás Dujovne set out his plans in February.

At a press conference on 22 February, Dujovne said the government would cut the fiscal deficit by one percentage point of GDP in both 2018 and 2019. The target is for the deficit to fall from 4.2% of GDP this year, to 3.2% in 2018 and to 2.2% in 2019. "It's a considerable effort, one point per year, which leaves us in 2019 nearly stabilising the debt to output ratio" the minister said. Dujovne also confirmed that the government is working on tax reform proposals, with a view to submitting them for congressional approval next year.

He introduced another innovation – for the first time the government is announcing quarterly deficit targets. Given seasonal fluctuations in revenue and spending, this year's quarterly deficit targets are 0.6% of GDP in Q117, 2.0% in Q217 and 3.2% in Q317. If the country meets these targets, the greater transparency in the pace of fiscal adjustment may impress credit ratings agencies and help cut interest rates. In January, the country raised US$7bn worth of five- and 10-year bonds, paying 5.625% and 7.00% respectively.

Dujovne may be making a good start: the central government reported a primary fiscal surplus of AR$3.6bn (US$231.7mn) in January, the first such surplus since January 2016. However, Fitch Ratings, while welcoming greater fiscal transparency, also warned that the interest burden was rising and that growing provincial level deficits would put pressure on the federal government's attempts to narrow the deficit. Analysts also note that the fiscal squeeze, although extended over a number of years, will be challenging, not least because windfall tax revenues received in 2016 and 2017 as part of a partial amnesty on undeclared savings will dry out in 2018 and 2019.

Overvalued peso?

Dujovne and other government officials have sought to dismiss worries that the Argentine peso is overvalued. In February, the currency traded at AR$15.70 to the US dollar, the same rate as a year earlier, despite still significant-domestic inflation. Some analysts say the heavy inflow of foreign lending has kept the peso excessively strong, creating a phenomenon known as 'atraso cambiario', to the detriment of exporters. But Dujovne insisted that the exchange rate was "normal". He argued that if the peso was truly overvalued then speculators, "who have a role to play in the economy", would be buying dollars at a much greater rate as a hedge.

SPECIAL FOCUS

REGION

Malnutrition and Obesity – a challenge for Latin America's agricultural policy

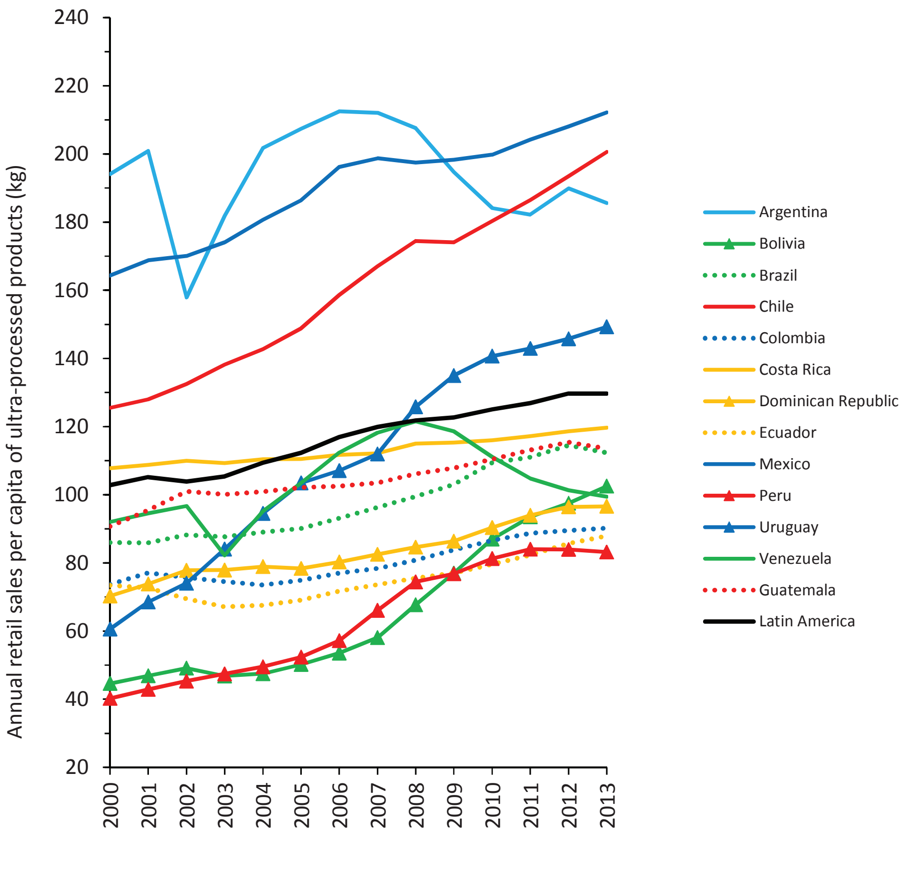
A new report from the UN Food and Agriculture Organisation (FAO) and the Pan American Health Organisation (PAHO) warns that over half of the population of Latin America and the Caribbean, or 360m people, are now overweight, while more than a fifth – 140m people – are obese.

In the minds of most people outside of the region, Latin America typically has been associated with poverty and undernourishment. In fact, as the '*Panorama of Food and Nutritional Security in Latin America and the Caribbean 2016*'[2]

Ultra-processed food and drink products (UPP) are ready-to-eat or drink formulations based on refined substances with a combination of sugar, salt and fat, plus several additives. They include sugary drinks, snacks and fast foods.

– *PAHO*

Annual retail sales per capita of ultra-processed food and drink products in 13 Latin American countries, 2000–2013



Ultra-processed products here include carbonated soft drinks, sweet and savory snacks, breakfast cereals, confectionery (candy), ice cream, biscuits (cookies), fruit and vegetable juices, sports and energy drinks, ready-to-drink tea or coffee, spreads, sauces, and ready-meals. Quantity in liters is converted into kilograms. Sales data are from the Euromonitor Passport Database (2014) *(38)*.

Source: *Ultra-processed food and drink products in Latin America: Trends, impact on obesity, policy implications, PAHO 2015*

[2]Panorama de la Seguridad Alimentaria y Nutricional en América Latina y el Caribe 2016, Organizacion de las Naciones Unidas para la Alimentacion y la Agricultura y Organizacion Panamericana de la Salud, Santiago, 2017.

emphasises, the region is now facing a significant obesity crisis. This crisis is linked to decades of evolving changes in the region, the most of important of which has been a major population shift from rural to urban areas.

Mass urbanisation, along with a gradual rise in average incomes and also the integration of Latin America into international markets, including via free trade agreements, has led to changing dietary patterns. Among the most salient of these, city dwellers tend to consume less traditional home-cooked food and more highly-processed (and typically imported) products. A previous PAHO study[3] showed that between 1999 and 2013 per capita sales of so called "ultra-processed products" continuously increased in 12 Latin American countries, displacing traditional diets based on wholesome foods and meals. Ultra-processed foods had a market share of 16.8% in Latin America in 2013, according to the 2016 report.

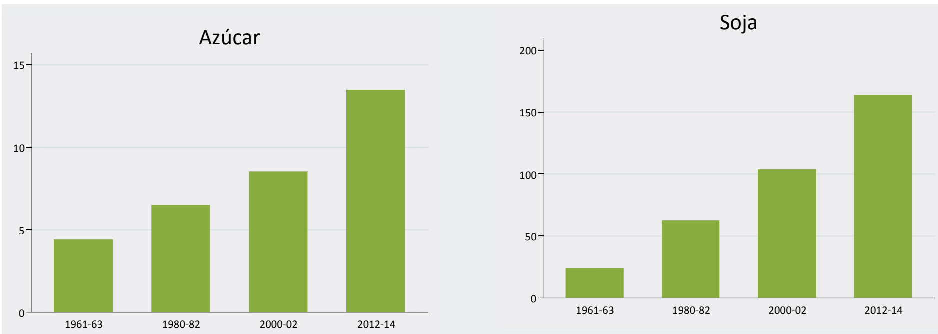
This remains lower than in the US (22.3%) but higher than in Europe (15.9%). In volume terms, of course, the US and Asia still by far consume the most ultra-processed food (given their much larger overall volume consumption of food). Nonetheless, it is notable that Mexico and Chile ranked at number 4 and 7 (of 80 countries) for per capita consumption of ultra-processed foods in 2013 (with Argentina ranked at 14).

This dietary shift, combined with sedentary lifestyles plus factors like tobacco use and urban air pollution, has had negative health consequences, with an increasing incidence of diabetes, cancer, respiratory and heart disease across Latin America. As the report stresses, these non-communicable diseases (NCDs) not only have consequences on human health, but also have important effects on national economies by reducing productivity, and significantly increasing public health costs.

Bread basket of the world – a misnomer?

Added to this mass urbanisation is a problem with unsustainable agricultural development in the region. While South America in particular has long been hailed as "the bread basket of the world", the region's intensifying focus on export-driven industrial agriculture (including the mono-cropping of soya, beef, wheat and palm oil) means that Latin America is failing to properly meet the nutritional needs of its own population.

Sugar and soya under cultivation in Latin America & Caribbean, avg millions of hectares/period



Source: *Panorama de la seguridad alimentaria y nutricional, PAHO 2017*

According to the report, "while food availability in Latin America and the Caribbean is sufficient to meet the energy needs of its entire population, there are worrying trends: sugar availability is higher than in developed regions and the availability of fats per capita is higher than the recommended ranges for a healthy diet, while fish availability per capita is the lowest in all regions of the world". It is important to note that the agriculturally strong South America, in general terms, is more self-sustaining in food supply terms, than Mexico and Central America, which are more reliant on food imports.

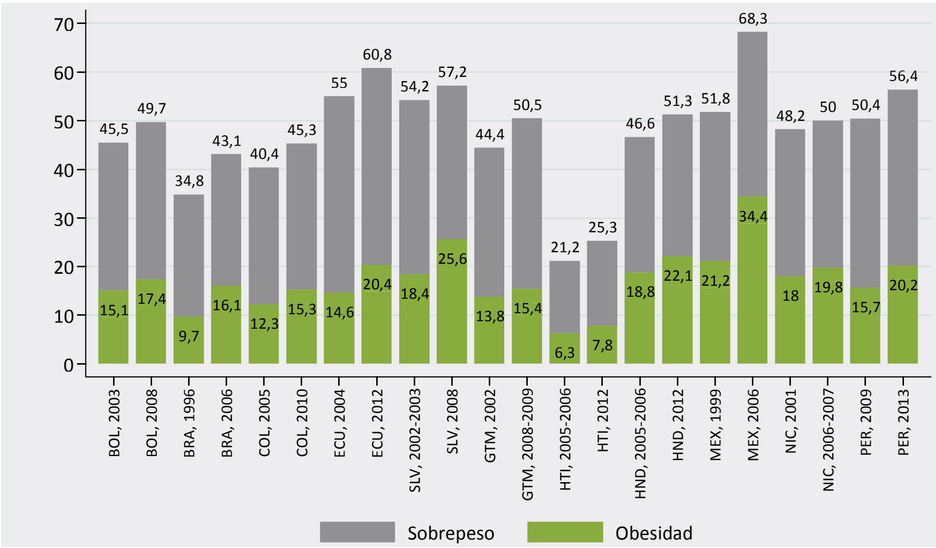
[3]Ultra-processed food and drink products in Latin America: Trends, impact on obesity, policy implications, PAHO/WHO, October 2015.

Agri-food trade in Latin America & Caribbean, 2014-2015, US$m				
Country / region	Exports		Imports	
	2014	2015	2014	2015
Argentina	37,387	34,368	1,786	1,783
Bolivia	1,914	1,486	820	698
Brasil	81,250	73,078	11,953	9,513
Chile	16,498	15,087	6,394	5,934
Colombia	7,309	6,918	6,180	5,752
Costa Rica	4,349	4,146	2,237	1,858
Ecuador	9,676	9,348	2,208	1,944
El Salvador	1,041	1,110	1,739	1,794
Guatemala	4,881	4,882	2,585	2,591
Honduras	2,428	2,553	1,472	1,552
Mexico	25,820	26,767	26,815	24,584
Nicaragua	2,395	2,257	968	1,010
Panama	552	492	1,645	1,676
Paraguay	6,437	5,298	956	867
Peru	8,043	7,521	4,598	4,465
Uruguay	6,038	4,793	1,356	1,262
Venezuela	43	83	8,645	3,848
Latin America and Caribbean	**219,453**	**203,491**	**88,536**	**76,965**
Caribbean	3,391	3,304	6,181	5,835
Central America	41,467	42,207	37,461	35,064
South America	174,595	157,979	44,895	36,066
Source: *Panorama de la seguridad alimentaria y nutricional, PAHO 2017*				

Women and children most affected

Weight problems and obesity are particularly problematic among women and children. In more than 20 countries in the region, for instance, the rate of female obesity is 10 percentage points higher than that of men, while, rather shockingly, the FAO calculates that 3.9m Latin American children under the age of five are overweight. This equates to 7.2% of the children in that age group, which is above the global average of 6.2%

Prevalence of overweight and obesity in women of reproductive age in Latin America & Caribbean. Selected countries & years, %



Source: *Panorama de la seguridad alimentaria y nutricional, PAHO 2017*

Mexico – leading by bad example

As is well known, one of the worst-affected countries is Mexico, where two-thirds of the population is overweight; and one third (32%) is obese. This is a higher percentage than in the US, previously the world's 'fattest' country.

Attempts by Mexico's federal government to deal with the country's obesity crisis through the introduction of a sugar tax on fizzy drinks, for example, have yet to show firm results in health indicators such as the rate of diabetes; albeit it may be a little early to know the full impact.

Health experts point out that apart from the high prevalence of sugar in local diets, Mexico also has to face up to broader lifestyle challenges. These include the heavy use of fast-food restaurants, high levels of weekly screen time, a lack of physical activity, and a frequency of 'over-nourishment', which creates as much of a health burden (if not more) than under-nourishment.

Under-nourishment still at 5.5%

While 50% of the region is overweight, 5.5% of the regional population remains under-nourished, according to the UN/PAHO report, with the rural poor disproportionately affected. Stunting affected 11% of children in 2015, with 1.3% of children under the age of five suffering from wasting. The countries most affected by hunger are: Haiti (53.4% of the population), Nicaragua (16.6%), Bolivia (15.9%) and Guatemala with (15.6%).

A regional economic slowdown since 2013 has also eroded some of the gains made in the fight against poverty in the previous decade. "Signs of slower economic growth coupled with the stagnation of poverty reduction pose significant risks to food and nutrition security. Governments must maintain and increase their support to the most vulnerable so as not to undo their progress in the fight against hunger, and to reverse the rise of malnutrition in all its forms", the report urges.

According to the report, nine countries in the region have managed to reduce their levels of undernourishment to less than 5%: Argentina, Barbados, Brazil, Chile, Costa Rica, Cuba, Mexico, Uruguay and Bolivarian Republic of Venezuela.

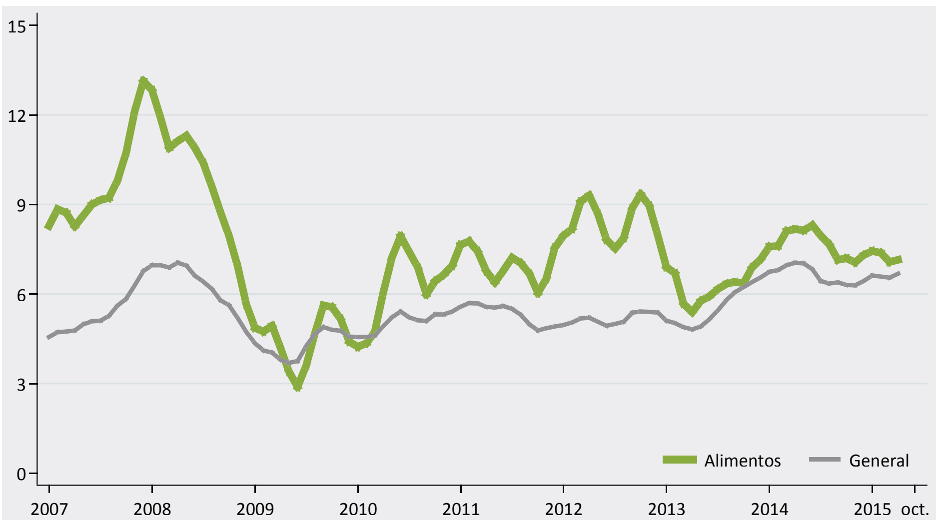
Eleven countries have achieved the hunger reduction target included in the Millennium Development Goals, reducing their prevalence of undernourishment to less than half with regards to the levels of 1990-92: Argentina, Brazil, Chile, Cuba, Guyana, Nicaragua, Peru, Dominican Republic, Saint Vincent and the Grenadines, Uruguay and the Bolivarian Republic of Venezuela.

Under the Food Security, Nutrition and Hunger Eradication Plan of the Community of Latin American and Caribbean States (CELAC), all the countries of the region have committed themselves to eradicate hunger by the year 2025.

Inflation

Food and non-alcoholic drinks have traditionally accounted for between and quarter and a third of the inflation basket in Latin America & The Caribbean. Food prices are vulnerable to changes in weather and harvests, changes in commodity prices, variations in the exchange rate and various other external shocks. In the past year, food prices in South America were particularly affected by supply shocks linked to inclement weather (including the El Nino phenomenon) and weaker exchange rates against the US$. On the other hand, lower global oil prices also helped reduce some food prices.

General and food price inflation in Latin America & Caribbean, %



Source: *Panorama de la seguridad alimentaria y nutricional, PAHO 2017*

Recommendations

The need for sustainable agriculture

PAHO's director, Carissa F Etienne, says that the region faces "a double burden of malnutrition", in reference to these twin crises of under-nutrition and obesity.

She argues that the problem needs to be tackled by introducing balanced diets, based on "fresh, nutritious and sustainably produced food", and by "addressing the main social factors determining malnutrition, such as lack of access to healthy food, water and sanitation, education and health services, and social protection programmes".

The UN/PAHO calls for **the transformation of food systems to make them sustainable and sensitive to nutrition**. This means "improving productive systems so that they guarantee food and nutrition security in the present without damaging the future, through actions that reduce the negative impacts of productive systems on the region's natural resources and the environment, while integrating nutritional criteria and concerns in the development of agriculture to transform the current food supply towards more healthy standards".

Studies by the UN/PAHO and others have found a strong correlation between sustainable agriculture and nutrition rates. Countries with more sustainable agriculture have been shown to have better nutritional scores but also – notably, less food loss and waste. **According to PAHO estimates, roughly 127m tonnes of food are lost or wasted annually in Latin America and the Caribbean.**

The current trajectory of regional agricultural growth is unsustainable, the report emphasises, not least due to its deleterious effect on local ecosystems and natural resources. By way of example, Brazil's agriculture sector is considered to have a very heavy 'water footprint', linked to its mono cropping of grains like soya and its major focus on livestock – both of which are also linked to mass deforestation of Amazon zones, with negative global climatic effects, according to current scientific consensus. Brazil, along with neighbouring Argentina, also has heavy levels of food loss and waste.

To ensure equitable access to food, the UN/PAHO argues, it will be necessary to make the use of land and other natural resources more efficient and sustainable, to improve food production, storage and processing techniques, and to reduce food loss and waste. "A profound change in current food systems is needed to ensure their sustainability and ability to provide nutritious and accessible food for all, preserving ecosystems through a more efficient and sustainable use of land and natural resources and better techniques for food production, storage and processing", it emphasises.

Back to family agriculture and traditional production?

Notably, the UN/PAHO suggests that family agriculture and traditional production forms must play a major role in order to move towards greater sustainability, not least because small farmers actually produce a large part of the fresh fruits and vegetables of the region, two of the key components of a healthy diet.

The need for public policies focused on demand and supply

The report recommends that changes in food demand should be promoted through consumer-centred policies, promoting better eating habits, while at the same time changes in food supply should be made through producer-centred policies that allow for a greater offer of healthier food for the population.

In this context, Latin American governments are urged to strengthen and expand public policies so as to promote the consumption of healthy foods. It lists initiatives already under way, including regulations on advertising of ultra-processed products, regulations on advertising of products aimed at children, new food labelling rules (like the 'traffic-light' system) and taxation of sugary drinks.

These should be complemented, it says, "with policies to increase the supply of healthy food, such as public procurement programs and their connection with family farming and urban and peri-urban agriculture; school feeding, nutritional education and the implementation of short food production and marketing circuits, among others".

"Food supply has to improve both in terms of quantity and quality", it notes. Efforts to improve food systems and their role in an appropriate nutrition "will require family farmers to have access to better technologies, resources, finance and technical capabilities in order to make more efficient their production of healthy food. Markets will also have to adapt to respond to these challenges by fostering local food production and short marketing and distribution circuits."

REGIONAL BUSINESS REVIEW

PERU

Mining: good, but could be better

Peru's mining sector did well in 2016, and is set for another good year in 2017, based on increased output of copper and other key metals, at a time when international prices are beginning to firm up again. The country also has a large pipeline of future projects. But mining companies still complain of too much red tape, and investment looks set to contract for a second year running. The government is planning some stimulus measures but it is not yet clear how effective they will be.

Last year saw big increases in Peru's mining output as new capacity came on-stream. According to the private sector Sociedad Nacional de Minería, Petróleo y Energía (SNMPE), copper production surged by 38.4% to 2.35m tonnes, with gold rising by 4.2% to 153,006kgs, silver by 6.7% to 4.37m kgs, molybdenum by 27.8% to 25,757 tonnes, and iron ore by 4.7% to 7.663m tonnes. These increases more than offset falls in lead production (which dipped 0.4% to 314,174 tonnes, zinc (down 5.9% to 1.336m tonnes) and tin (down 3.7% to 18,789 tonnes). Overall, according to the central bank (BCRP), metallic mining output value rose by 21.2%. The big story was in copper, where output surged as a result of the production start up at the Las Bambas mine, and capacity expansion at Cerro Verde.

According to Juan Lorenzo Maldonado of Credit Suisse, Peru's mining sector made the single largest contribution to the country's GDP growth last year. He said it contributed 1.9 percentage points, reflecting strong output of copper, gold, silver and iron. Other services and telecommunications contributed a further 0.9 percentage points. In contrast, manufacturing, construction, and fishing contracted, and therefore made negative contributions to GDP growth. The national statistics institute (INEI), estimates total GDP growth of 3.9% in 2016.

A further positive for the mining industry was that Peru for the first time moved up past Chile in the global mining attractiveness index compiled by the Canada-based Fraser Institute. The institute carries out an annual survey of 2,700 mining companies, which are asked to score countries on criteria such as mining policy and geology. In the 2017 edition, Peru was ranked 28th in the world (up from 36th the previous year), and pushing ahead of Chile, ranked in 35th place.

Marco Contreras, an analyst at the Lima-based Kallpa Securities, says Peruvian mining is going to have a good year in 2017. Strong automobile production in China and the surge in infrastructure investment promised by President Trump in the US should boost metals demand. Contreras expects international copper prices to rise by 13% to US$2.50/lb this year, with zinc prices rising by 21% to US$1.15/lb. Concern over financial volatility may boost buying interest in precious metals. He expects gold prices to rise by over 4% to US$1,300/oz, with silver rising just over 5% to US$18.0/oz. At these prices, Peruvian mining companies will see rising profitability, as they have competitive cost structures compared to other parts of the world. Contreras expects Southern Copper and Cerro Verde to boost net income in a 60-80% range, relative to 2016, while Volcan and Milpo (polymetallic miners largely focused on zinc) could gain over 60% and nearly 10%, respectively.

Despite the sector's good performance, a number of industry stakeholders say it could do better. While there is an impressive mining investment pipeline, totalling US$46.9bn across 47 different projects, some say the process of turning those projects into reality is just too slow. The new government led by President Pedro Pablo Kuczynski has said it expects US$14bn of the current pipeline to be implemented over the next five years. "I'd like us to be more ambitious. Investing US$14bn over the next five years would add around 800,000 tonnes of production capacity. We can do better than that," says Luis Marchese, president of the SNMPE, who is also general manager of Anglo-American in Peru.

Private sector analysts point out that mining investment levels have actually been falling. Total mining investment in 2016 fell by 44% to US$4.25bn. According to a forecast by consultancy EY, mining investment will fall a further 6% to US$4bn in 2017. Energy and Mining minister Gonzalo Tamayo argues that investment will nevertheless pick up in 2018, with Anglo-American's paused US$5bn Quellaveco development set to be reactivated. Other big projects expected to move forward in 2018 are Ariana (Junín), Pampa de Pongo (Arequipa), Mina Justa (Ica) and expansion plans at Toromocho (Junín) and Laguna Norte (La Libertad). This year the ministry may also re-tender the Michiquillay copper mine in Cajamarca.

There has been much criticism of Peru's long project approvals process, including the very complex negotiations required to reach local community approval and get environmental permits. Going through all steps of the process takes a number of years. The new Kuczynski administration is looking at various ways to reduce red tape. In early March, Minister Tamayo said that a number of initiatives were under consideration. One possibility was to refund the sales tax levied on mining companies, in the event that their exploration efforts prove unsuccessful. Also in the pipeline were reductions in paperwork, such as the environmental and archaeological affidavits required to gain exploration permits. Those permits would instead only be required at a later, post-exploration and pre-production stage. "We want to reactivate exploration," the minister told the *Reuters* news agency. He added that there might also be a reduction in costly and unnecessary safety training session. The government was also reported to be creating a new cabinet office to prevent or defuse social and community conflicts that have arisen around specific mining projects.

Pemex – 2017 a 'point of inflection'

Mexico's state-owned oil firm Petróleos Mexicanos (Pemex), which has just reported better results for 2016 following two years of tough budget adjustments, is making progress in its efforts to take on private sector partners that can help the cash-strapped and over-stretched company in its urgent efforts to arrest its flailing production levels.

On 6 March, Mexico's hydrocarbons commission (CNH), the sector's regulator, said that it had approved conditions for Pemex to proceed with a second farm-out (production-sharing) deal. Under the landmark 2013-2014 energy reform, which opened up Mexico's energy sector to increased private participation and ended Pemex's long-standing monopoly on oil production, Pemex cannot itself negotiate directly with third companies in order to take on production partners. Rather, it has to go through a public bid-process administered by the CNH. This requirement was put in place to ensure transparency and accountability on all sides.

In September 2016, Pemex submitted a formal request to the energy ministry (Sener) to take on a partner in the Ayin and Batsil fields, shallow water deposits in the Gulf of Mexico, located off the coast of Tabasco state. The fields have possible reserves of 281m barrels of oil equivalent (BOE), of which 46m are proven. The CNH has now approved the bid and contract terms for the production-sharing proposal.

On 3 March, Pemex finalised and signed its first farm-out deal with BHP Billiton for the large deep-water Trión field located in the Plegado Perdido belt in the Gulf of Mexico. In December, BHP Billiton presented a US$624m bid for a 60% stake in the venture. At the signing ceremony, which was attended by President Enrique Peña Nieto and BHP Billiton CEO Andrew Mackenzie, Pemex director general José Antonio González Anaya said that the new agreement represented "a parting of the waters in the history of Pemex" and celebrated the new partnership "with a world leading company".

The Ayin-Batsil farm-out is expected to take place alongside pending auctions for other shallow-water concessions scheduled for later this year (*see box below*). Pemex boasts the lowest shallow-water costs of production worldwide.

Pemex cuts losses by 60%

On 27 February Pemex reported total losses of US$14.3bn in 2016, 58.5% less than the losses registered in 2015. Income fell by 7.4% year-on-year to US$52.2bn. Nonetheless, the firm's gross profit increased by 528.9% to US$23.8bn, on the back of a recovery in oil exports. Pemex registered its 17th consecutive quarterly loss in the fourth quarter of 2016, but the US$1.64bn loss was a 90% improvement over the year-earlier period.

Pemex attributed its overall results to operational improvements (it reduced operating costs by 26% last year), ongoing adjustments elsewhere and a reduced tax bill. The company noted that it had managed to "revert the trend of rising debt, with a stable production platform of 2m barrels per day, and lower economic and operational losses". Output averaged 2.15m barrels per day (bpd) in 2016, the first time in the past six years that the company met and surpassed its output target of 2.13m bpd.

The company's corporate finance director, Juan Pablo Newman, said the reduction in losses was "an important achievement" given the complex scenario faced by the company in 2016. He admitted that there was more to be done, but stressed that the company can look to a "promising future" by concentrating on its more profitable businesses. Newman noted the company's new farm-outs, recent asset sales, and also the sale of a record Eurobond in mid-February (of €4.25bn, the largest-ever emerging market Eurobond) as evidence that Pemex is on the right road, telling investors on a conference call: "2017 represents an inflection point. We now have stable finances with a positive trend, but we believe there is still a lot of room for improvement".

Newman suggested that the company could return to surplus by 2019/2020. Nonetheless, there is still concern about the company's accumulated debt – total liabilities and equity rose by a 25% in 2016 to hit US$107bn, prompting a warning by ratings agency Fitch. There is also the question of the 2018 general election – which could see a swing to the Left in Mexico. In that scenario, official policy on Pemex, and the wider oil sector, could see some adjustment.

Financing needs for 2017 covered

Following its Eurobond issue in February, which Pemex noted was almost 4.2 times oversubscribed, the company said it had covered its minimum financing needs for 2017. It also raised US$5.5bn in December 2016, had has other credit available. However, the company said it could re-tap international debt markets "in order to strengthen liquidity, maintain credit lines fully available, stay present in key markets and develop new financing sources or to partially pre-fund 2018 needs".

Pemex sold three benchmark Eurobonds at 4.5, 7 and 11 years in mid-February. This included €1.75bn of notes due in August 2021, with an interest rate of 2.51%, €1.25bn due in February 2024, at a rate of 3.84%; and another €1.25bn due in February 2028, at a rate of 4.98%. Among the major investors were pension funds, portfolio managers and financial institutions in Europe, Asia and Middle East, the firm reported. BNP Paribas, Crédit Agricole, Deutsche Bank and HSBC were the underwriters. Pemex said the successful issue "reflects investors' confidence in Petróleos Mexicanos as a state productive company, and in the opportunities offered by the Energy Reform, which foster the competitive development of the company and the Mexican oil and gas industry". It added that the funds would be used to finance strategic investment projects under the 2017 plan.

2017 auctions

Despite still-low international oil prices, private sector interest in Mexico's oil production sector has been positive since the new auction process began in 2014-2015. From the point of view of the Mexican government, the energy reform is starting to deliver. (Mexican consumers, however, have yet to be convinced, as domestic gasoline market liberalisation has led to a price adjustment in [long below-market] local prices.)

The next licensing round auctions – for Rounds 2.1, 2.2 and 2.3 – are as follows:

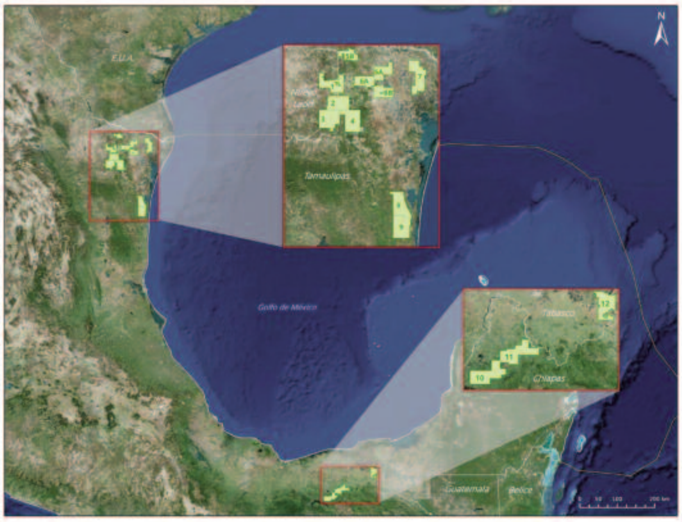
Round 2.1 – Shallow Water – 22 March/19 June. This comprises production contracts for 15 exploratory shallow water blocks, four located in the Tampico-Misantla basin, one in the Veracruz oil region and 10 in the south-eastern basin. Ten of the 15 have oil and gas, with the other five holding gas only. According to the CNH website, 23 companies had registered to access the data room by end February, including BP, Shell, Conoco, Chevron, Statoil, Total, Repsol and Lukoil, among others.

Round 2.2 – Onshore – 12 July. Comprising 12 onshore exploration and production contracts. Nine are located in the Burgos gas basin (Nuevo León and Tamaulipas states) and three in the Sureste basin (Chiapas, Tabasco). Four companies have shown interest, according to the CNH website.

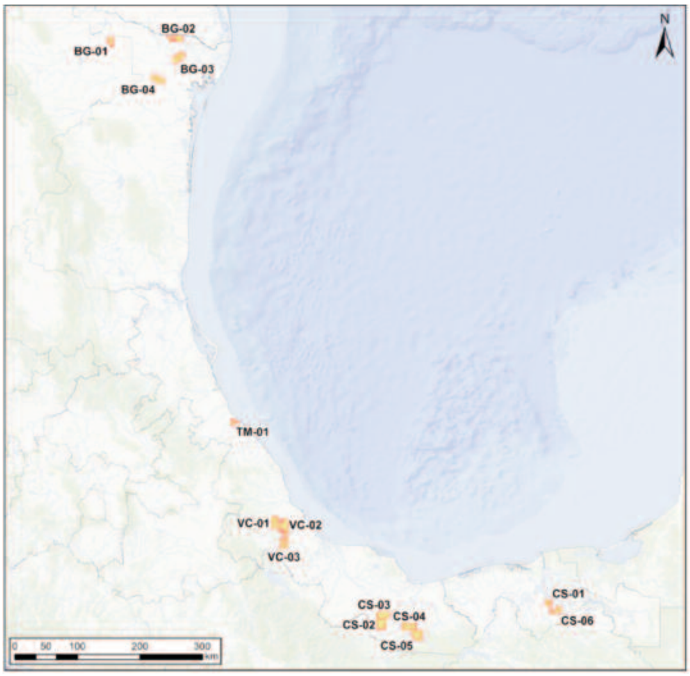
Round 2.3 – Onshore – 12 July. Comprising 14 onshore exploration and extraction blocks covering the Burgos, Tampico-Misantla, Veracruz and Cuencas del Sureste areas. Five have a mix of light oil and dry gas, four wet gas, four light oil only, and one dry gas. Eight companies have shown interest, according to the CNH.

CNH map for Round 2.1, 15 shallow water blocks

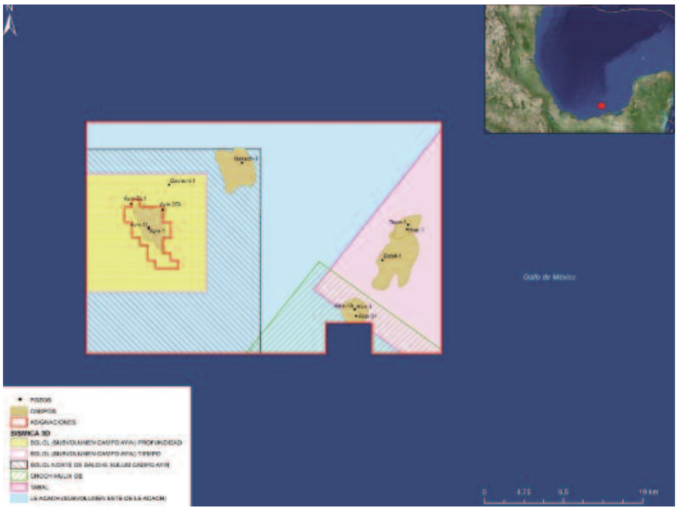
CNH map for Round 2.2, 12 onshore blocks



CNH map for Round 2.3, 14 onshore blocks



Pemex map of Ayin-Batsil field



*The Ayin-Batsil farm-out could take place alongside these auctions in mid July, it is believed.

MEXICO

Electricity demand a huge investment opportunity

A new report by the International Energy Agency (IEA), emphasises soaring future growth in electricity demand.

The special *Mexico Energy Outlook* by the Paris-based IEA, to which Mexico hopes to complete accession this year, praises the country's comprehensive Energy Reform, which it says has "already made remarkable progress, in no small part thanks to the leadership and vision shown by [Energy] Secretary Pedro Joaquin Coldwell".

The 2013 reform, the IEA notes in its executive summary, "was spurred by the recognition that key energy indicators were moving in the wrong direction, with the attendant risk of a widening gap between the performance of the oil, gas and power sectors and the needs and aspirations of a modern Mexico". The Reform, it notes, "recasts the structures that have governed the energy sector for over 80 years", and seeks to bring in new investment and technology across the hydrocarbons value chain by ending the monopoly of the state oil company Pemex and by attracting new players into the power sector to ensure cost-efficient investment into both traditional and low-carbon sources of electricity.

These changes "reflect both the government's broader vision of modernising the Mexican economy, as well as its intention to show leadership on environmental issues". Mexico, it notes, was among the first countries to submit a climate pledge in advance of the COP21 meeting in Paris "and to embed its clean energy target in domestic legislation".

According to the report, energy demand in Mexico has grown by a quarter, and electricity consumption by half since 2000, "but per-capita energy use is still less than 40% of the average in the Organisation of Economic Cooperation and Development (OECD)", of which Mexico is a member, therefore leaving strong potential for further growth. Considerable opportunities for energy savings also exist, it notes, with the energy intensity of Mexico's economy higher than OECD average, "and showing only a limited improvement since 2000". Given its lower than OECD-average per-capita energy use, this is a particular red flag, indicating a very inefficient energy system, and a high cost of converting energy into GDP.

The country's energy mix is still very much dominated by fossil fuels, particularly oil, which accounted for more than half of total demand in 2014, making Mexico one of the most oil-reliant major economies in the world. (Accounting for almost 45% of final oil consumption, transport is by some distance the largest end-use sector, the report notes, making the added point that Mexico's heavily congested main cities far exceed the World Health Organization's upper recommended limit for particulate matter concentrations).

In the IEA's main scenario, the Mexican economy doubles in size to 2040, but total primary energy demand grows only by around 20%; assuming "efficiency improvements and structural shifts that halve the energy intensity of the economy". As per this scenario, oil loses ground in the overall energy mix, its share declining to 42% in 2040, while that of gas continues to rise (reaching 38% by 2040) "and low-carbon sources grow rapidly from a relatively low base".

Within the primary energy sector, electricity demand is set to skyrocket in coming decades. Electricity demand in Mexico has more than doubled in the last 20 years and in 2014 accounted for around 18% of total final energy consumption (a level consistent with the global average share, albeit slightly below the OECD average of 22%). According to the IEA, Mexico needs to meet an 85% increase in electricity demand to 2040. Putting it another way, the agency says that local electricity demand will grow at a pace more than three-times faster than that of the OECD average. To cover this need, the country needs to invest an estimated US$10bn a year.

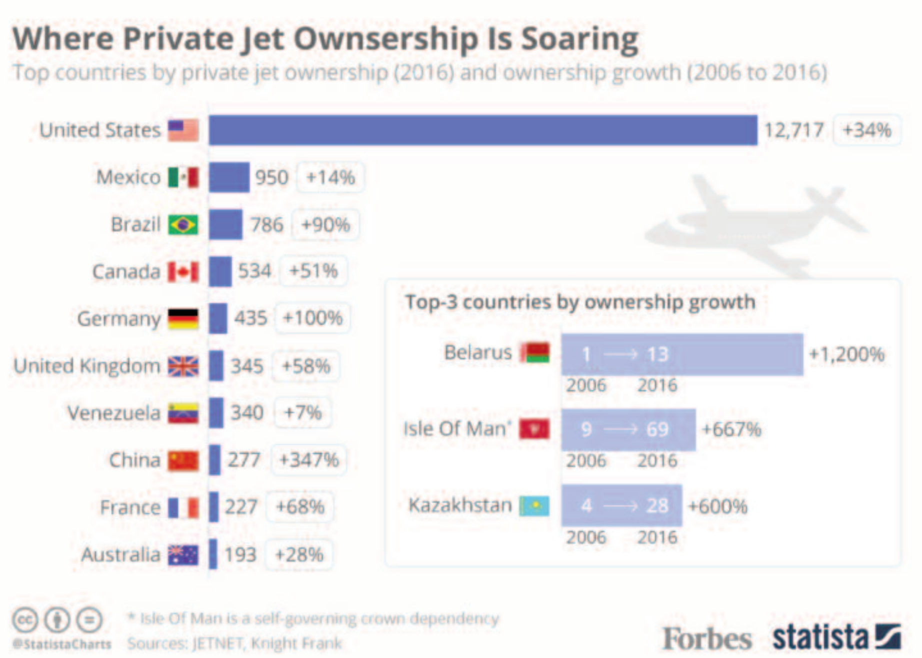
VENEZUELA

Its ok for some...but not for most

Things are not getting any better in 'Zimbazuela', as inflation continues to skyrocket.

According to a 2 March article in *Forbes* magazine, Venezuela last year was among the top 10 countries for ownership of private jets. With some 340 registered last year (up 7% over 2015), it was ranked 7th, just after the UK (with 345) and ahead of China (277), France (227) and Australia (193).

No doubt President Nicolás Maduro would point to the US position at the very top of the list (with 12,717 registered private jets last year), followed by Mexico



(950) and Brazil (786). And while the gap between rich and poor in the US, Mexico and Brazil is appalling to citizens of those countries, it will be particularly difficult for Venezuelans to stomach their country's place on this latest ranking, given the desperate state of affairs right now for most people in the country.

The daily press stories of dying hospital patients, malnourished babies and rubbish-scavenging children are too becoming too numerous to mention (and can be difficult to verify from outside the country), but there is little doubt that daily life on the ground in places like Caracas these days is a very far cry from the jet-set modus operandi still enjoyed by some of the country's wealthy elite, who can afford to go to Miami to escape it all. Equally painful to stomach is the widespread perception that many of these people are from within the Socialist government itself.

According to the latest nationwide annual survey of households known as the Encuesta Condiciones de Vida (Encovi), released on 27 February by the private Andrés Bello Catholic University (UCAB), 82% of Venezuelan homes did not have sufficient income last year to meet their basic needs, with almost half (49%) of those newly in that situation, as the economic crisis in the country extended into a third consecutive year. This means that cyclical poverty is edging into structural poverty in many households, the UCAB warned, which has devastating consequences across many indicators (including health, education and personal security, to name but a few).

On 8 January, President Maduro announced that the minimum wage would be increased by 50%, to BsF40,638 per month. Including food vouchers, known as 'Cestaticket', the so-called integral minimum wage now stands at BsF104,358. At the weakest official exchange rate, that amounts to US$60 (US$154 including food vouchers), but at the black-market exchange rate these figures amount to just US$12 and US$31 respectively.

Hikes to the minimum wage are becoming more frequent, and getting bigger each time, triggering warnings about hyperinflation. The latest increase marked the fifth in 12 months. The minimum wage was BsF9,648 a month at the beginning of 2016, less than a quarter the new rate. The integral wage has increased even more rapidly, by over six times, over the course of 2016. This reflects worsening food shortages, with the government seeking to compensate by providing more food vouchers, albeit that doesn't tackle the underlying lack of availability.

The difficulty is that these wage hikes are funded by printing money. Monetary aggregates were already rising at a rate of nearly 160% year on year end-December 2016.

The much-reported supply shortages of consumer goods and medicines are but one side of the problem for Venezuelan consumers, the other, much bigger issue, is that despite the government's continual double digit increases in the minimum wage and associated benefits, inflation is running away in the country, in large part because of the central bank's continual money printing to finance the government's budget deficit (which private economists estimate at anywhere between 15% and 25% of GDP).

For the past 2-3 years, the central bank (BCV) has ceased releasing macroeconomic data, ostensibly on national security grounds. The last inflation release was on 18 February 2016, when the bank reported end-year 2015 inflation of 181% year-on-year. As such, figures for inflation in Venezuela vary wildly. Citing BCV sources, *Reuters* in January suggested that last year's inflation had hit 800%, with a real GDP contraction of 18.6%. The US-based Troubled Currencies Project, run by John Hopkins University and the conservative Cato Institute, estimated that inflation ended 2016 at 290% and calculated that the country entered into hyper-inflationary territory in November 2016 (typically defined as at least two months of inflation over 50% month-on-month). The International Monetary Fund (IMF) put 2016 inflation at 476%, and has a very dramatic forecast of 1,660% in 2017.

In the prolonged absence of the BCV data, the opposition-controlled national assembly (AN) is now launching its own national inflation index, which it will publish every month. The index has been drawn up under the supervision of the opposition deputy José Guerra, a respected economist and currently head of the AN's finance and economic development commission.

Guerra said that using the BCV's own methodology, the finance commission had estimated inflation of 550% in 2016. He suggested that prices rose by 18.7% month-on-month in January. If correct, that would be the highest recorded for the month since inflation data began to be compiled in 1945, he observed. On that basis, the commission projects inflation of 679.7% by year-end 2017.

The AN's inflation index will be released the 15th day of each month, "so that Venezuelans know how much their salary is worth", Guerra noted. He said that salaries should be linked to "an economic policy that seeks to contain inflation", noting that, "it's of no use increasing salaries when consumer purchasing power is undermined by inflation". He also called for a policy to restrict money supply. "What generates high inflation the world over is when central banks inundate the market with money to finance the fiscal deficit. It's a universal lesson", he noted.

REGION

Corporate Radar

Graña y Montero troubles: The Peruvian construction group Graña y Montero has been hit by the knock-on effects of corruption allegations involving Odebrecht, the Brazilian construction group it has partnered with on various large projects, including the US$7.3bn Gasoducto del Sur pipeline. One of the allegations is that former Peruvian President Alejandro Toledo (2001-2006) was paid a US$20m bribe to ensure that an Odebrecht-led consortium won the tender to build a segment of the Brazil-Peru Inter Oceanic highway. Jorge Barata, Odebrecht's former Brazil representative and now turned state's witness in Brazil as part of the major corruption investigations there, has claimed that the other companies in the consortium including Graña y Montero, were aware of the payment. Graña y Montero shares, which are listed in both Lima and New York, fell by 33.3% and 34.7% respectively on the news. The company rapidly denied the allegations that it had knowledge of any bribery payments, but this did not head off the announcement of a class action on behalf of shareholders led by Rosen Law of the US, alleging that the company's shareholders had been given materially inaccurate information.

Trump's Mexico move could hit China's Alibaba: President Donald Trump's threat to crack down on remittances sent home by Mexican workers in the US could have an unexpected consequence: hitting the business interests of Jack Ma, leader of China's Alibaba, one of the world's largest e-commerce groups. Ma and Trump have met various times and are reputed to get on with each other. In January, Alibaba announced that it was acquiring MoneyGram, a US company specialised in international payments, which is number two in the market behind Western Union. The acquisition will require US regulatory approval. Sending money between the US and Mexico accounts for around 10% of MoneyGram's total turnover. The purchase of MoneyGram by Ant Financial, an Alibaba subsidiary that also owns the Alipay international payments platform (a rival to PayPal), was widely interpreted as part of the Chinese group's emerging globalisation strategy. Whether the Trump administration will be able to tax remittances sent from the US to Mexico is still a moot point. Various Republicans in the US Congress have suggested a 2% tax on remittances could be applied, with the proceeds earmarked to fund Trump's proposed border wall on the frontier with Mexico. But critics say that such a tax, differentiating between people sending money out of the US on the basis of their nationality, could be unconstitutional.

Rappi jumps the wall: Another technology company may be about to increase cross-border integration between Mexico and the US, at a time when the Trump administration is seeking to exert greater control of trade movements. The Colombian online courier company Rappi, which operates in major urban centres such as Bogotá and Mexico City, says it is about to expand into the US. So far, the company has specialised in carrying out deliveries or fulfilling bureaucratic chores for clients within each city. According to Adán Ramos of Rappi México, customers have nevertheless suggested a new service, which would allow people in the US to choose and pay for goods, for delivery, within hours, to friends and family in Mexico. The system would allow delivery of goods, medicines or money (a service known as Rappicash). Rappi has around 1m customers, but so far has little presence in the US. But its Mexican customers have family and friends north of the border; and thus Rappi is aiming to build up a presence in California, Texas, Illinois, New York and Florida.

SQM seeks lithium boost: SQM, Chile's chemicals and mining group, says it is positioned to benefit from an 8-10% increase in global demand for lithium this year. Lithium has a range of applications including in batteries, steel and aluminium manufacture, and in heat-resistant glass and ceramics. SQM is a leading global supplier of iodine and potassium nitrate. Gerardo Illanes, vice-president for finance at SQM, told the Chilean daily *El Mercurio* that lithium sales could help the company boost its Ebitda to US$1bn by 2020. The company is planning to invest US$100m this year to increase potassium nitrate and lithium hydroxide production capacity. Coupled with a capital injection for its mining operations in Argentina, total investment this year would reach US$300m, Illanes said.

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