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Mexico's Peña Nieto preparing "important changes"

On 24 November Mexico's interior minister, Miguel Angel Osorio Chong, said that President Enrique Peña Nieto would announce new initiatives on the rule of law, the role of the federal attorney general's office (PGR) and the struggle against corruption.

For over a month and a half, Mexico has been in a prolonged political crisis marked by demonstrations over the disappearance and presumed murder of 43 trainee teachers in Iguala, Guerrero state, and by other human rights, corruption and governability concerns. Osorio Chong said that President Peña Nieto would announce "important changes" to modify "those things that aren't working well". He indicated that this includes the weakness of the State at the municipal level, corruption and the role of the PGR.

President Peña Nieto was expected to make the announcements as we went to press on 27 November. Some initiatives have been discussed before, so the question is whether the president will merely dust them off and relaunch them, or whether he will make more substantive new proposals. The federal government has, for example, already proposed changing the status of the PGR to grant it full autonomy from the federal executive (the PGR head has ministerial status and is appointed by the president). The current PGR head, Jesús Murillo Karam, who was appointed by Peña Nieto, has been heavily criticised for his handling of the Iguala investigations. There have also been inconclusive talks on creating a 'national anti-corruption system'.

At the heart of Mexico's security problems lies the pervasiveness of corrupt practices, which affect not only the public sector but are also entrenched in the private sphere. However, to date the Peña Nieto administration has not seemed to prioritise this issue. Critics accuse the government of failing to deliver a strategy to build effective institutions, particularly police and judicial capabilities at both the federal and the state level, where it is obvious that the need is increasingly urgent. Without more serious efforts to address these problems, there can only be marginal and temporary improvements in the security situation, notwithstanding the apparent decline in the number of drug-related murders and the capture of major cartel leaders.

Mexico's political class as a whole fears becoming completely discredited by the current crisis, so the issue of reform has resonance. The main left-wing opposition Partido de la Revolución Democrática (PRD) has proposed ten urgent measures to deal with the "crisis of the State", including the establishment of a truth and justice commission and the creation of a new police force to allow the gradual removal of the armed forces from the struggle against

Fuelling optimism that Mexico's recovery is gathering strength, third quarter growth was broad-based, led by a rise of 7.3% in the primary sector (agriculture), with an increase of 2.0% in both the secondary and tertiary sectors. In the secondary sector, there was a rebound of 4.0% year-on-year in construction, along with a 3.2% rise in manufacturing, and a 1.5% increase in the electricity, gas and water sector. Against this, however, mining fell 2.1% year-on-year overall, dragged down by a 2.7% decline in oil production. Given the spectre of weak prices and stagnant production, never has the government's new energy reform seemed so timely. Finally, tertiary sector growth was driven by a 3.9% increase in retail activity.

drug gangs and organised crime. But the PRD is itself deeply tainted by the Iguala case. The president of the federal senate, Miguel Barbosa (PRD), has proposed the creation of a national commission of 'notables' from the three branches of government to recommend reforms.

Economic implications

Peña Nieto's success in navigating 11 major reforms through congress in under 24 months is unparalleled in recent Mexican history. Investors are genuinely interested in, and excited by, deep reforms that include opening up a seven-decades old energy monopoly to the private sector. In our Special Focus this month we examine the upcoming oil concession rounds, as the new energy reform moves on to the next stage. And the Mexican economy is growing: moderately this year, with a faster pace expected in 2015 and beyond. That is more than can be said for a number of other large but recession-troubled Latin American economies such as Brazil, Venezuela and Argentina. In these countries, the prospect of new structural economic reforms looks very problematic.

Compared to Brazil in particular, which is stuck in low gear, Mexico is positively blooming, with manufacturing and exports, in particular, strengthening in line with the quickening recovery in the US. Real GDP grew 2.2% year-on-year in the third quarter, up from 1.6% in the second and the fastest pace since 2012. There are still headwinds ahead, amid continued uncertainty as to oil prices and the wider global economic situation. The government has now reduced its 2014 annual GDP forecast to a range of 2.1%-2.6%. Its 2015 forecast is a more flexible 3.2%-4.2%; the official 2015 budget goal is 3.7%.

However, it has to be acknowledged that there is some substance in some of the fears being expressed about the Mexican State. Uruguay's President José Mujica caused a diplomatic incident after saying in a 21 November interview that Mexico was staring to resemble "a failed state". "This is terrible.... One gets the impression, looking from afar, that it resembles a failed State, in which all public powers have been lost, eroded. It is very painful what is going on in Mexico", he stated (he later backpedalled and apologised). But crime and the infiltration and corruption of Mexico's institutions, including the security forces, is a real issue.

In a recent Special Report on Mexico for London's Canning House, we suggested that Peña Nieto had perhaps calculated upon taking office in December 2012 that the battle against crime would take a long time and yield very few results: hence better to concentrate on the economy: indeed, a dynamic economic recovery might ultimately erode some of the causes of crime.

However, if the president back then had hoped to 'compartmentalise' security and economic policies, his gamble has failed. The government failed to anticipate the cartels' ability to virtually engulf municipal and state governments. The security problem is back at the top of the agenda, and worse still, it threatens the economic reforms.

Many analysts argue that what is at stake is the rule of law, not only for the protection of Mexican citizens, but also to provide the guarantees needed in a modern economy for precisely the type of foreign investors the country is seeking to attract. With mid-term elections due in June next year, the fate of the economic reforms may now depend on the government's ability to formulate a more effective security policy.

MEXICO

Oil companies prepare for Round One in Mexico

Mexico's first round of oil and gas licensing starts in early 2015. The stakes could not be higher. The government says it hopes the 169 exploration and production (E&P) blocks on offer will attract around US$12.5bn worth of investment from international oil companies. With rounds 2, 3 and 4 expected to follow in 2016, 2017 and 2018, and with each bringing in similar amounts, a total of around US$50bn worth in energy-related inward investment is expected during the current administration. It is also hoped that in the process the gradual fall in oil output over the last decade will be reversed, and that the ensuing energy renaissance will add one percentage point to Mexico's underlying rate of GDP growth. Will it work?

José Pablo Rinkenbach of AINDA Consultores, a Mexico-based oil and gas consultancy, is adamant that Mexico's energy model was heading for a crisis and that something needed to be done. He says the government's response – a move to end the seven-decade old monopoly exercised by the oil giant Petróleos Mexicanos (Pemex) and open up the industry to private sector investors – is a well thought-out and ambitious plan. Speaking to *Latin American Economy & Business* in Mexico City in early November, Rinkenbach pulls out a series of presentations and charts, drawing diagrams to make his point.

The main point is that "the old oil and gas paradigm" is over. In that paradigm, Pemex produced oil from conventional and highly productive reservoirs such as the giant offshore shallow waters field at Cantarell. In a fairly lineal manner, more investment in exploration and production would lead to greater proven reserves and greater production. But the key problem is that "the easy sources" of oil have begun to run out. Proven reserves peaked in the early 1980s and have been trending downwards ever since. Production peaked in 2004, and has also been trending down over the last decade (to about 2.4m barrels per day [bpd] this year).

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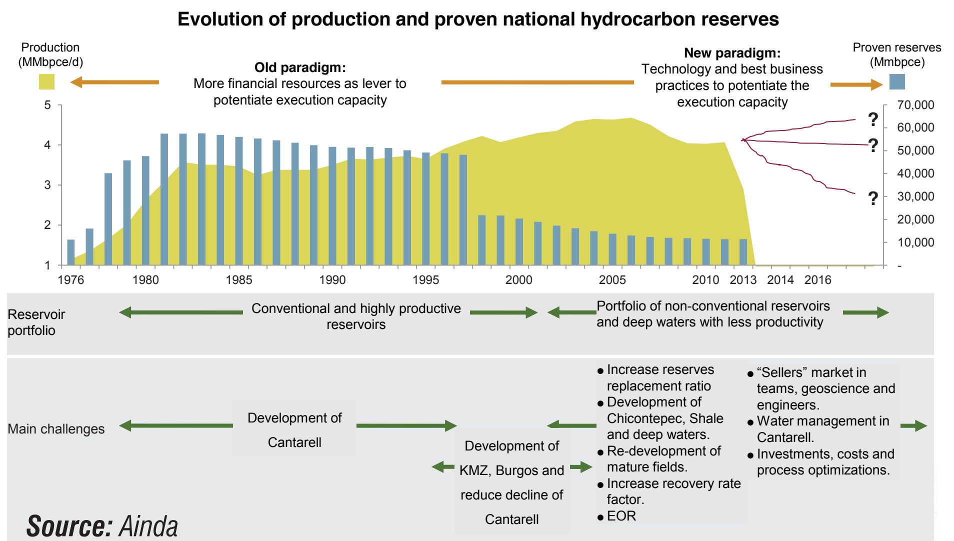
Current situation: A more complex project portfolio
In the short term even if it will be difficult to significantly increase Mexico's oil production, the level of physical activity will increase substantially given the lower productivity and greater complexity of the reservoirs.



It is not as if there isn't enough oil in Mexico. Rinkenbach says there is plenty: the problem is that it is more complicated and expensive to get it out of the

> “Pemex’s chief financial officer, Mario Beauregard, says it has been given enough to maintain annual production at around current levels of 2.4m bpd for the next 20 years. With that baseline assured, Pemex will assess whether to bid for further licences in subsequent rounds.”

ground, and involves working in more challenging areas: deep waters, heavy oils, shale and EOR (enhanced oil recovery) among them. To dramatise the problem, he stresses that the ‘do nothing’ option would be very negative. Reserves and production would continue dwindling, and depending on various assumptions about the rate of decline and international oil prices, the government, which is reliant on Pemex revenues, could find itself losing one-fifth of its total fiscal income.

To avoid this, Rinkenbach talks of “the new paradigm”, where, in a mixed public and private sector oil and gas industry, new investment flows are brought in and technology and know-how is applied to develop more complex reservoirs and recovery processes. These will include the challenging Chicontepec basin and deep-sea deposits in the Gulf of Mexico. To make this step-change happen, the government has created a new oil and gas ‘ecosystem’. Rather than having the entire industry run by a Pemex monopoly, its future evolution is now to be determined by the interactions of a ‘triangle’ of three key players: the ministry of energy (Secretaría Nacional de Energía, or Sener), which is responsible for setting national energy policy, a semi-autonomous regulator (Comisión Nacional de Hidrocarburos, or CNH), and the production companies (including Pemex and a whole range of new private sector players).

Under Round Zero the CNH this year allocated a large number of exploration and production fields to Pemex, which was the only bidder. The company got 100% of the ‘1P’ (proven) reserves on offer, 83% of the ‘2P’ (proven and probable) reserves offered, and 21% of the ‘3P’ (or prospective) reserves. Pemex’s chief financial officer, Mario Beauregard, says it has been given enough to maintain annual production at around current levels of 2.4m bpd for the next 20 years. With that baseline assured, Pemex will assess whether to bid for further licences in subsequent rounds.

Sener’s main intent in choosing the areas offered under Round 1 seems to have been to attract world-class oil companies with the financial muscle to make major investments and the technical know-how to find and extract oil and gas in difficult geological formations. José Sifuentes of Nader, Hayaux & Goebel, a legal practice working with various foreign oil companies, notes that to win a licence it is necessary above all to meet the technical specifications; thereafter under the terms of the new legislation CNH must award the licence to the bidder offering Mexico the best deal in terms of (i) amount or percentage of oil revenue to be received and (ii) total investment commitment.

A total of 169 blocks or fields are being offered under Round 1. Of these, 109 are for exploration and 60 for production. The blocks are located in five main areas. They include onshore non-conventionals (shale) in Coahuila state near the Texas border; the Perdido offshore area in the Gulf of Mexico; the southern deep-water fields; the Chicontepec onshore basin, and a final group of onshore, shallow waters, and extra heavy oil fields. In addition, private sector players are being asked to bid to work on a farmout basis on 10 Pemex-controlled blocks. At the end of October, Energy Minister Pedro Joaquín Coldwell said the government was planning to hold one licensing round a year for the remainder of the government’s term in office.

For Round 1, Sener is working to define model contracts and licences, while the finance ministry is finalising the fiscal and economic terms. Once this work is completed, it is envisaged that from 23 January 2015 CNH will be in position to formally launch the licensing round. In parallel, the government has required Pemex to collaborate in the creation of virtual ‘data rooms’ for each block, which will contain all the relevant geological information, and be accessible on an exclusive basis to interested oil companies. While Pemex is the traditional holder of that information, its chief executive Emilio Lozoya has noted that “the law requires us to hand over the data to the CNH, because

it is data that belongs to the country, it is the property of the Mexican state'. He said the 'data rooms' would be completed "from November onwards".

In November the government was also due to release pre-bid draft documents for the purpose of consultation and feedback from oil companies. The drafts for shallow waters were expected in the first half of the month, to be followed by extra heavy oils (December) and by Chicontepec and non conventionals (January). Onshore and deep-water draft documents are due in February and March respectively. The first set of final bid documents is expected to be ready for sale between February and May 2015. Coldwell has also said that the government is hoping winners will be announced and the first licensing contracts with oil & gas companies signed between June and September 2015. Start dates will be set from the beginning of 2016 onwards. It is a very tight schedule, but the government is pushing hard.

For foreign oil companies, going into Mexico is a major strategic move and needs to be assessed against a number of criteria including of course the profitability and attractiveness of the deposits, measured against other oil and gas opportunities elsewhere. Some have expressed concern about domestic political risk factors, including corruption and organised crime (for example, drug cartels have been particularly active in places like Tamaulipas state, home to important oil ports such as Tampico and Altamira). Gustavo Mohar, a former senior official in Mexico's national security agency, Centro de Investigación y Seguridad Nacional (CISEN), who as chief executive of the security consultancy Grupo Atalaya advises foreign companies, acknowledges that there are real risks, but argues that they can be successfully managed. He recommends, for example, that foreign companies should actively develop community relations in the different municipalities in which they are active. He also notes that while high levels of violence in some states make international headlines, there are others that, based on indicators such as the homicide rate, are actually safer than parts of the US.

> "Before as a monopoly, we had a production mandate, and we thought in terms of barrels of production. Now we have to think about the optimum production level to optimise profitability for our shareholder, which is the government."

The scale of the changes being made is major. Not least is the fact that Pemex has to reinvent its business model. Pemex is the largest company in Mexico, the second largest in Latin America (having just been outpaced in revenue terms by Petrobras of Brazil), and the 11th largest oil & gas company in the world, down from 6th place in 2000, according to the *Petroleum Intelligence Weekly* ranking). It currently employs an estimated 150,000 people. Its revenues in 2013 came to US$123bn (slipping behind the US$141bn mark reached by Petrobras in the same year). Production in 2013 was 2.52m bpd, down 2.7% on the preceding year. In the first nine months of 2014, the company reported a loss of US$10.9bn, due in part to lower international oil prices.

Speaking to us, Pemex CFO Mario Beauregard said that despite this year's losses Pemex remains a fundamentally profitable company. "Of course it is a concern that we registered losses, but as you know Pemex contributes 35% of the Mexican government's revenues. As part of the energy reform our tax contribution to the government will be phased down, and if you look at our EBITDA in the first nine months of this year, it was positive to the tune of US$54bn." Beauregard also said he was relatively relaxed about the current dip in international oil prices. "Pemex's average extraction cost is 22 dollars per barrel. That's what it costs us to produce the 2.4m barrels of our current output. The proportion of those 2.4m that are coming from more expensive sources like shale or deep water oil is at present zero. So we are relaxed about lower oil prices. Obviously, like any production companies we'd like to see higher prices, but at present we are relaxed about our position in the market". Beauregard went on to acknowledge the scale of the culture change Pemex faces. "Before as a monopoly, we had a production mandate, and we thought in terms of barrels of production. Now we have to think about the optimum production level to optimise profitability for our shareholder, which is the government".

REGION

Doing business in Latin America gets easier overall

Over the year to June 2014, it became easier to do business almost everywhere in the region. Trinidad & Tobago stood out for the improvements made.

The World Bank was upbeat in its assessment of Latin America and the Caribbean in its *Doing Business 2015* report, published at the end of October. At least one reform to improve the ease of doing business was implemented in most countries in the region over the year to the end of 2014. Except for Puerto Rico, the overall score for the ease of doing business improved in every country in the region.

In its assessment, the World Bank considers 10 factors: starting a business; dealing with construction permits; getting electricity; registering property; getting credit; protecting minority investors; paying taxes; cross-border trading; enforcing contracts; and resolving insolvency. In relation to each factor, the World Bank considers the 'distance to the frontier' (DTF – or divergence from global best practice). The overall score assigned to each country is a composite of the scores for the various categories.

"According to the World Bank, it is significantly easier to do business in Colombia than in a number of developed countries including Italy (ranked 56th overall) and Luxembourg (59th)."

The 2015 report finds that Colombia is the country in the region in which it is easiest to do business. Its overall score means that it is ranked at no. 34 of the 189 countries surveyed for the report. According to the World Bank, it is significantly easier to do business in Colombia than in a number of developed countries including Italy (ranked 56th overall) and Luxembourg (59th). Since 2005, the World Bank has counted 29 different regulatory reform measures in Colombia, or more than in any other country in the region. Ranked in 35th, 39th and 41st positions respectively, Peru, Mexico and Chile are the next three Latin American countries best ranked for ease of doing business. In fifth place in the region, and 47th overall, is Puerto Rico.

A number of insights are evident from **chart 1**, which shows the overall rankings for each of the countries, as well as their rankings for each of the 10 different doing business factors considered by the World Bank. For instance, there is a very wide divergence between the countries in terms of the ease of doing business. Most of the countries are ranked between 46 and 144, which means that they are second or third quartile in global terms. However, the environment for business in Haiti and Venezuela is among the worst anywhere globally. Moreover, the scores for each of the various doing business factors often vary markedly within countries. Among the top ranked countries, for instance, Colombia is assessed highly for the ease of getting credit, protection of minority investors and resolution of insolvency. However, Colombia is not an easy place in which to enforce contracts, being ranked 168th. St Kitts & Nevis is ranked at 121 for overall ease of doing business. However, access to electricity does not feature as a problem at all.

O Custo Brasil, the additional challenge of doing business in Brazil relative to other countries, is plain to see. Brazil is at no. 121 in the global ranking. Of the larger emerging markets, the only three with worse rankings are Argentina (124), Pakistan (128) and India (142). Brazil is assessed favourably for access to electricity and the protection of minority investors' interests. However, starting a business, dealing with construction permits and paying taxes are as costly and/or complicated as they are anywhere in the world.

Chart 1: Ease of doing business rankings out of 189

	Global Rank	1	2	3	4	5	6	7	8	9	10
Colombia	34	84	61	92	42	2	10	146	93	168	30
Peru	35	89	87	86	26	12	40	57	55	100	76
Mexico	39	67	108	116	110	12	62	105	44	57	27
Chile	41	59	62	49	45	71	56	29	40	64	73
Puerto Rico	47	48	158	32	163	7	78	133	84	92	7
Panama	52	38	63	29	61	17	76	166	9	84	132
Jamaica	58	20	26	111	126	12	71	147	115	117	59
Guatemala	73	98	122	18	65	12	174	54	102	143	155
Trinidad & Tobago	79	71	113	21	159	36	62	113	76	180	66
Uruguay	82	60	162	39	146	52	110	140	83	106	57
Costa Rica	83	118	52	46	47	89	181	121	47	129	89
Dominican Republic	84	113	96	119	82	89	83	80	24	73	158
Antigua & Barbuda	89	102	30	17	141	151	35	159	89	76	114
Paraguay	92	126	43	51	60	71	166	111	150	90	106
Bahamas	97	95	92	50	179	131	141	31	63	125	60
Dominica	97	63	43	53	149	131	87	94	88	148	121
St. Lucia	100	72	39	23	132	151	141	69	122	145	100
St. Vincent & the Grenadines	103	80	35	8	155	151	71	93	45	101	189
Honduras	104	138	103	110	81	7	174	153	70	166	140
Barbados	106	94	147	118	144	116	177	92	38	160	26
El Salvador	109	121	155	144	56	71	154	161	73	82	79
Ecuador	115	165	59	120	80	89	117	138	114	88	151
Belize	118	148	69	54	120	160	169	61	91	170	71
Nicaragua	119	120	134	95	134	89	172	164	74	70	110
Brazil	120	167	174	19	138	89	35	177	123	118	55
St. Kitts & Nevis	121	87	16	10	170	151	87	137	67	116	189
Guyana	123	99	38	155	103	165	135	115	82	71	150
Argentina	124	146	181	104	119	71	62	170	128	63	83
Grenada	126	80	40	77	128	131	141	106	51	144	189
Bolivia	157	171	129	127	130	116	160	189	125	111	96
Suriname	162	181	79	69	178	171	171	71	106	184	130
Haiti	180	188	132	94	175	171	187	142	142	89	189
Venezuela	182	182	152	155	102	104	178	188	176	79	165

Note: Overall scores improved for all countries listed other than Puerto Rico.
Trinidad was among the top 10 countries worldwide for improvement in score.

Legend:

1. Starting a business	6. Protecting minority investors
2. Dealing with construction permits	7. Paying taxes
3. Getting electricity	8. Cross-border trading
4. Registering property	9. Enforcing contracts
5. Getting credit	10. Resolving insolvency

Source: *World Bank, Doing Business 2015*

Chart 2 (*overleaf*) looks at positive changes in the region through 2013/14. Many of the reforms and improvements occur in just four of the 10 factors assessed by the World Bank: ease of starting business; ease of paying taxes; legal rights of creditors/debtors; and resolution of insolvency. Conversely, across the region as a whole, there was little progress in relation to construction permits (except in Puerto Rico), registration of property (except in Colombia) or enforcement of contracts (except in the Bahamas and Uruguay).

The chart also indicates that positive changes were concentrated in relatively few countries. Yet again, most progress was made in Colombia. The World Bank highlighted a new law allowing all movable (i.e. mainly financial,

Chart 2: Changes in 2013/14	
Making it easier to start a business	
Simplified pre-registration and registration formalities	Guatemala
Cut post-registration procedures (tax, social security etc.)	Jamaica
Introduced/improved online procedures	Trinidad & Tobago
Created/improved one-stop shop	Suriname
Making it easier to deal with construction permits	
improved building inspection process	Puerto Rico
Making it easier to get electricity	
Improved regulation of connection processes and costs	Jamaica
Improved process efficiency	Costa Rica
Making it easier to register property	
Combined or eliminated procedures	Colombia
Making it easier to pay taxes	
New or improved electronic systems	Costa Rica, Guatemala
Reduced profits tax rate by 2 percentage points (pp) or more	Colombia, Guatemala, St Kitts & Nevis
Reduced labour taxes and mandatory contributions by 1 pp.	Colombia
Making cross-border trade easier	Ecuador, St Lucia
Improved customs administration	St Lucia
Improved risk-based inspections	Uruguay
Strengthening legal rights of borrowers/lenders	
Created unified registry for movable property	Colombia
Introduced integrated secured transactions regime	Colombia, Jamaica
Improved rights of secured lenders	Mexico, Trinidad & Tobago
Allowed out of court enforcement	Panama
Expanded range of assets that can be used as collateral	Panama
Improved sharing of credit information	
Improved regulatory framework for credit reporting	Dominican Republic
Established credit bureau or registry	Jamaica
Introduced credit scores	Nicaragua
Greater protection of minority investors	
Increased disclosure requirements for related-party deals	Ecuador
Expanded shareholders' role in company management	Dominican Republic
Improved enforcement of contracts	
Inceased procedural efficiency at main trial court	Bahamas, Uruguay
Making it easier to resolve insolvency	
New restructuring procedure	Trinidad & Tobago
Strengthened creditors' rights	Mexico
Improved likelihoold of successful reorganisation	Mexico
Regulated profession of insolvency administrators	Trinidad & Tobago
Source: *World Bank, Doing Business 2015*	

rather than real estate) assets to be used as collateral for loans. (Note: This is shown on the chart as the introduction of a secured transactions regime). Guatemala made a number of improvements to its tax system.

Interestingly, Trinidad & Tobago was the country whose overall score for ease of doing business improved most in the region over the year to June 2014. The World Bank noted that the improvement was among the top 10 of any country worldwide. Reforms were undertaken in three broad areas – starting a business, legal rights of borrowers/lenders and resolution of insolvency. Among these, a new online platform for company registration has reduced the time it takes to register a company in Trinidad & Tobago from 38 to 14.5 days.

As **chart 3** shows, Trinidad & Tobago was not the only country in the region where progress was made on several fronts. In Jamaica, it became easier to

Chart 3: Changes in year to June 2014 - some highlights		
Country	**Change making it easier to do business**	**Change making it harder to do business**
Argentina		Construction permits more expensive
The Bahamas	Enforcing contracts easier	Construction permits more expensive
Bolivia		Increased customs clearance time
Colombia	Transfer of property easier Increased access to credit	Paying taxes more complicated
Costa Rica	Reduced time needed to get electricity	
Guatemala	Easier to start business and pay tax	
Honduras		Construction permits more expensive
Jamaica	Easier to start business, get electricity and get credit	Paying taxes more costly via new minimum business tax
Mexico	Resolving insolvency easier improved access to credit	
Nicaragua	Easier to start business	
Panama	Improved access to credit	
Puerto Rico	Easier to deal with construction permits	
St Kitts & Nevis	Easier to pay taxes	Construction permits more expensive
St Lucia	Easier to trade across borders	
Suriname	Easier to start business	
Trinidad & Tobago	Easier to start business and get credit	
Uruguay	Easier to trade across borders and to enforce contracts	
Venezuela		Starting business more expensive
Source: *World Bank, Doing Business 2015*		

start business, to pay tax and to get electricity. Unfortunately, movement and change was not necessarily for the better. Construction permits became more expensive in Argentina, the Bahamas, Honduras and St Kitts & Nevis. Changes in Venezuela made it more expensive to start a business.

On balance, we share the optimism of the World Bank. Economic performance depends on a lot of factors, and not just the ease of doing business. The changes that have been made do not guarantee that regional economic growth will be significantly improved in the coming year or so. Nevertheless, what stands out from the *Doing Business 2015* report is that it is much easier to see evidence of improvement than of the reverse. Some countries that have had challenging business environments should benefit from multi-faceted reform. However, it remains to be seen if the administration of re-elected President Dilma Rousseff makes much progress in 2015-2016 in addressing *O Custo Brasil*.

Latin America especially vulnerable to climate change

Augusto de la Torre, the World Bank's chief economist for Latin America and the Caribbean, has said that the region is "especially vulnerable" to the effects of climate change.

Speaking at a conference in Washington in November, De La Torre argued that "we are already in a danger zone, and if we don't make progress in energy efficiency and the reduction of pollution, we will be getting close to the precipice". With global temperatures increasing by one degree centigrade a year, low-level glaciers are beginning to thaw in the Andes region, impacting on water distribution, and tropical corals are beginning to die out in the Caribbean, he claimed. According to De La Torre, Latin American and the Caribbean accounts for 9% of world GDP but for 12% of global greenhouse gas emissions.

The World Bank economist also noted that Latin America is particularly rich in forests – about 30% of the world's forests are located in the region – meaning it is well placed to develop renewable energy. Harold Forsyth, the Peruvian ambassador to Washington, who was also present at the conference, highlighted the significance of the UN Climate Change conference due to be held in Lima in December. "We need a joint and coordinated response", Forsyth said.

Plugging a credit gap?

It is well known that many small and medium-sized enterprises (SMEs) in Latin America and the Caribbean struggle to raise the financing they need. Perhaps less well known in the estimated size of this deficit. According to the Inter-American Investment Corporation (IIC – part of the Inter American Development Bank group) the gap is somewhere between US$125bn and US$155bn.

The IIC argues that something needs to be done to improve the connection between investors and SMEs. It says that in a country like Ecuador, there are 16,000 SMEs, which in effect form the backbone of the local economy. However, they receive only 15% of total credit flows. So the IIC chose the annual FOROMIC conference – considered one of the main regional microfinance industry get-togethers – to launch InvestAmericas, an online platform designed to connect Ecuadorean SMEs with local and international investors. The conference was held in Guayaquil in November.

"We want InvestAmericas to be the place where deals start, where companies in the region – including in Ecuador – find financing and where investors can access the most interesting business opportunities. The platform will be a meeting place that stimulates the country's and the region's development" said Gregory Da Re, strategy and innovation head at the IIC. The platform will not fully launch in Ecuador until 2015. In the first phase it will also operate in Colombia, Costa Rica, Trinidad & Tobago and Uruguay.

"The regional micro-credit portfolio is believed to be worth US$40bn, reaching over 22m clients."

Speakers at the FOROMIC conference showed that the trend to open up new types of funding – such as online lending platforms and different types of crowd funding – are rapidly developing within the region. In some cases, non-traditional credit sources are well established. A paper by Verónica Trujillo and Sergio Navajas of OMIN, the IDB's Multilateral Investment Fund, for example, notes that there are over 700 banks, 500 non-banking institutions and almost 1,500 regulated cooperatives acting as financial intermediaries in the region. In the non-regulated sector, there are over 3,000 credit providers, many of which are also cooperatives.

While, as might be expected, conventional banks provide over 85% of credit in the formal financial sector, the role of non-banking institutions is significant. In Peru, for example, non-banking institutions serve over 50% of the clients in the financial system. Non-governmental organisations (NGOs) and other non-regulated credit providers serve at least 5% of the working population in countries like Bolivia, Nicaragua, and the Dominican Republic. Total credit represents roughly 35% of Latin American and Caribbean GDP.

Trujillo and Navajas also indicate that the micro-credit industry, consisting of making small loans to entrepreneurs operating in the informal sector, is alive and well. It has been present for over 30 years in the region, and targets the 35% of the population not registered to pay taxes or receive social security. The regional micro-credit portfolio is believed to be worth US$40bn, reaching over 22m clients. Microcredit penetration is highest in Bolivia, Colombia, Ecuador, Peru, Mexico and Chile. The average micro-credit loan is worth around US$1,800, although it varies sharply from country to country. Interest rates range from below 20% in Bolivia and Ecuador to above 50% in Mexico and Argentina.

Birth of an oil and gas multilatina?

In October, Alfa SAB, Mexico's diversified industrial and energy conglomerate, said it might seek to gain control of the Canada and Colombia-listed oil company Pacific Rubiales, in which it has already increased its stake to 19%. If the takeover materialises, it could herald the emergence of an important new regional private sector energy company.

Grupo Alfa sees the opening up of the Mexican oil and gas sector as a major opportunity. The company, based in the northern city of Monterrey, manufactures car parts, refrigerated foods and petrochemicals. In October, it sought – and by early November had secured – shareholder approval to issue around US$1.2bn worth of new shares (although some reports indicated that the company was seeking to raise up to US$3bn) to fund new energy sector investments. Its executives say that in 2015 Alfa will seek joint ventures with Mexico's state oil company Pemex, particularly in three mature onshore fields. It will also seek to boost its involvement in electricity generation. And in late October the company said that a bid to seek outright control of Pacific Rubiales was under consideration.

"According to Fernando Bolaños, an analyst at Monex in Mexico City, if Alfa's petrochemicals subsidiary Alpek SA is included in the equation, the takeover could create "the biggest vertically integrated energy company in Latin America"."

According to Fernando Bolaños, an analyst at Monex in Mexico City, if Alfa's petrochemicals subsidiary Alpek SA is included in the equation, the takeover could create "the biggest vertically integrated energy company in Latin America". He notes that Pacific Rubiales is known for its expertise in heavy oil drilling, one of the types of deposits on offer in Mexico's upcoming licensing round. On his calculations, Grupo Alfa would need around US$4.3bn to take its shareholding of Rubiales to 100% – something that it might seek to achieve in partnership with investment funds or other parties.

Alfa's interest led to a spike in Pacific Rubiales shares, but both parties say they are keeping their options open and that they are for the moment just exploring possibilities. Alfa CFO Ramón Leal was quoted saying: "We want to become an E&P player. Whether this option is the right option, we need to assess it. It could be something else, or some other company, so we want to keep flexibility". Rubiales CEO Ronald Pantin said his company would consider takeover bids that offered value to shareholders. Stressing that much would depend on the price, he said, "If there is the right offer, that makes sense to our shareholders, why not?" Under Canadian law, when a shareholder acquires a stake of 20% or higher in a company, it must make an offer for acquiring the full 100%. There has also been media speculation that instead of a takeover the two companies might opt for some kind of strategic alliance.

Pacific Rubiales says it too has earmarked around US$1bn to fund new investment in Mexico with the aim of doubling its output by 2020. It too has a collaboration agreement in place with Pemex. The company's share price has dropped around 30% over the last year, on the back of worries that it is over-reliant on its licence to operate the Rubiales-Piriri field in Colombia, where output levels will begin to decline.

Royal Bank of Canada (RBC) analyst Nathan Piper has warned that if the Alfa bid does not go through Rubiales could be in some difficulty, particularly given the current weak outlook for crude oil prices. "We now see asymmetric risk in the event an Alfa bid does not materialise or participation in the Mexican upstream takes longer or is more modest than expected", he wrote in a note to investors. In his view, this puts Alfa in the driving seat in negotiating the terms of a takeover. "Given falling oil prices and limited investor interest in international exploration and production, a significant premium may not be necessary to complete the acquisition" he suggested. Pacific Rubiales shares have been trading at roughly eight times earnings, making them competitively priced relative to other oil companies.

AT&T completes acquisition of Iusacell

AT&T, the US telecoms company, confirmed in November that it was paying US$2.5bn to acquire Mexican mobile phone operator Iusacell. Mexican media entrepreneur Ricardo Salinas Pliego is selling Iusacell; media giant Televisa had earlier sold its 50% stake in the company. The acquisition by AT&T has been described as one of the first moves likely to bring more competition to the Mexican telecoms sector, as intended by the country's new telecoms reforms.

However, it may take some time before any results begin to be seen. América Móvil, the telecoms giant owned by Carlos Slim, continues to dominate the industry, with a 70% market share. While Slim has acknowledged that in future he may have to divest part of América Móvil to meet Mexico's new regulatory requirements (which seek to prevent any company from having more than a 50% market share), no specific plans to do so have yet been filed. Hopes of greater competition hinge on AT&T's business plans, along with those of Telefónica of Spain, which is also present as a mobile operator in Mexico.

Iusacell has a relatively small number of subscribers, 8.6m – which gives it an 8% market share – and covers only 70% of Mexico's territory, but its new owner may invest to boost all three of those numbers. AT&T CEO Randall Stephenson has suggested that his company now has a unique opportunity "to create the first-ever North American mobile service area covering over 400 million consumers and businesses in Mexico and the United States. It won't matter which country you're in or which country you are calling – it will all be one network". AT&T had for many years been a close partner of, and shareholder in, América Móvil, but the two companies began to go their own ways in May this year after AT&T announced a US$48.5bn takeover bid for *DirecTV*, a competitor of América Móvil.

BRAZIL

The rise of Kroton

The Brazilian stock exchange was underwhelmed by the re-election of Dilma Rousseff to another four-year term in office at the end of October. Notoriously, the prices of most shares took a tumble. But the share prices of one company, Kroton, kept motoring ahead. Through mergers and acquisitions as well as organic growth, this Brazilian enterprise has grown to become the largest private education company in the world (measured by total asset value).

"In 2012, only 15.4% of Brazilian students aged 18-24 went to university. The government wants to get that proportion up to 33% by 2024."

One way of ensuring sustained growth is to be connected to an underlying social or demographic trend. Kroton can make that claim. In its case, the trend is the sustained growth of the Brazilian middle class and its increasing demands for education. "The Brazilian education market is divided into two completely opposed halves" says Kroton president Rodrigo Galindo. "On the one hand public primary and secondary education has a reputation for poor quality. On the other, public higher education is considered excellent". Parents and students are prepared to pay a large proportion of their incomes to gain access to university and vocational education. In 2012, only 15.4% of Brazilian students aged 18-24 went to university. The government wants to get that proportion up to 33% by 2024, and to do so is offering students low interest loans and scholarships through loan programmes such as Fies (higher education), Prouni (known as 'university for everyone') and Pronatec (vocational and technical). Kroton wants to make sure a lot of that money gets spent on its courses.

The company was launched in 1966 in Belo Horizonte (initially using the name Pitágoras) as a small operation specialised in preparing students to sit the public university entrance exams. In 2009, a US investment fund, Advent, bought a 28% stake in Kroton and helped it begin a merger and acquisitions campaign. Kroton to date has taken over no less than 25 other education

companies – the largest acquisition came this year, when it took over Anhanguera Educacional, a distance learning and vocational training specialist. Galindo himself started out in Unic, a small company based in Matto Grosso. "Just to survive, we had already started a process of modernisation and professionalisation at Unic: what we did was take that learning process to the rest of the company" he says.

Now Kroton says it has 130 campus sites in 19 of Brazil's 27 states. It has over 1.5m signed-up students. In 2014, it is predicting revenue of BRL4.7bn (US$1.72bn). Profits in 2013 (before the incorporation of Anhanguera) were BRL157m (US$60.3m). Third quarter 2014 profits have just been announced at BRL213m (US$81.8m), double the year-ago level. Kroton's market capitalisation is just under BRL25bn (US$9.6bn), making it the largest private education operator in the world, ahead of Graham Holdings of the US (the group that owns education company Kaplan).

Galindo says he is expecting revenue growth of around 10% per annum in higher education enrolments, whether face-to-face or in distance learning. This should be achieved even if Brazil continues experiencing sluggish growth. "The worst macroeconomic scenario for us is rising unemployment and increasing arrears on fee payments, but even in that eventuality our industry is going to be less badly affected than other sectors. Education is one of the last things people want to cut back. In 2015 there'll be fiscal austerity, but in 2016 we expect things to improve. And then there is government support for education. Paying off a subsidised government education loan at BRL17 (US$6.52) a month is a lot better than paying BRL700 (US$268) a month in full student fees".

REGIONAL ECONOMIC REVIEW

ARGENTINA

Debt dispute drags on

In early November Argentine newspapers carried reports that the country's long-running dispute with its mainly US-based holdout creditors might be heading towards a settlement at some point in early 2015. But a review of the latest moves in the legal battle suggests that the fundamental deadlock remains in place.

Those who think a settlement is possible under the current Argentine government base their optimism on the impending expiry of RUFO – a clause in existing bond contracts. RUFO stands for 'Rights Under Future Offers' and at present prevents Argentina from offering the holdout creditors (who represented around about 8% of the country's total debts at the time of the default of 2001/2002) better terms than those already given to the 92% majority who accepted restructured bonds in 2005 and 2010. The 92% accepted a write-down of roughly 70% on the face value of their debt. Some of the 8% of holdouts who refused that deal now have a US District Court ruling saying they are entitled to 100% of face value, but have been unable to enforce it. So, say the optimists, with the RUFO out of the way at the end of this year, surely it will be possible to negotiate a deal somewhere between a 70% write-down and a 0% write down? Such a settlement would also require a change in Argentina's *ley cerrojo* – legislation that prevents governments from re-opening the debt rescheduling – but the government's majority in congress could be invoked to achieve that.

> "RUFO stands for 'Rights Under Future Offers' and at present prevents Argentina from offering the holdout creditors better terms than those already given to the 92% majority who accepted restructured bonds in 2005 and 2010."

Hints on the possibility of a deal came from Economy Minister Axel Kicillof, who in early November told the Mexican newspaper *La Jornada* that "at the end of this year", when the RUFO clause expires, "there will be greater possi-

bilities of having a dialogue with the creditors who opted not to take part in the debt rescheduling". Most analysts are unconvinced. One reason for this is that the mud-slinging between the Argentine government and the holdout creditors such as NML Capital has been so intense that it will be difficult for Buenos Aires to settle without losing face. Having condemned the "vulture funds" for just about every possible conspiracy against Argentina, the current government (which comes to the end of its term in office in December 2015) may prefer to bequeath the whole mess to its successor to sort out. One analyst, Daniel Kerner of Eurasia Group, has made precisely this point, commenting, "President (Cristina Fernández de) Kirchner is unlikely to pay the political costs of settling with the holdouts for an amount close to what they obtained in the ruling".

"Having condemned the "vulture funds" for just about every possible conspiracy against Argentina, the current government (which comes to the end of its term in office in December 2015) may prefer to bequeath the whole mess to its successor to sort out."

Another reason for relative pessimism is that the dispute has a tendency to snowball and become more entrenched and complex as time goes by. While US District Court Judge Thomas Griesa has taken various steps to try and coax an agreement (such as widening the negotiating powers of Daniel Pollack, his special representative/mediator, or allowing some bondholder interest payments to be made via Citibank), other developments appear to be making things more difficult to solve. It was initially only a small group of holdouts, led by NML Capital and Aurelius Capital Management, that successfully sued Argentina in the US courts and obtained Griesa's favourable ruling that they be paid in full US$1.33bn plus interest. But they now have been joined by at least 25 of the other holdouts who have filed 'me too' claims reported to total an additional US$4.7bn. A further problem is the possibility of 'acceleration', a process where a partial default on bond coupon payments allows creditors to demand immediate payment of all monies owed. Some holders of Argentine bonds have reportedly been in discussions with Chicago law firm Kirkland and Ellis to see if they may group together to gather more than 50% of the holders of a single bond series needed to trigger an acceleration claim.

Other complications are posed by various separate legal battles. Lawyers for Elliot Management have been keen to pursue money-laundering claims against Argentine companies in the US, who they say are linked to President Fernández. Argentina is appealing against Judge Griesa's contempt order. Another group of Argentina's creditors led by George Soros's Quantum Partners have initiated legal action in London, asking a UK court to declare that the interest payments are subject to English law and that any attempt by a foreign court to modify contracts governing them would be ineffective. Argentina has meanwhile admitted that its offer of another bond swap allowing creditors of bonds issued under New York law to swap them for bonds issued under Argentina law has had no takers.

HAITI

Still trapped in poverty

By many measures, Haiti's economy has been performing quite well in the recent past. However, inadequate infrastructure remains a major challenge.

The International Monetary Fund (IMF) mission that visited Haiti in mid-2014 was positive about the economy's performance. Real GDP growth in the six months to the end of March had been 3%-4% year-on-year. Inflation had been (and is expected to remain) in mid single-digit levels. The IMF considered monetary policy settings appropriate. It applauded efforts by the central bank and the finance ministry to improve the effectiveness of public sector investment and debt management. Looking forward though, the Fund highlighted the need to cut fuel subsidies (equivalent to about 2% of GDP, or around one third of the overall fiscal deficit) and to improve the performance of Haiti's electricity sector.

The focus on electricity and exports is being driven by two industrial parks, which account for over 80% of exports from the country. Both are overseen by the government agency, Société Nationale des Parcs Industriels (SONAPI).

The Caracol Industrial Park, located in the northeast of the country, was inaugurated in November 2011. The Inter-American Development Bank (IDB) and the US government provided US$55m and US$124m respectively for the construction of industrial buildings, housing and power generation facilities. A third partner in the project was a South Korean apparel manufacturer, See-A Co. The IDB's involvement recognises that major employment needs to be generated in Haiti if there is to be a meaningful reduction in the level of poverty, estimated in mid-2012 at 78%. All manufacturers that operate at the industrial park will have to commit to best practices in labour conditions if they are to benefit from US trade preferences for Haitian goods.

As of late 2014, press reports indicated that the number of people employed at the Caracol Industrial Park surged by 43% in Q3 14 to 4,766. The power plant that serves the park is also connected to 7,300 consumers in the surrounding towns and villages. Arrangements have been finalised for construction of new factory buildings that will accommodate another 4,000 workers from 2015/16. Nearly three quarters of the workers at the park are women. See-A and affiliated businesses employ nearly 85% of the workers. In the first nine months of 2014, total payments to workers amounted to the equivalent of US$5.4m.

"According to the Banque de la République d'Haïti (BRH, the central bank), total exports in the fiscal year to the end of March 2013 amounted to about HTG66,544m (US$1.45bn, or about 12% of GNP)."

According to local media sources, additional facilities are also being built at the Metropolitan Industrial Park, which is located close to the airport in Port au Prince. This is being partly funded with a US$20m contribution from the government of Mexico. The Haitian government hopes that the number of workers employed there will rise from 12,000 to 24,000. (First, however, the government will have to evict squatters occupying 50 hectares of land earmarked for the new facilities).

In its June 2014 *Poverty Reduction Strategy Paper*, the IMF noted that the long-term objective is to make Haiti a proper emerging economy by 2030. However, one of many challenges is that, despite the best efforts of SONAPI, the government and other actors involved with the Industrial Parks, the export sector is still too small relative to the overall economy. According to the Banque de la République d'Haïti (BRH, the central bank), total exports in the fiscal year to the end of March 2013 amounted to about HTG66,544m (US$1.45bn, or about 12% of GNP).

In short, a South-East Asian style export-led economic miracle is unlikely to happen anytime soon. As **chart 1** (*overleaf*) shows, the IMF expects the volume of export growth to be 1.6 percentage points more, on average, than overall annual GDP growth in 2015-2018. Yet even in 2018, exports still will not be large enough relative to the entire economy to have a meaningful impact on overall unemployment and poverty. Imports are also expected to rise faster than overall GDP – which means that Haiti should gradually become more integrated with the global economy.

The chart highlights several other challenges. One pertains to the fiscal balance. Although, as the IMF notes, progress is being made in reducing the budget deficit, public sector debt is still rising quite rapidly. Gross debt was just over 21% of GDP in 2013. It should be nearly 40% of GDP in 2018. By the standards of developed countries, these are low numbers. Some of the government's borrowing (such as the Extended Credit Facility from the IMF) is on extremely concessional terms. Nevertheless, the trend is clearly in the wrong direction, which raises the risks of problems in the future.

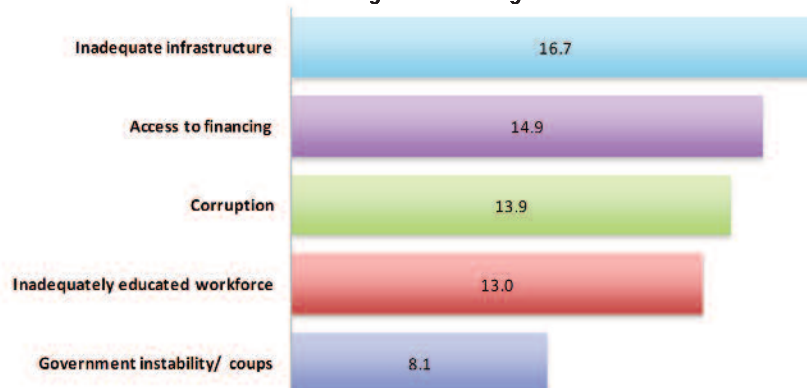
Chart 1: Haiti's economy - as the IMF sees it									
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Population mn	9.9	10.0	10.2	10.3	10.5	10.6	10.7	10.9	11.0
GDP, current prices US$bn	6.6	7.5	7.9	8.5	8.9	9.4	10.0	10.7	11.5
Percentage change:									
Gross domestic product, constant prices	-5.5	5.5	2.9	4.3	3.8	3.7	4.0	4.0	4.0
Inflation, end of period consumer prices	4.7	10.4	6.5	4.5	5.8	6.0	5.0	5.0	5.0
Volume of imports of goods and services	38.7	-9.7	-4.9	6.1	3.8	3.4	5.1	4.8	4.8
Volume of exports of goods and services	-4.3	21.8	0.9	17.0	4.6	5.5	5.4	5.4	5.7
Percent of GDP:									
General government revenue	23.9	21.9	23.4	20.8	19.5	20.5	21.6	22.0	22.1
General government total expenditure	22.8	25.5	28.2	27.5	25.2	25.2	25.2	24.5	24.3
General government net lending/borrowing	1.1	-3.6	-4.8	-6.7	-5.6	-4.7	-3.7	-2.5	-2.2
General government gross debt	17.5	12.0	16.4	21.3	24.5	29.9	33.7	36.9	39.8
Total investment	25.4	27.9	29.6	30.0	27.3	27.4	27.2	26.5	26.3
Gross national savings	23.9	23.5	23.9	23.3	20.5	21.5	21.9	21.3	21.1
Current account balance	-1.5	-4.3	-5.7	-6.7	-6.8	-5.9	-5.3	-5.3	-5.3

Source: *International Monetary Fund, World Economic Outlook Database, October 2014*

The other main challenge is the low savings rate. At around 21% of GDP, it is significantly lower than investment, which amounts to 27% of GDP. The difference of around 6% is the current account deficit. The small absolute size of Haiti's economy means that the current account deficit can be financed reasonably easily by Foreign Direct Investment (FDI), loans, other transfers from foreign governments and remittances from expatriate Haitians. While nominal GDP is growing by 8%-9% annually, the increase in absolute claims on the country from foreign parties will be manageable. However, this would not necessarily be the case if exports were to shrink, or if some other shock were to constrain the economy's growth.

As we noted on page six in our Regional Business Review, Haiti compares unfavourably with other countries in the region (and elsewhere) for the ease of doing business, as assessed by the World Bank. Using a different methodology, the World Economic Forum (WEF) found in its latest *Global Competitiveness Report 2014-2015* that businesses perceived the lack of training for the workforce, corruption and lack of financing to be problems of broadly similar magnitude, as **chart 2** shows.

Chart 2: The most problematic factors for doing business in Haiti
Weighted rankings



Source: *World Economic Forum, Global Competitiveness Report 2014-15*

However, the biggest challenge remains inadequate infrastructure. The development of basic manufacturing industry, the creation of jobs and the reduction of poverty really depend on the industrial parks. Haiti's economy is benefiting from constructive policies, led by the finance ministry and the BRH. However, the growth of the economy is both fragile and insufficient to make much of a dent in the country's widespread poverty levels.

PANAMA

Star pupil has fiscal worries

Lifted by broadly market-friendly policies and massive infrastructure projects, Panama was one of the fastest-growing economies in Latin America 2013 (when real annual GDP expanded by 8.4%), a position it will retain in 2014 (when growth is forecast at 6.5%). There is one little grey cloud in Panama's blue sky, however: a growing fiscal deficit. Should it be a cause for concern?

The new centre-right government led by President Juan Carlos Varela, which took office in July, has made a relatively good impression on the markets. The appointment of Dulcidio De La Guardia as minister of economy and finance reassured the private sector. The president has been moving to implement campaign promises. Although analysts may not have liked one of them – a temporary price freeze on 22 food products – it appears to have helped keep the lid on inflation, which stands at 2.1%. Others include boosting scholarships and a 20% increase in pensions (along with a reduction in the qualifying age from 70 to 65). While mining and construction slowed a little, this boost in public spending, along with strong commerce, telecoms and transport sectors, have together helped keep up the pace of the economy. Real GDP expanded 6.2% in the first half.

"Some analysts have lauded the budget for being based on realistic growth projections (the economy ministry projects real GDP growth of 6.5% in 2015). Others note some significant risks that could lead to a wider-than-planned deficit."

But the question is whether the fiscal cost may be too high. The original draft of the government's 2015 budget, which was approved in its first reading in the national assembly, proposed widening the fiscal deficit allowed under Panama's fiscal and social responsibility law from 2.7% of GDP to 3.9%. By the third reading at the end of October, the allowable deficit had been edged up to 4.1%, implying that the government will be allowed to spend up to US$1.95bn more than it receives in revenues. Asked about the increase, the economy ministry attributed it to changes made by legislators, not to anything it had itself sought.

There is divided counsel over how much to worry about the deficit. Some analysts have lauded the budget for being based on realistic growth projections (the economy ministry projects real GDP growth of 6.5% in 2015). Others note some significant risks that could lead to a wider-than-planned deficit. There has already been fiscal slippage in the first half of 2014. The government's large infrastructure projects could face more cost overruns. Panama Canal income and port revenues could be lower than expected because of sluggish world trade.

There are also political risks. Lacking an outright majority in congress, President Varela's Partido Panameñista (PP) has had to sign a 'governability' pact with the opposition centre-right Partido Revolucionario Democrático (PRD). While it is positive that these parties have agreed to collaborate on various policy initiatives (including education reform, health reform, municipal decentralisation and better scrutiny of big infrastructure projects), it is possible to imagine various scenarios in which deals are done that increase, rather than reduce, planned government spending.

The government has estimated that it needs around US$10bn worth of financing during its five year term, of which roughly half will be needed to cover fiscal shortfalls, with the other half to meet maturing debt commitments. However, there is also thought to be a further US$3.6bn worth deferred debt payments and capital investment commitments inherited from the previous government. Given that Panama is an investment-grade sovereign borrower, with a dollarised economy and a sophisticated banking system, the government is unlikely to have major difficulty in covering its

funding needs. But another of the new administration's promises – that it will reduce the public-debt-to-GDP ratio from 39% in 2013 to 34% by the end of its term in 2019 – will be hard to deliver. Based on current trends, some analysts believe the ratio is going to break through the upper limit of 40% set by the fiscal and social responsibility law.

PERU

Stimulus package number four

At the beginning of November, Peru's new economy minister, Alonso Segura, had both bad news and good news for congress. The bad news was that he was again trimming back expectations of growth for this year. After real annual GDP growth of 5.8% in 2013, the economy ministry was now expecting growth of "a little under 3%" in 2014 (a reduction on the previous official forecast of 3.0%-3.5% for the year). The good news was that the minister was announcing the fourth stimulus package of the year, designed to "reactivate the economy in the short term, but also, and fundamentally, to improve competitiveness and productivity in the medium term".

The stimulus measures announced on 6 November will inject an estimated PEN1.6bn (US$550m) into the domestic economy through increased public spending. Segura said that taken together the measures should boost GDP by a third of a percentage point. These include streamlining the process of environmental approvals for mining projects; a reduction in import duties on capital inputs; and new incentives for employers to hire young people under the age of 24. Perhaps with an eye on the government's volatile popularity ratings, the package also included a PEN300 (US$102) per-recipient boost to the Christmas bonus for public sector employees and pensioners (taking the total bonus per recipient to PEN500, or US$172), further spending on social programmes in public schools, and additional investment in school renovation works.

The latest measures to facilitate environmental permits have come under fire from environmentalists – especially as Lima is hosting the United Nations Climate Change Conference from 1 to 12 December.

The streamlining of environmental approvals is considered central to boosting Peru's important mining sector. Peru is the world's third largest copper producer and the fifth largest gold producer. There are some US$57bn worth of mining investment projects in the pipeline, but many are stuck or progressing very slowly. Officials said that as a result of the changes the duration of the approvals process will be shortened by three and a half years. Earlier, Prime Minister Ana Jara had described the process as 'interminable" for investors. Under the new approach, the environmental regulator, Servicio Nacional de Certificación Ambiental (Senace), will be required to decide whether to authorise projects no more than 150 days after submission of environmental impact assessments (EIAs). The scope of the process is also being widened from mining and hydrocarbons to include water and forestry projects.

Import duties on around 1,800 raw materials used by local industries are being slashed to zero, brining them into line with the current zero-rating on capital goods imports. Tax incentives are being offered to employers who hire young workers in the 18-24-age range. When the employers are small and medium sized enterprises (SMEs), the government will pay the employees' social security contributions for the first year. 'These measures have teeth and they are going to have a real impact" Segura said, adding "but we're not going to stop there. More measures are going to come."

Analysts welcomed the measures. However, given continuing signs of economic deceleration, they suggest the central bank (BCRP) may make at least one more downward move in interest rates. In the three months to August, indicators suggested economic growth had been only 0.9% year-on-year. The BCRP left its key interest rate untouched at 3.5% in its November

meeting, but another 25bps cut may be in prospect. Although headline inflation at 3.1% in the 12 months to October was just outside the 1%-3% target range, the core rate has been falling, so the BRCP is unlikely to be too worried on the prices front. A greater obstacle to further monetary easing may be concern over the current account deficit, which in the second quarter stood at 5.4% of GDP. Too much monetary easing might therefore put pressure on the Peruvian Sol. On the whole, however, most analysts believe a recovery will begin to make traction in 2015, with GDP growth rising to around 4%.

REGION

Trade and investment stagnation

New data from the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC) shows that Foreign Direct Investment (FDI) in the region has basically stagnated this year. The same is true of trade between the region and the rest of the world – mainly because of lower commodity prices. Equally noteworthy is the fact that intra-regional trade has contracted by 5%-6%.

In a late October update to its annual regional FDI report (published in May), the ECLAC noted that net FDI to the region in the first six months of 2014 amounted to US$84.6bn, about 23% less than in H1 13. Much of the US$25.7bn drop in inflows could be accounted for by two transactions in Mexico: Anheuser Busch InBev's US$13.2bn purchase of the local brewer Modelo in H1 13, and AT&T's sale of its stake in América Móvil in H1 14. This meant that the figure for the first half of 2014 was always likely to be lower; in the event it was down by US$4.2bn.

"In a late October update to its annual regional FDI report (published in May), the ECLAC noted that net FDI to the region in the first six months of 2014 amounted to US$84.6bn, about 23% less than in H1 13."

As **chart 1** shows, Argentina registered a net FDI outflow of US$55m in the first six months of 2014. However, this included a US$4.23bn outflow associated with Repsol's divestment of Yacimientos Petrolíferos Fiscales (YPF).

Chart 1: Foreign direct investment (FDI) flows (US$m)

Total 2013		H1 13	H1 14	Variation
11,353	**Argentina [3]**	5,878	-55	-5,933
2,030	**Bolivia**	863	852	-11
63,996	**Brazil [1]**	38,976	42,001	3,025
20,258	**Chile [1]**	12,286	10,367	-1,919
16,199	**Colombia**	7,698	8,452	754
2,714	**Costa Rica**	1,358	1,075	-283
140	**El Salvador**	76	25	-51
1,309	**Guatemala**	693	713	20
1,060	**Honduras**	537	542	5
39,172	**Mexico [2]**	28,784	9,733	-19,051
4,654	**Panama**	2,045	2,575	530
9,298	**Peru**	5,729	4,680	-1,049
1,991	**Dom. Republic**	982	1,175	193
2,754	**Uruguay**	1,439	1,568	129
7,040	**Venezuela**	3,790	1,761	-2,029
183,968	**Total**	**111,134**	**85,464**	**-25,670**

1. Figures for first eight months of 2013 and 2014
2. H1 13 figure boosted by US$13,249mn purchase of Modelo by Anheuser-Busch InBev
2. H1 14 figure reduced by AT&T's sale of its stake in América Móvil for US$4,495mn
3. But for Repsol's sale of its YPF stake, the H1 14 figure would have been US$4,289mn

Source: *ECLAC*

Even excluding these deals, FDI in the region in the first half of 2014 still would have been about 4% lower than in the year-earlier period. Lower minerals prices contributed to falls of US$1.0bn and US$1.9bn in FDI flows to Peru and Chile respectively. However, the US$3.3bn purchase of Chile's energy company CGE by Gas Natural of Spain should ensure that FDI in Chile actually rises for the year as a whole. The deteriorating economic environment in Venezuela is reflected in a US$2.0bn drop in inwards FDI, to US$2.2bn.

The absolute size of Brazil's economy means that foreign corporations continue to see it as one they cannot ignore. Inwards FDI rose from almost US$39bn in H1 13 to US$42.0bn in H1 14. It may well be that FDI in Brazil in 2014 exceeds last year's US$64bn. A rise of US$754m in FDI in Colombia in the first half means that, there too, the total for 2014 should match last year's figure. Other significant increases in the first six months of 2014 took place in Uruguay (US$129m), the Dominican Republic (US$193m) and Panama (US$530m).

Trade flows with the rest of the world slow

The stagnation in regional FDI inflows has coincided with a small decline in trade in goods between the region and the rest of the world. According to ECLAC, exports contracted 0.3% in the first half of the year relative to H1 13. Imports contracted 0.6%. In spite of the respectable growth rates still being achieved by China and much of South East Asia, exports to Asia only managed growth of 1.6%. Exports to the US, meanwhile, grew by 2.6%. However, growth to Asia and the US was more than offset by a 0.5% drop in exports to the European Union (EU). Interestingly, imports from the EU also fell significantly; by 6.0%. This was due to a sharp drop in EU sales to Argentina (10.9%), Venezuela (21.7%) and Chile (20.6%). Against this, regional imports from the US and Asia rose by 2.7% and 1.8% respectively.

> "Lower commodity prices have been a challenge for many exporters. The 0.3% fall in exports from the region in H1 14 was the result of a 5.5% drop in prices, which offset a 5.2% rise in volumes shipped."

Lower commodity prices have been a challenge for many exporters. The 0.3% fall in exports from the region in H1 14 was the result of a 5.5% drop in prices, which offset a 5.2% rise in volumes shipped. The impact of lower prices appears to have been greatest in Argentina and Peru, whose total exports in the first half of the year contracted by 10.1% and 10.2% respectively. Lower commodity prices (and, possibly, discounting by suppliers of manufactured goods) had an impact on imports too. ECLAC's data indicates that, across the region as a whole, import volumes rose by 2.2%, while prices dropped by 2.8%.

As **chart 2** shows, Mexico's exports increased by 4.2% in the first half of the year: this was due overwhelmingly to a 5.8% rise in exports to the US. Other coun-

Chart 2: Year-on-year growth (%) in foreign trade in goods, H1 14

	Exports		Imports	
	Intra-regional	Total global	Intra-regional	Total global
Lat. America & Carib.	-5.6	-0.3	-5.2	-0.6
Argentina	-16.1	-10.1	-18.8	-7.5
Brazil	-12.7	-3.4	-10.1	-3.8
Venezuela	-1.3	-0.9	20.8	-5.9
Colombia	-11.1	-4.4	-6.0	6.1
Peru	-2.8	-10.2	-5.6	-1.1
Central America [1]	4.8	1.7	-8.7	2.2
CARICOM [2]	8.8	-5.3	2.4	2.0
Mexico	-6.6	4.2	2.0	3.2
Chile	-1.3	0.1	-8.4	-8.8

1. Costa Rica, El Salvador, Honduras, Guatemala, Nicaragua, Panama.
2. Antigua & Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Kitts & Nevis, St Lucia, St Vincent & Grenadines, Suriname, Trinidad & Tobago.

Source: *ECLAC*

tries posting good growth in exports during the first six months of 2014 included Nicaragua (8.2%), Ecuador (9.7%), Paraguay (9.2%) and Uruguay (8.2%).

Import trends by country were quite varied. The sluggish growth (or worse) in Argentina, Brazil, Chile and Venezuela led to a fall of imports of between 6% and 9% in H1 14. Conversely, Colombia's imports rose by 6.1%, while Mexico's grew by 3.2%. In both cases, the growth was driven by higher demand from the US and Asia.

Trade within the region also declines

However, a standout feature of the first half of the year was the contraction in trade *within* Latin America and the Caribbean. Reported exports to other regional markets dropped by 5.6%, while imports fell by 5.2%, according to ECLAC. Given the general improvement in the ease of doing business in the region (as we discuss elsewhere in this edition), the fall in intra-regional trade is mainly attributable to the weakness of the larger economies. The double-digit fall in Argentina and Brazil's intra-regional exports and imports, for instance, is a reflection of the (near)-recession conditions in both countries.

Brazil's problems also explain much of the 11.1% fall in exports from Colombia to the rest of the region. Elsewhere, Chile's imports from the region fell 8.4%, and Peru's 5.6%, indicative of the slippage in commodity prices and also the fall in FDI in those countries.

"Given the general improvement in the ease of doing business in the region (as we discuss elsewhere in this edition), the fall in intra-regional trade is mainly attributable to the weakness of the larger economies."

Chart 3: Year-on-year growth rates (%) for foreign trade in goods: ECLAC's projections

	Exports				Imports			
	2013	H1 14	H2 14	2014	2013	H1 14	H2 14	H2 14
Latin America & Caribbean	-0.4	-0.3	1.9	0.8	2.6	-0.6	-0.6	-0.6
Mercosur [1]	-1.4	-3.6	-0.9	-2.3	3.9	-4.5	-2.6	-3.6
Andean Community [2]	-3.0	-2.6	-0.5	-1.5	3.2	2.6	0.3	1.4
Central America [3]	-0.6	1.7	6.2	3.9	1.9	2.2	3.6	2.9
CARICOM [4]	-10.3	-5.3	-3.2	-4.3	-2.1	2.0	-5.1	-1.6
Mexico	2.5	4.2	5.8	5.0	2.8	3.2	1.5	2.3
Chile	-1.6	0.1	1.4	0.8	-1.2	-8.8	-5.3	-7.0
Cuba	-2.3	6.9	2.0	4.3	-0.3	-3.3	12.3	4.4
Dom. Rep.	6.4	2.3	4.1	3.1	-7.1	3.7	-4.6	-0.6

1. Argentina, Brazil, Paraguay, Uruguay, Venezuela
2. Bolivia, Colombia, Ecuador, Peru
3. Costa Rica, El Salvador, Honduras, Guatemala, Nicaragua, Panama
4. Antigua & Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Kitts & Nevis, St Lucia, St Vincent & Grenadines, Suriname, Trinidad & Tobago

Source: *ECLAC*

Looking forward, ECLAC expects regional export growth to accelerate to 1.9% year-on-year in the second half of the year, giving overall annual growth of 0.8% for calendar 2014, as **chart 3** shows. Most of this will be driven by increased export sales to the US from its main regional suppliers. By far the most important of these is Mexico. ECLAC expects Mexico's export growth to rise to 5.8% year-on-year in the second half, up from 4.2% in the first. Other beneficiaries are Central America and the Dominican Republic. By contrast, ECLAC expects exports from Chile to grow slowly.

ECLAC is far less optimistic about the prospects for exports from other countries. In the Southern Common Market (Mercosur), exports from Argentina and Brazil are expected to decline by 0.3% and 2.7% respectively in the second half. Having contracted by 0.9% year-on-year in the first half, ECLAC expects Venezuela's exports to shrink by 0.8% in the second. And in the

Andean Community, Peru's exports are expected to contract by a sharp 10.9% in the second half, marginally more than in the first six months of the year.

Regional imports are expected to continue contracting at an annual rate of 0.6% overall through the second half. This is due to falls in Argentina (5.8%), Brazil (2.6%), Chile (5.3%) and Peru (3.6%). Imports are expected to grow on a year-on-year basis in Colombia (1.9%) and Ecuador (2.3%), as well as in much of Central America. ECLAC expects Venezuelan imports to rise by 0.7% in the second half, having contracted by 5.9% in the first. However, given the well documented problems in Venezuela's economy, imports may in fact continue to contract through the second half as well. And as we note in the **box**, Cuba appears to be something of an exception.

In summary, latest regional FDI and trade data are fairly uninspiring. The decline in inwards FDI in the first half of this year needs to be considered in the context of ECLAC's expectations that, globally, FDI will grow by 10% overall in 2014. The fall in commodity prices has had an impact on both imports and exports. The general weakness of Brazil and Argentina has also been a challenge. More worrying, though, is the decline in intra-regional trade. Regional integration has been a key aspect of the rapid growth of the Asia-Pacific over the last 30 years. Notwithstanding the continued political rhetoric in support of regional integration in Latin America, it does not seem that much progress has been made in 2014.

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Cuba – A new trade and investment hotspot?

ECLAC projects that Cuba will increase its imports by 12.3% in the second half of 2014. This would be consistent with substantial growth in domestic demand and investment which, however, does not seem to be the case at the moment. The Cuban government is looking to boost annual inwards FDI to US$2bn year in a bid to stimulate economic growth, in part through the new Special Development Zone at the newly upgraded port of Mariel (ZEDM). Official delegations from the UK, Chile and Uruguay, among many others, were in attendance at the recent (early November) 32nd Havana Fair to discuss trade and investment opportunities, where Cuba's minister for foreign trade, Rodrigo Malmierca Díaz, announced a list of 246 potential projects requiring an estimated US$8.6bn in investment. The director-general of the ZEDM office, Ana Teresa Igarza, suggested that the government would shortly green-light the first investment projects in the ZEDM; in sectors including biotechnology, construction, food-processing, light industry, logistics and renewable energy. But despite the optimistic official tone, these projects will not be delivered immediately.

Nonetheless, there are tentative signs that Cuba's access to foreign markets and capital is likely to improve. One is the fact that the country is hosting the Colombian peace talks in Havana. Cuba is one of just four countries on the US State Department's list of state sponsors of terrorism (the others being Iran, Sudan and Syria). Cuba's long inclusion on the list has been due mainly to its links with the Fuerzas Armadas Revolucionarias de Colombia (Farc), Colombia's main left-wing insurgent group. However, even the State Department's 2013 overview of state sponsors of terrorism notes the role of the Cuban government as the host of the peace negotiations between the Colombian government and Farc. The overview also observed (repeating past observations) that ties between the Cuban government and the Basque separatist group Euskadi Ta Askatasuna (ETA) have become more distant.

On 24 October 2014, the Financial Action Task Force (FATF) noted that Cuba (along with Argentina, Ethiopia, Tajikistan and Turkey) would no longer be subject to the FATF's ongoing global anti-money-laundering and anti-terrorist finance (AML/CMT) compliance process. The FATF noted that Cuba had established a legal and regulatory framework which addresses the deficiencies identified by the FATF in early 2013. This too is notable, as the US State Department has used Cuba's inclusion on the FATF list as justification for leaving the country on its list of states that sponsor terrorism. The FATF change could facilitate flows of funds to Cuba, particularly if the US finally removed it from said list.

OIL

All eyes on Opec

Ahead of the critical Organization of the Petroleum Exporting Countries (Opec) summit on 27 November in Vienna, Austria, Foreign Minister Rafael Ramírez visited Venezuela's Opec partners, as well as dropping in on some other friends like Russia.

Ramírez is well acquainted with Opec presidents and oil ministers from his recently ended-decade long stint (from 2004 to September 2014) as Venezuela's energy minister and president of the state oil company Petróleos de Venezuela (Pdvsa). He began his tour on 12 November in Algeria where, officially, he was to meet President Abdelaziz Bouteflika, to "reassert bilateral relations", according to a tweet from the Venezuelan foreign ministry. Notwithstanding, Ramírez was met at the airport by none other than the country's energy minister, Youcef Yousfi. After Algeria, Ramírez was bound for Qatar and Iran (also Opec members) and then to Russia, not an Opec member but also suffering from the oil price shock.

Venezuela and its fellow Latin American Opec partner, Ecuador, are working on a joint proposal to put to Opec in Austria, Ecuador's finance minister Fausto Herrera confirmed on 4 November. Herrera refused to give details and said that other countries were involved, but clearly Ecuador and Venezuela are interested in putting a floor under falling oil prices, as are other oil majors like Russia and Iran. According to Ramírez, Opec should defend oil at US$100/b. Some private economists calculate that the breakeven price for Venezuela is now higher, at about UD$120/b.

The dominant Opec producer, Saudi Arabia, seems to have other ideas, however. Ahead of the Opec meeting, Brent crude futures for January 2015 delivery fell to US$78.3 per barrel (/b), while West Texas Intermediate (WTI), the reference oil price for Ecuador and Venezuela, tumbled to a four year low of US$74/b on 26 November. Venezuela's President Nicolás Maduro continues to rail against the US for "destroying" the global oil market – and indeed the planet – by extracting shale oil and gas. That's forgetting that the US does not (yet) export oil, although the massive fall-off in US demand for global oil imports has impacted international oil prices, prompting other OPEC members to also call out the US for damaging the global oil market.

Maduro might also point a finger at Saudi Arabia, which has been cutting oil prices for its US and Asian customers, sparking fears of a price war within Opec itself. Opec production was almost 31m barrels per day (b/d) in October, the most since August 2013, leading to suspicion that the Saudi tactic is to win both a volume and a price war. Coincidentally, the long-standing Saudi oil minister, Ali al-Naimi, was in Venezuela in early November – ostensibly to attend a climate change conference on the island of Margarita – although he also had a private meeting with Ramírez. Al-Naimi's rare trip to Venezuela, his first in eight years (since 2006), prompted memories of the fierce price war over the US market between Saudi Arabia, Venezuela and Mexico (and to a lesser extent Ecuador) in the late 1990s, when oil prices fell to US$10/b. That only ended after Al-Naimi brokered a deal with Venezuela and (non-Opec member) Mexico to curb production.

Ahead of the Vienna summit, Saudi officials have signalled that major production cuts are not on the cards and that oil prices are going to have to come down and stay down. For Venezuela that is terrible news. Having said that, Venezuela in particular was long suspected of breaking Opec production quotas. For dollarised Ecuador which, unlike Venezuela, does even not have the ability to devalue, it is of equal import, with implications for the budget and balance of payments position.

Ecuador

Ecuador's approved 2015 budget is based on an average oil price of US$79.7/b and projects a fiscal deficit of about US$5.4bn, or about 5.0% of GDP. Total financing needs, including debt amortisations of US$3.6bn, are put at US$8.8bn, although real financing needs are expected to be higher, at upwards of US$10bn. Ecuador's left-wing government has indicated that it will increase its borrowing to sustain its high public spending, but it expects the current fiscal squeeze to be temporary, until major new oil reserves come on stream from 2016. Overall public debt remains low at less than 25% of GDP, but 2015 and 2016 promise to be tricky years for this still oil-dependent small economy. Fitch Ratings, for example, calculates that Ecuador's 2014 fiscal breakeven oil price is over US$140/b, compared to US$115/b for Venezuela. Oil contributes up to 40% of Ecuador's budget income.

SPECIAL ANNOUNCEMENT

PARTNERSHIP

Prosperity Index 2014

LatinNews is excited to announce a new partnership with the Legatum Institute, a London-based public-policy think-tank that produces the highly regarded Prosperity Index, the 2014 issue of which launched this month.

Subscribers to *LatinNews* will enjoy strong added-value from this collaboration, combining our deep understanding of Latin America and the Caribbean, gained over nearly 50 years of engagement in the region, with the broad range of socio-economic data provided by the Legatum Institute. Watch for our upcoming special focus in which we use the latest Prosperity Index data to examine whether the recent gains in living standards in many Latin American countries are sustainable following the end of the recent commodity boom.

The Legatum Institute's Prosperity Index uses rigorous research and in-depth analysis to rank countries based on their performance in eight sub-indices—Economy, Entrepreneurship & Opportunity, Governance, Education, Personal Freedom, Health, Safety & Security and Social Capital.

Among Latin American and Caribbean countries, Uruguay, Chile and Costa Rica are ranked the most prosperous this year at 30th, 33rd and 34th respectively (global rankings). At the other end of the scale sit Venezuela, Honduras and Haiti, at 100th, 105th and 135th. Raw changes in rank from year to year must be viewed in context. As more countries are added to the Index (32 were added in 2012), some countries slip down a place or two as the table grows, but the relative annual ranking is a very useful metric in itself, and the addition of new countries does not account for big falls and gains. Venezuela, for example, has slipped 22 places since 2013, while other countries in the same portion of the table have moved about far less (Haiti, the worst performer in Latin America, has dropped just one place since last year).

Interestingly, the 2014 Index ranks Argentina (relatively) highly, at 46th globally. Despite performing poorly in the Economy (54th), Entrepreneurship & Opportunity (55th) and Social Capital (53rd) indices, and extremely poorly in terms of Governance (97th), it is performing better in Education (44th), Health (42nd) and Safety & Security (47th), and does well in terms of Personal Freedom (30th).

This puts Argentina ahead of the region's two largest economic actors, Brazil and Mexico, which achieve global rankings of 49th and 64th respectively. Of course the data, while useful, only tell half the story. Without the contextual understanding that *LatinNews* provides, the raw numbers can be misleading. Key findings in the Index that might indicate an important trend such as an economic improvement, for example Ecuador's Economy indicator, which has gone from 55th in 2012, to 54th in 2013, to 47th this year, do not explain the drivers of this change, nor the potential fragility of the country's growth. Similarly, the data show that Bolivia's Economy indicator has travelled the other way, slipping from 44th to 46th to 51st over the same period. Again, this raises questions for further discussion, and *LatinNews* is perfectly positioned to answer them.

Elswhere

The 2014 Index reveals that globally, Norway is the most prosperous country for the sixth year in a row, retaining its place thanks to its high ranking in the Economy (3rd), Health (5th), Education (5th), Governance (7th), and Personal Freedom (2nd) sub-indices. The US ranks 10th overall, and the UK 13th, the most prosperous of all the leading major European Union nations, coming ahead of Germany (14th), France (21st), Spain (26th) and Italy (37th).

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