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What will Trumponomics mean for Latin America?

While the policies of the next government of the United States are not yet clear, a picture is beginning to emerge. President-elect Donald Trump will follow a more protectionist agenda, will introduce deep corporate tax cuts, and will spend heavily on infrastructure. This could boost US growth in the short term – a good thing for Latin America – but there is a lot more to worry about, with Mexico probably the main loser and other economies also facing serious threats.

The incoming US government due to take office on 20 January is going to be more protectionist. It remains to be seen whether the Trump-led administration with renegotiate or even exit the North American Free Trade Agreement (NAFTA) with Mexico and Canada. On 21 November, just a day after the Asia-Pacific Economic Cooperation (Apec) summit concluded in Lima, Peru, with a message against protectionism and a call to press ahead with a Pacific-Rim area free trade agreement, Trump announced that one of his first acts would be to withdraw from the 12-country Trans Pacific Partnership (TPP), effectively the death knell for the deal as currently constituted. He described the TPP as "a potential disaster for our country". The Transatlantic Trade and Investment Partnership (TTIP) between the US and the European Union (EU) is also at risk of abandonment, as Trump pledged to negotiate "fair, bilateral trade deals that bring jobs and industry back onto American shores."

During the election campaign Trump frequently promised to slap import tariffs of up to 35% or 45% on goods manufactured in Mexico and China, among other trade partners, so it is reasonable to expect some kind of (perhaps smaller) increase in US tariff or non-tariff barriers, along with heightened risks of a trade war,

The other two emerging pillars of his domestic policies appear to be deep tax cuts for corporations and the wealthy, and a programme of infrastructure investment. Both promise to be big. The tax cuts for the wealthy will do little to help the 'left-behind' sectors of the US electorate that voted for Trump; but deep cuts are nevertheless planned, including a reduction in the corporate tax rate to just 15%. The Trump transition team website, meanwhile, has put the desired infrastructure spend at US$550bn. According to calculations by the Tax Policy Centre at the Brookings Institute, a US think-tank, because of this lower revenue and higher spending, the US fiscal deficit could rise by three percentage points of GDP to reach 5.5% by 2020. The cumulative addition to federal debt over the next four years could be 25 percentage points of GDP. This is all very reminiscent of Reagonomics – the supply side policies favoured by Republican President Ronald Reagan (1981-1989). In some respects, however, Trumponomics may end up being more extreme

than Reaganomics. According to the Tax Policy Centre, while Reagan's tax cuts reduced annual federal government revenue by almost 3% of GDP over four years, Trump's could represent a cut of 4% over the same time scale. Higher US inflation (and thus steeper interest rates) can be expected as a result of a bigger deficit.

For Latin America, a key issue is how this will impact on the world and regional economies. If it is assumed that the US tax cuts and infrastructure spending come into play before the imposition of protectionist tariffs, there might be an initial spurt in US demand for the world's exports before the negative effect of increased trade barriers kicks in. This has led some analysts to identify countries like Brazil, Peru and Chile as potential beneficiaries, because of increased US demand for commodity exports such as iron ore and copper, which could benefit from a US-based infrastructure boom.

But in other respects, the global economic environment will take a turn for the worse. As in the Reagan years, the world is likely to see higher US bond yields (fuelled by increased demand for debt) and a stronger US dollar. Investors could again turn away from emerging markets. Charles Robertson of Moscow-based Renaissance Capital told the UK's *Financial Times*, "If US interest rates are going up, you're not so excited about what Brazil has to offer".

It is also worth noting that in the 1980s, the rise in the US dollar also caused big problems for Latin American countries with large US-dollar denominated stocks of foreign debt. Dollar-denominated debt levels in the region are now lower than they were then, but high debt repayment costs could still be an issue for some countries – as well as for those regional corporates that borrowed heavily in cheap dollars in recent years.

The case of Mexico

From almost any angle, Mexico is set to be the big loser. It stands at the intersection of two often overlapping categories: countries that have a high export dependence on the US market, and countries that have a high dependence on remittances sent home from expatriate workers in the US. The trade problem is particularly acute. Under NAFTA, the Mexican and US economies have become increasingly inter-dependent. Fully four fifths of Mexico's exports, or 82% to be exact, go to the US. In 2015, Mexico's merchandise exports to the US were valued at US$309.1bn. It imported goods valued at US$187.3bn from the US, giving it a trade surplus of US$121.8bn.

Increased border checks, walls or fences, may disrupt some of this flow. Some initial estimates suggest tariff barriers could trigger a decline of 10% or more in Mexican exports to its northern neighbour. In response to the nervous post-election selloff of the Mexican peso, on 17 November the central bank (Banxico) increased its benchmark interest rate by 50 basis points to 5.25%, a tightening which is likely to hold back economic activity levels. Initial reaction by analysts has been to suggest Mexican GDP growth might halve to around 1% next year; at least one forecaster says GDP could be negative. Diversifying exports will be difficult – Mexico runs a deficit in its trade with the rest of the world.

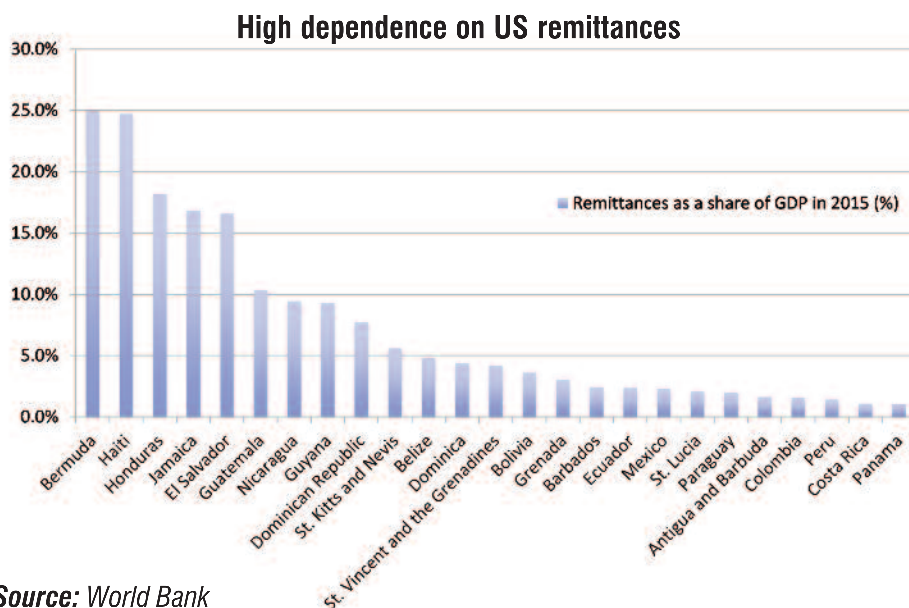
Other countries in the region that are also dependent on exports to the US could suffer. These include Colombia (which ships 28.8% of its total exports to the US) and many Central American countries, such as El Salvador (47.3% of its exports go to the US), Guatemala (37.5%), and Honduras (22.4%).

It is still too early to know the real impact on trade with the US, and there are also some offsetting factors to consider. The depreciation of the Mexican peso (which has fallen by around 11-12% against the US dollar since Trump's

election victory on 8 November), along with that of some other currencies will make Mexican and other regional exports more competitive (something that will help against tariff barriers, but not against non-tariff barriers).

Trump's pledge to deport undocumented migrant workers could have serious negative effects for their countries of origin. Mexico and the Northern Triangle countries (El Salvador, Guatemala, and Honduras) have the greatest numbers of expatriate workers at risk. The situation is still unclear, but Mexico is preparing for the possibility of having to absorb up to 3m returnees – an operation which will have significant economic costs. There may also be a threat to remittance income, most of which comes from expatriate workers. Mexico's remittance income in 2016, for example, is estimated at US$28.1bn, which will exceed its earnings from oil and gas exports and account for 2.3% of GDP. In some of the smaller Central American and Caribbean economies a fall in remittance income could have severe effects: In Bermuda, Haiti, Honduras and Jamaica, total remittances, most of which come from the US, typically account for over one-fifth of GDP.

Elsewhere, there is also uncertainty over whether Trump will continue or reverse President Barrack Obama's diplomatic and trade opening to Cuba: the rise in US tourism and other business links is critical for the island's future pattern of economic growth (*see page 13*).



Source: *World Bank*

Brazil

Much will depend on the impact of Trumponomics on Brazil, Latin America's largest economy. Initial assessments suggest that the impact there will not be as bad as in Mexico, but nonetheless will still be negative.

Anticipating that capital will flow out of emerging markets assets, the currency markets delivered a 6% depreciation of the Brazilian Real in the first two weeks after the US elections. Brazil, however, is much less dependent on US trade than Mexico – exports to the US represent 13% of the total, and there is a surplus in favour of the US. Nevertheless, the fear is that the Trump stimulus package will lead to higher global interest rates, forcing Brazil to delay its hoped-for interest rate cuts and therefore putting back the economic recovery expected for 2017, after two years of unprecedented recession in 2015 and 2016. Finance Minister Henrique Meirelles has said that a risk-averse climate could "increase costs and limit access to capital…[and] assuming that hypothesis, there could be a reversion in growth rates for many countries, including Brazil."

REGION

Regional currencies react to Trump

The victory of Donald Trump in the US presidential election on 8 November will have significant economic implications for Latin America, with the most immediate impact being felt on the region's currencies. Aside from a sharp hit to the Mexican peso, many of the other main currencies in the region have also weakened since Trump's win. This reflects a variety of factors, including market fears about weaker growth and lower investment in Latin America, but also reflects dollar strength, with the US currency strengthening against most other global currencies. Given that many Latin America currencies were already fairly weak before Trump's win, continued depreciation in 2017 could have second-round implications, raising domestic inflation and complicating monetary policy management.

The Mexican peso has lost around 11% of its value since the start of November – a phenomenon directly attributable to Trump's victory. Moreover, this extends further losses earlier in the year: trading at Ps20.4:US$1 on 22 November, the peso is around 18% weaker than it was at the start of 2016.

It is a similar case elsewhere in the region. At Ps3,145:US$1 on 22 November, the Colombian peso is around 5% weaker than at the start of the month. Brazil's Real incurred similar losses, partly reversing a previous rally against the dollar. Meanwhile, the Chilean peso lost 4% over the same period. The Peruvian sol and the Argentinean peso losses were smaller, at around 2%, but were still significant given the relatively short time frame.

Trade and investment concerns

The near-universal losses by the Latin American currencies reflect several factors. The most obvious are market concerns about the impact of Trump's economic and political policies on Latin America. Although there remains significant uncertainty about the extent to which he will follow through on campaign promises, markets fear that his 'America First' line will prompt less investment in Latin America and reduced trade flows – a factor that will have a direct impact on the strength of regional currencies. The fact that the US is the main trading partner for many countries in the region, notwithstanding some diversification to Asian markets in recent years, will mean that Latin America would be severely hit if trade and investment flows decline.

However, part of the phenomenon of Latin American currency depreciation is also explained by recent dollar strength. It is no coincidence that the dollar has appreciated against virtually all of the world's major currencies since Trump's win. Although Trump's protectionist rhetoric implies reduced international usage of the dollar, this is being offset by market expectations that a surge in infrastructure spending will boost GDP growth but also lift inflation, prompting the US Federal Reserve to raise interest rates more rapidly than initially expected. Assuming that the Fed raises rates when it meets in December, Latin American currencies could weaken further.

Monetary policy dilemmas

These developments raise several problems for central banks in Latin America. Although Brazil's real had rallied throughout most of 2016, most major currencies had already weakened against the dollar over the course of the year. Following on the back of depreciation during 2014-15, virtually all currencies are much weaker than they were at the start of 2014.

Many central banks have ample reserves these days with which to defend their currency, but they tend to employ such a strategy only to reduce excessive volatility, rather than target a particular rate. If US interest rates rise more rapidly, it is difficult to see what authorities in Latin America could do to prevent their currencies from weakening even further.

The fear is that this scenario would boost inflation, by raising import prices. Mexico's central bank, Banxico, has already raises interest rates by 50 basis points in response to Trump's win (and the peso slump) in an attempt to ward off inflation fears. This marked the fourth such increase in rates this year.

The Colombian central bank has already been raising interest rates in the past year in response to higher inflation; it had been expected to put rates on hold, given that monthly inflation has begun to edge down, but renewed currency depreciation might force it to continue raising rates. Renewed currency weakening may also causes headaches for the Brazilian authorities, which finally began reducing high interest rates only weeks before the US election. Higher inflation risks interrupting these efforts. And in Chile, it had been looking likely that the central bank would begin cutting rates in an attempt to bolster weak economic growth, but this could be complicated by the impact of currency depreciation.

The difficulty in tightening monetary policy is that it might hamper domestic demand at a time when many governments in the region were hoping for an economic rebound, after several years of recession and/or feeble growth. The International Monetary Fund (IMF) was already downbeat on growth prospects for 2017, forecasting GDP growth of a weak 1.6%, but this forecast – which was carried out in early October, prior to the US election – may be overly optimistic in the light of the past month.

IMF reduces Mexico forecast

On 22 November the IMF cut Mexico's growth forecasts for 2016-2017, citing the main risks to the economy as external protectionist trends and financial volatility. The Fund cut its real annual GDP forecast for 2016 to 2.1%, from 2.5% previously, and its 2017 forecast to 2.2%, from 2.6% previously.

Mexico's economy is highly affected by global developments because of its close production and financial links with other economies, the Fund noted in its latest annual assessment of the country. It added that in its estimates, global factors, such as changes in risk aversion or commodity prices, "explain about half of the variance in Mexico's bond inflows". Moreover, the heavy presence of foreign investors in Mexico's real economy and financial markets make it even more important for policymakers to maintain strong macroeconomic policies, it stressed.

The IMF thus warned that while Mexico's economy continues to grow, albeit slowly, "the country will need to navigate an uncertain and complex external environment, with elevated risks of protectionism and heightened global financial market volatility".

The Mexican financial system "remains strong and resilient to severe shocks, given that financial institutions and non-financial corporations have high initial capital levels", the Fund said. It cited "buoyant" credit growth of 16%, "contributing to financial deepening". Monetary policy has been tightened "through increases in the policy interest rate, as inflation rose from historic lows toward the 3 percent inflation target. Inflation expectations are close to the target, confirming the credibility of monetary policy", it emphasised.

Meanwhile, the 50% depreciation of exchange rate against the US dollar over the past two years "is helping facilitate the adjustment of the economy to external shocks. Going forward, the exchange rate should remain the first line of defence. It can play this role precisely because of the central bank's credibility", it observes.

The Fund praises the government's recent structural reforms, which it notes are helping to lower debt and build fiscal stability, via a multi-annual deficit reduction plan

to reduce the deficit to 2.5% of GDP by 2018. Having met the 2015 deficit goal, the authorities are on track to also meet this year's target, it observes, adding that, "a particularly important aspect of this consolidation pertains to reforms in PEMEX, the state-owned oil company". The Fund notes that PEMEX in November released a five-year business plan "that aims at turning the company profitable by 2020, through efficiency improvements and a focus on high-return activities".

"While Mexico has achieved macroeconomic stability, per capita output has grown slowly over the past two decades", the report continues. "Structural reforms implemented over the past few years addressed important bottlenecks, including in the energy, telecommunications, and the financial sectors, which have all been opened to more competition. These steps are expected to raise potential growth by about 0.5 percentage points to about 2¾ percent over the medium term. But even higher growth could be achieved through further improvements to the investment climate, which would entail, among other measures, strengthening the rule of law and raising female labour force participation", it concludes.

REGION

Looking West

The message to US president-elect Donald Trump from leaders at the Asia-Pacific Economic Cooperation (Apec) summit held in Peru's capital, Lima, on 17-19 November was clear: global trade is not dead and integration will proceed with or without you. China is quickly gearing up to take the lead in Washington's absence. For their part, Latin American countries, led by those in the Pacific Alliance (Peru, Colombia, Chile, and Mexico) are likely to redouble efforts to build links with Asian markets.

Peru's President Pablo Kucyznski closed the summit with a strong message against economic protectionism and a call to press ahead with a Pacific-Rim area free trade agreement. Acknowledging that the summit came at a critical juncture for the world economy, Kuczynski echoed the final summit declaration, which stressed support for regional trade integration, sustainable economic development, and, notably, the new Paris Agreement on Climate Change. "In the US and Britain, protectionism is taking over. It is fundamental that world trade grows again and that protectionism be defeated", Kuczynski said, urging anyone keen on protectionism "to read an economic history of the 1930s". "We have to deliver an unequivocal message to the world that trade continues to be beneficial", he declared, calling on the 21 Apec leaders present – including Russia's Vladimir Putin, China's Xi Jinping, Japan's Shinzo Abe, and the outgoing US president, Barack Obama – to "carefully study the possibility for an Asia-Pacific Free Trade Area".

For his part, President Obama reiterated his support for the TPP, the newly sealed free trade agreement comprising 12 Apec countries including Peru, Mexico and Chile. But less than 48 hours later, Trump made clear that he would be quitting the deal on day one of his term.

The TPP, which took seven years to negotiate, did not include China. Now, however, China clearly is looking to step into the vacuum being left by the US. Beijing has already concluded a new Regional Comprehensive Economic Partnership (RECP) deal with the 10 members of the Association of Southeast Asian Nations (Asean), plus the likes of Australia and India. Seven of the 12 TTP signatories, including the three Latin American members may yet be added to that deal. China's 'One Belt, One Road' economic diplomacy initiative is also open to all Latin American countries.

Last but not least, China is also proposing a broader Free Trade Area of the Asia-Pacific (FTAAP). Ahead of the Apec summit, President Xi stated:

"Protectionism is rearing its head and the Asia-Pacific region faces insufficient growth momentum…China believes we should set a new plan to respond to the expectations of industry and sustain momentum for the early establishment of a free trade area".

Will global reality trump Trump?

Writing in the *Financial Times* on 21 November, the paper's chief economics commentator, Martin Wolf, observed the following: "It is the new dynamic of trade that drove the protectionism that brought Mr Trump to power. The political struggle is now over who benefits from the know-how developed by the companies of high-income countries. That struggle raises an important normative question: who ought to win? It also raises a positive one: who will win? Will Mr Trump favour US workers over the owners and managers of US companies?

Or will he merely pretend he does so, offering token gestures – rejecting TPP, renegotiating the North American Free Trade Agreement or threatening China with tariffs while leaving most world trade much as it is? Might he not conclude, in fact, that giving China a chance to organise world trade is against US interests? Might he not fear that, by limiting the US role in the global unbundling of production, his country's companies would be at a disadvantage and might move even more of their activities to more welcoming regions?

It is not possible for Asia as a whole, let alone China, to maintain the dynamism of world trade on its own. The west matters far too much, not least for China. Fortunately, the forces in favour of global trade remain quite strong. Even Mr Trump might lack the ability or the will to thwart them altogether."

ARGENTINA

The contrary economy

Argentina's economy often swims against the Latin American current, and it seems to be doing so once more. As the Mexican peso slumped and local interest rates tightened in reaction to the victory of the firebrand Republican Donald Trump in the US presidential election, so the Argentine peso has strengthened. In recent months, the Banco Central de la República Argentina (BCRA) has been cutting interest rates from earlier record levels this year. Most notably, unlike most of its Latin American neighbours (with the notorious exception of Venezuela), Argentina still has very high inflation, which recently touched 40%, before beginning to ease back. And although the economy is in recession, it now seems to be enjoying a dollar glut.

Part of the reason for these anomalies is that Argentina has done half the work of restructuring its economy, and has paused before tackling the second half of the job. The new government led by President Mauricio Macri, now in office a year, has freed the exchange rate, lifted trade controls, reduced taxes and swept away over a decade of disputes with holdout creditors, restoring the country's access to international credit markets. But it is moving much more gradually to tackle a big imbalance: the gaping fiscal deficit inherited from the preceding radical left-wing administrations led by Cristina Fernández and her husband and predecessor, Nestór Kirchner, who between them held power for 12 years (2003-2015).

The deficit fuels inflation. Paradoxically, some measures taken to begin to reduce it – such as raising long-frozen gas and electricity tariffs in order to cut back on the huge public cost of energy subsidies – have also led to a short-term inflationary spike. So initially at least, the authorities have relied almost exclusively on tighter monetary policy measures to try to squeeze out inflation.

At the beginning of 2016, the BCRA pushed up its benchmark interest rate to 38%, before lowering it in increments to the current 26%. The Macri government's game plan is to gradually reduce the fiscal deficit, progressively taking the pressure off monetary policy; and allow a convergence of interest rates and inflation down into single digits by the end of its term in 2019. Politics plays a part in this "gradualism" – there is an assumption that more draconian fiscal austerity would lead to trade union and popular protests on a scale that the administration wants to avoid. So the second half of the restructuring job will be done over time.

Added to this scenario is a novelty – especially for a country that was starved of foreign currency for a number of years – that dollars are now pouring in. One reason for this inflow is that after its years locked out in the financial cold, Argentina has emerged from the deep freeze with a low debt-to-GDP ratio, while the new government has moved smoothly to re-establish access to capital markets, and has struck a deal with global investors willing to bet on the country doing well.

According to one rough estimate, the new government will have borrowed a total of US$45bn this year, with a further US$40bn planned for 2017. Good agricultural harvests are also helping, and a tax amnesty is encouraging Argentines to repatriate back dollar assets to the country. In principle, this big capital inflow is beneficial, as long as it ultimately leads to an increase in the country's productive capacity and competitiveness. But some Argentine economists with long memories are worried that an inflow of too many dollars could stimulate a purely financial or real estate bubble and recreate a speculative circuit and an overvalued peso known in the past as the 'bicicleta financiera'.

Eduardo Blasco of consultancy Maxinver says, "This is going to continue, because the government needs to take on debt to fund the deficit, and the dollars are going to keep on coming…we think the BCRA will be able to control this, as the central bank did in Brazil. The only problem will be if there is international financial turbulence". The BCRA president, Federico Sturzenegger, is aware of the risk, saying that high inflation subsidises the financial system by allowing high loan spreads. "This will end in 2019, when we get inflation down to single digits. It is a challenge for us and for the banks", he recently said.

Argentina: Selected economic and financial indicators

	2015	2016	2017	2018	2019
GDP at constant prices (% change)	2.5	-1.8	2.7	2.8	2.9
Domestic demand (% change)	3.7	-2.2	3.4	3.6	3.6
Consumption (% change)	4.1	-1.8	2.3	2.7	2.7
Private (% change)	3.6	-1.7	2.5	2.8	2.8
Public (% change)	6.6	-2.5	1.6	2.1	2.4
Investment (% change)	4.2	-3.6	8.2	7.2	7.2
CPI Inflation eop y-o-y %	…	39.4	20.5	17.5	13
Unemployment %	…	9.2	8.5	8.3	7.5
Exports (US$bn)	56.8	55.3	57.2	59.5	62
Impots (US$bn)	-57.2	-51.6	-56.4	-61.1	-65.5
Trade balance (US$bn)	-0.4	3.8	0.8	-1.5	-3.5
Total external debt (US$bn)	25.2	31.7	32.5	33.8	34.5
Public sector overall balance (%GDP)	-6.6	-7.3	-6.9	-6.2	-5
Gross international reserves (US$bn)	25.6	33.3	36.5	49.2	56.5

Source: *IMF Article IV Report November 2016*

With some caveats, the IMF has put its seal of approval on the government's gradualist approach. The first Article IV consultation report in over a decade, released on 10 November, praised the government for the changes it has made, including the transition to a modern inflation-targeting system and the rebuilding of the national statistics institute (INDEC), which it adjudged to have restored "improved and credible statistics". Real annual GDP will contract by 1.8% this year as the government corrects imbalances, but should rebound by 2.7% in 2017 and achieve a trend growth rate of 3% in the medium term, the IMF says. The primary fiscal deficit will narrow marginally from a target of 4.8% of GDP this year to 4.2% in 2017 as a result of further cuts in energy subsidies, a reduction that IMF directors described as "appropriate", although some suggested it would be advisable to accelerate the pace of deficit reduction if economic activity rebounds more strongly than expected. They also noted that the pace and composition of the rebalancing should be "sensitive to its impact on growth, jobs, and the most vulnerable segments of the population" – in effect recognising the government's case for gradualism.

The IMF lists upside risks to its forecast– such as a faster rebound in private investment, a more successful tax amnesty, or a stronger than expected recovery in Brazil. Among the downside risks for Argentina is a tightening of external financial conditions – which might require stronger fiscal correction. There is also recognition that the peso's appreciation could be subject to abrupt reversal, with the Fund noting: "In Argentina's own history, episodes of a persistently overvalued real exchange rate have eventually led to sharp devaluation of the currency. Such a sudden correction could lead to a contraction of economic activity and high social costs, as the resulting jump in inflation reduces households' purchasing power". There is also a risk that inflation could remain higher and "entrenched".

EL SALVADOR

Is the new fiscal deal enough?

The good news is that after coming close to defaulting on its debts in October, the government of El Salvador has reached an agreement with the opposition on a fiscal responsibility law that allows it to borrow the extra money it needs and gradually reduce the deficit. The bad news is that a number of analysts don't think the deal goes far enough to solve the problem.

El Salvador's ruling left-wing party, the Frente Farabundo Martí para la Liberación Nacional (FMLN), was in deadlock with the right-wing opposition Alianza Republicana Nacionalista (ARENA) for months. The government wanted to raise new loans and taxes; ARENA opposed new taxes and wanted a different approach focused on spending cuts to balance the budget. Neither party can command a congressional majority, but ARENA, in alliance with smaller parties, was strong enough to withhold authorisation for new borrowing. With a dollarised economy, the government cannot print money to cover its fiscal deficit. Therefore, having reached its borrowing limits in early October, it looked as if the government might simply run out of money and default on its debts.

An eleventh-hour deal was struck in November. Congress voted a law enabling the government to raise US$550m worth of international bonds (less than the US$1.2bn the government had been seeking). US$307m of this will be used to pay off short term treasury bills (Letras de Tesorería, or Letes), thereby reducing total outstanding Letes debt. Of the rest, US$82m will go on transfers to municipal governments, US$65m on public sector wages,

US$46m on electricity tariff subsidies, and US$40m on reducing government debts to suppliers.

At the same time, the political parties agreed on a fiscal responsibility law (approved by 76 of the 84 members of congress). The law stipulates that in the three years commencing from January 2017, tax revenues must be increased to not less than 17% of GDP, while spending must be contained at not more than 18.5% of GDP.

With estimates of the non-financial public sector (NFPS) fiscal deficit currently running at around 4% of GDP, this implies a commitment to reduce it to 1.0%-1.5% by 2020. The law also establishes that total non-financial public sector (NFPS) debt cannot exceed 45% of GDP, while total NFPS debt including pension liabilities must be capped at not more than 65% of GDP.

The deal is clearly a step forward, but a number of analysts fear that it doesn't go far enough. The international credit-rating agency Moody's Investors Services has cut El Salvador's rating twice, on 11 August (from Ba3 to B1) and on 8 November (to B3 with a negative outlook). According to Ariane Ortiz-Bollin, a Moody's analyst, the fiscal deal (which was signed on 11 November) is a "good signal", but does not really do enough to tackle the problem of high Letes debt.

By law, governments cannot borrow more than US$1.3bn worth of Letes (the limit is set at 30% of current public revenue). But Ortiz-Bollin says that as far as Moody's is concerned, the upper limit should be no more than US$800m. This is because local banks hold around 60% of the total Letes in circulation and for some, Letes exposure is equivalent to 20% of paid-up capital, a level that many consider to be too risky. Many local branches, which are subsidiaries of risk-averse international banks, are being told to cut their exposure. As a result, Ortiz-Bollin says, "it is difficult to know if the markets are going to be there for El Salvador when it issues the bonds", suggesting that the country may find itself having to pay higher interest rates that it would have hoped (the timing has also coincided with a tightening of interest rates associated with the outcome of the US elections).

Much will depend on whether the FMLN government can execute the kind of fiscal restructuring required by the new law, as well as tackling reforms to the pension system to reduce large unfunded liabilities. However, according to think-tank Fundación Salvadoreña para el Desarollo Económico y Social (FUSADES), if the government can achieve a reduction in the annual fiscal deficit equivalent to three percentage points of GDP over the next three years, coupled with average GDP growth of 2% per annum, then it will be able to cut its overall debt by an amount equivalent to 26.2% of GDP. In contrast, if nothing is done to manage the deficit, by 2025 total debt will reach 82.7% of GDP.

JAMAICA

Continued progress on economic stabilisation

The announcement by the IMF on 11 November that its Executive Board had approved a three-year US$1.64bn Stand-By Loan Arrangement (SBA) with the Jamaican government is a reflection of the progress made by the Jamaican authorities in stabilising the economy since the previous Extended Fund Facility (EFF) agreement was signed in 2013. The IMF praised the government's efforts at fiscal consolidation, including the continued generation of large primary surpluses and a reduction in the large public debt stock. Although real GDP growth remains weak, it is

nevertheless showing signs of acceleration. Coupled with wide-ranging and ambitious reform plans for the coming year, the government hopes to continue its recent impressive track record.

The government led by Prime Minister Andrew Holness of the Jamaica Labour Party (JLP), elected in February this year, has stated that it plans to use the US$1.64bn available under the new SBA as precautionary financing, not drawing down from the funds unless external conditions deteriorate sharply. This also marks a sea change from recent years, when disbursements from the EFF were vital to supporting the balance-of-payments position, as well as financing the overall fiscal deficit.

As in recent reviews under the EFF, the IMF was extremely positive about macroeconomic developments, highlighting low inflation, the accumulation of foreign reserves and a fall in the current-account deficit as particular factors that have engendered greater economic stability.

Purse strings will remain tight

Like the preceding EFF, the new SBA will maintain a tight focus on continued fiscal discipline. One of the main quantitative targets will remain the primary balance (the balance before debt interest payments). Jamaica has run very high primary surpluses of 7-7.5% of GDP for the past three financial years, in line with IMF targets, reflecting both spending cuts and higher revenues.

Combined with proactive debt management, including fresh sovereign bond issuance designed to buy back more expensive debt falling due in the short term, the public debt to GDP ratio has fallen. According to the IMF, this ratio stood at 141% in the 2013/14 financial year (April-March) but this had fallen to 120% by 2015/16.

The IMF's primary surplus target remains unchanged at 7% of GDP until 2019/20; if the government continues to meet this target, the Fund estimates that this will bring public debt below the 100% of GDP threshold. The long-term aid is to reduce debt further, to 60% of GDP by 2025/26.

To achieve these goals, the Fund recommends a mixture of spending constraint and reforms to boost the revenue base. On the expenditure side, there will be continued efforts to reduce spending on public-sector salaries, which at 10% of GDP currently is above average compared with the rest of the Latin America region.

Spending on wages has come down in recent years, mostly through natural attrition, but the government hopes to make further cuts in the coming two years by reducing the number of public-sector employees, as well as capping salary increases. The government has outlined a timeline for shrinking the size of the public sector and is expected to unveil plans for consolidation of several departments early next year, ahead of implementation mid-year.

On the revenue side, the IMF applauded the decision by the JLP government to follow through on an election campaign pledge to raise the personal income tax threshold. From the start of July, the threshold nearly doubled, from J$592,800 to J$1m, with a second step scheduled for April 2017, which will raise this to J$1.5m.

Given that this will exempt the majority of taxpayers from paying any income tax, there had been speculation that the IMF might criticise the new government's move on the grounds of veering from the previous administration's commitment to fiscal discipline. However, this has not been the case, with the IMF praising the fact that the government has successfully identified replace-

ment sources of revenue, and even went so far as stating that the shift from direct to indirect taxation will support medium-term economic growth.

Government acknowledges the need to boost growth

That said, the IMF acknowledged that important challenges remain. The most immediate is the prospect of still-weak economic growth and high levels of unemployment, which could threaten public support for the IMF programme, particularly given the fact that fiscal austerity has already been in place for so long.

According to the Statistical Institute of Jamaica, GDP has either contracted or recorded weak (below 1%) growth for most of the 2010-15 period (peak growth was a rather uninspiring 1.7% in 2011). The pace of growth has picked up marginally in 2016, from 0.8% year on year in the first quarter to 1.4% in the second, and the government has indicated that it expects a further acceleration to over 2% in the third quarter.

However, this is mainly due to a recovery in agricultural production after several years where drought hampered output. There is little concrete sign of stronger consumer demand or increased investment and unemployment – at 12.9% in July – remains high, if somewhat improved from levels of over 13% earlier this year.

In order to maintain broad public backing for the IMF-mandated measures, the government is placing a greater emphasis on improving the social safety net through adjusting the conditional cash transfer payments system (a pro-poor subsidy). Known as the Path of Advancement through Health and Education (PATH), it provides payments to pregnant women and new mothers, the poor, families with children of school age, the elderly and the disabled. The government has stated that it plans a significant increase in PATH benefits in the 2017/18 budget, as well as renewed efforts to improve coverage only 55% of households in the poorest quintile receive PATH payments).

Security also remains a major concern

Improvements in security are also paramount to maintaining public support for the IMF programme, as well as boosting potential growth rates (the ministry of national security has previously estimated that the impact of violent crime costs the economy up to 7% of GDP annually, through the medical costs and productivity losses of injuries, as well as additional security spending). The government has stated that it will devote more financial resources to security and has outlined plans to table a comprehensive reform of the police force to parliament by next October. Few details are yet available, as detailed discussions have yet to begin in earnest, but this may involve a wholesale replacement of the much-troubled Jamaica Constabulary Force (JCF).

The key question is whether the government will be able to make good on this ambitious economic and political agenda. In its favour, the JLP commands a working (if extremely narrow) parliamentary majority, which should facilitate continued progress on the reform front. The opposition People's National Party (PNP), which lost the February general election, remains preoccupied by internal differences, including an ongoing debate about whether the former prime minster, Portia Simpson Miller (2012-2016), should step down as party leader.

As a result, there has been very little opposition to the JLP since it took office, and little criticism of its planned legislative programme. For as long as the PNP remains weak and the economy shows tentative signs of improving, the public is likely to remain broadly supportive of the new government.

However, in the medium term there remains a risk that public opinion could turn against the JLP, particularly if the gradual economic recovery reverses amid a deterioration in external economic conditions.

CUBA

Nerves intensify over pro-embargo Trump advisors

Along with Mexico, Cuba is facing some deep uncertainty about the future shape of US policy under the incoming administration to be led by President-elect Donald Trump. While Trump played to the hard-line Cuban-American Miami constituency in the election campaign, US business interests, including many that sit on the Republican side of the fence, are not at all aligned with the pro-embargo lobby. Moreover, while Trump might hope to simply draw his executive red pen through President Barack Obama's various measures opening up trade and travel with Cuba, rolling these back, and demanding that US business deals done to date be 'undone', could prove more complicated than he expects. By way of example, these deals include dozens of new scheduled flights to Cuba from major US airports. These took a couple of years to negotiate, and involved the input of multiple US and Cuban agencies, as well leading US airlines like Delta and American Airlines, to name but two. Trump may need to put his 'art of the deal' skills to full use to find a compromise solution that would satisfy both the congressionally influential pro-embargo lobby and the expanding US corporate interests in Cuba.

Trump's attitude towards the historic US rapprochement with Cuba went from broadly supportive to heavily critical over the course of the 2016 election campaign. By the end, with the swing state of Florida heavily in play, he was pledging to roll back Obama's changes and demand more of the Cuban government led by President Raúl Castro in return for any future cooperation, including the release of political prisoners and religious and political freedom for Cubans.

As the new administration takes shape, there were few early signs of 'compromise' on this hardline stance. While it has not been officially confirmed, the conservative *Washington Examiner* reported that Mauricio Claver-Carone, a lawyer and executive director of the US-Cuba Democracy Political Action Committee (USCD-PAC), and head of a non-partisan organisation known as 'Cuba Democracy Advocates', had been appointed to the Trump transition team for the US Department of the Treasury, which has overseen and implemented most of the recent White House changes to Cuba policy. Claver-Carone was an attorney-adviser in the Treasury Department until November 2003, according to a profile in the *Miami Herald*.

Noting that Claver-Carone Cuba was one of the loudest opponents of the Obama government's Cuba policy, Cuba observers immediately suggested that his appointment signalled a hawkish tone from the Trump camp. Otto Reich, a conservative former US diplomat known in particular for his hardline views on Venezuela (where he once served as ambassador) told the Spanish language *El Nuevo Herald*, that the appointment "is a clear signal … that the president-elect will carry out the promise he made to the Cuban American community. In my opinion, not many other people know as much about Obama's mistakes on Cuba policy, and how to change them, as Mauricio." Indeed, writing in the *Miami Herald* in mid November, just before his apparent appointment to the Trump transition team, Claver-Carone was clear that under the Obama government, US policy towards

Cuba "has gone from what it initially portrayed as a noble purpose to pure sycophancy in pursuit of 'historic firsts'."

In several articles in the wake of the Trump victory, the *Miami Herald* has examined the options for Trump to reverse Obama's executive orders and regulatory changes and the possible repercussions of an abrupt change in US policy for US business interests (*see sidebar*).

Robert Muse, a Washington lawyer, told the paper that any move by Trump to undo the Obama government's Cuba policy "is a bigger decision than it might appear…The weakness of executive branch action is that what one president does another can easily undo. Trump can rescind the executive orders, but I think it's unlikely that he would do a wholesale repeal of Obama's executive actions," he was quoted as saying.

As the daily observed, since the US-Cuba rapprochement began in December 2014, "a Miami-based cruise line has begun to sail to Cuban ports, U.S. telecom companies have established roaming agreements with Cuba, commercial airlines are flying from U.S. cities to Cuba, Marriott has entered into a joint venture to manage some Cuban hotels, and Cuba has become Airbnb's fastest growing market. A pharmaceutical joint venture is about to begin clinical trials in the United States, and other U.S. companies are in various stages of trying to close deals with Cuba". US travel has also risen exponentially to Cuba (in the first six months of this year, 136,913 Americans visited Cuba, up 180% from the same period of 2015), while reports have noted a surge in US trademark registrations in Cuba. Famously, the US giant Netflix is also serving the island, and Google and Cisco are also doing business there, including to expand Internet provision.

Muse warned that "because these companies struck deals in good faith based on existing U.S. regulations, they could be entitled to compensation or would need to be grandfathered-in to new policies". "That interpretation is based on a provision of the Fifth Amendment that says no one can be deprived of property 'without due process of law; nor shall private property be taken for public use, without just compensation'. These companies have expended real time and money on these deals," he noted.

In other words, Trump would have to weigh up some fairly hefty political costs in seeking to play only to the Cuban-American lobby. And these costs could be most keenly felt in those mid-western US agricultural states that already sell produce to Cuba and have been among the strongest advocates of the outright removal by congress of the US economic embargo.

One stakeholder from the mid-west, Charlie Serrano, managing director of the Chicago-based Antilles Strategy Group, told the *'Herald* that he was optimistic that Trump would take a more pragmatic approach. "What I hope as a Republican and as someone who has been involved with Cuba for 24 years is that Trump would look at the potential for business with Cuba and fast-track things", he told the daily, suggesting that Trump might even see fit to speed things up in the name of US interests. "Some of this stuff is not moving fast enough…I think Trump will be interested in getting Cuban policies to a place where the United States benefits more. My hope is he will look at things from a business point of view. Cancelling out everything that Obama has done would not be a good thing; it wouldn't be wise for American business", he commented.

The question, the *'Herald* mused, "is whether Trump the businessman or Trump the politician will prevail when it comes to Cuba policy".

On the legal side, the *Miami Herald* suggested that Trump could do as follows:

- Downgrade the newly restored US Embassy in Havana, returning it back to an Interests Section, or even close it.
- Instruct the Republican-controlled senate not to approved Obama's choice for the new US ambassador to Cuba, Jeffrey DeLaurentis (currently chief of mission in Havana). Obama nominated DeLaurentis in September, but senate confirmation is still pending.
- The US president has broad discretionary power over Cuban immigration and travel policy. Trump could, for example, tighten the Cuban Adjustment Act, which allows Cubans to apply for permanent residency in the US after a year (even if they arrived illegally) by ordering the US attorney general not to grant discretionary parole to arriving Cubans. Likewise, the president may also unilaterally limit or expand US travel permits for Cuba.
- In October, Obama issued a 12-page presidential policy directive aiming to institutionalise his changes toward Cuba. According to the 'Herald, it was intended "as a manual to help guide federal agencies in their future relations with Cuba". However, it noted, "such presidential directives generally aren't made public and can be changed from one administration to the next".

CUBA

The march of the self-employed

The total number of Cuban self-employed workers, known as 'cuentapropistas', rose to 522,855 in September, up by 4.8% on the number at the end of last year. Although from time to time the government led by President Raúl Castro seems to have nurtured ideological doubts about the advisability of fostering a growing private sector, small businesses look set for further growth.

Self-employment has been permitted in Cuba since 2010, when the Castro government promoted it as a way of offsetting cuts in employment levels within the country's dominant state-owned sector. Officially, self-employment is seen as playing a complementary and subsidiary role to that performed by the state, as the authorities seek to modernise some aspects of the Communist system.

This new private enterprise is limited to 201 specific activities or professions. The better known include small-scale in-home restaurants, known as *paladares*, that have grown in step with the expansion of tourism. But many other ventures have also launched. These include a wide range of retail outlets including hairdressers and beauty salons, car repair shops, gyms, bars, estate agents, gift shops, photography studios, and more latterly, mobile apps. Despite Cuba's limited Internet connectivity, a growing number of on- and off-line services are also being offered including magazines, food guides and home delivery.

The number of *cuentapropistas* first broke through the half-million mark in 2015, but then dipped back down to about 490,000 before beginning to climb again this year. Some economists believe there are at least another 500,000 people who, although lacking formal *cuentapropista* permits, are illegally/informally involved in some kind of private sector activity. Some have attributed the fluctuations in the officially reported data on cuentapropistas to shifts in the government's stance on self-employment.

In September and October this year, for example, there was a hardening of attitudes towards the *paladares*. New licences were frozen and existing *paladares* were subject to a series of inspections, as the authorities said they were seeking to crack down on unlicensed bars and prostitution. However, by end-October, licences were being issued again. So far this year, a total of 1,870 licences to operate restaurants have been issued, compared to 1,650 in calendar 2015.

More than half – 65% – of the self-employed are located in the provinces of La Habana, Matanzas, Villa Clara, Camagüey, Holguin and Santiago de Cuba. The authorities say that an estimated 68% of *cuentapropistas* were previously unemployed.

According to a survey covering the first eight months of this year, 31% of *cuentapropistas* are young, 31.4% are women, and 11.7% are pensioners. In addition, aside from farm cooperatives there are also almost 400 non-agricultural cooperatives in operation, working in areas such as retailing, personal services, restaurants, taxis, construction and manufacturing.

Cuentapropistas and cooperatives have expanded despite facing a number of challenges. *Prensa Latina*, the state-owned news agency, has recognised "inadequacies and dissatisfaction" relating to taxation levels, the lack of inputs, access to financing, higher prices and "obstacles to going forward without breaking the law".

Official policy towards small and medium-sized enterprises (SMEs) is also unclear. To date, cuentapropistas have lacked the opportunity to set up

formal companies with clearly defined legal and property rights. Such a legal framework could be used, for example, to allow such entities to deal with banks, foreign investors and State-owned companies. A new 32-page document, released in May in the wake of the Communist Party's 7th congress in mid-April, stated that "Private property in certain means of production contributes to employment, economic efficiency and well-being, in a context in which socialist property relations predominate". For some, this suggested that Cuban SMEs could be given legal recognition in the relatively near future. Others warned that the process of reorganising property ownership in Cuba could still take a number of years.

Most *cuentapropistas* are also currently blocked from accessing raw materials and other products at wholesale prices. (While some wholesale markets have been introduced in agriculture, they remain the exception). Neither can cuentapropistas officially import (or export).

VENEZUELA

Maduro's new front – JP Morgan

President Nicolás Maduro has threatened legal action against the US investment bank JP Morgan after the bank reported delays by the state oil company Petróleos de Venezuela (Pdvsa) in making external bond payments. Maduro, along with his energy minister and Pdvsa president, Eulogio del Pino, accused JP Morgan, along with the US based Citigroup and the US treasury, of participating in a conspiracy to topple Venezuela's 17-year-old left-wing Revolution and re-assert direct or indirect US control over the country's vast oil reserves.

Maduro on 22 November accused JP Morgan of falsely reporting that Pdvsa was in default after the bank released a client note a day earlier reporting that Pdvsa had activated a (standard) 30-day grace period to complete some scheduled bond coupon payments.

Some US$539m of coupon payments on Pdvsa bonds maturing in 2021, 2024, 2026, and 2035 were due in mid November, but according to Citigroup and Clearstream (acting as financial intermediaries) only US$135m was received, investment bank JP Morgan Chase said in its 21 November client note. JP Morgan said it believed that Pdvsa had delayed a US$404m payment, but added that it believed that the company would make full payment within the 30-day grace period. However, the bank suggested, "this highlights the cash difficulties and mismanagement of PDVSA with regards to its liabilities".

Later that day Pdvsa issued a statement denying the veracity of the JP Morgan note, saying it had "punctually" paid its obligations for the 2021, 2024, and 2026 letters and was also "in the process of executing interest payments" for its 2035 bonds. "In this way, PDVSA honours its commitment...ratifying the financial solidity of Venezuela's main industry", it noted, insisting that it was not in default. Del Pino also tweeted: "The information about a PDVSA default spread by the enemies of the fatherland is totally false".

The Venezuelan economic analyst Francisco Rodríguez (currently at Torino Capital in New York), meanwhile suggested that there might have been a technical glitch with the payment. He noted that Pdvsa payments were going "through accounts not conventionally used for these purposes" and that there had "recently been some Pdvsa management changes, all of which may have resulted in a delay". The first part of that comment may have been a reference to the fact that in July Citi announced that it would no longer provide correspondent banking services to its Venezuelan clients (public and private), albeit it later agreed to continue to act for the Venezuelan government/central bank/Pdvsa until it could find a new provider, a process that

appears to be taking time. "Our tentative conclusion is thus that the delay in payments likely reflects administrative and technical issues of the type that the 30-day grace period is designed to handle. We do not believe it reflects a change in the [Venezuelan] authorities' willingness to service its international obligations", Rodríguez observed.

Whatever the facts, investor nerves were rattled, sending Pdvsa debt premiums (already ranked 'distressed' by the main ratings agencies) higher. Pdvsa has paid over US$2bn in debt obligations in the past two months. It also managed to swap US$2.8bn of 2016-2017 bonds for notes maturing in 2020, providing some relief to the cash-strapped company. But a spike in costs is the last thing it needs at this point.

Maduro thus immediately saw a conspiracy. "JPMorgan's attitude is of a criminal nature," he declared, during his new weeknight salsa music program (*La Hora de la Salsa*), broadcast from the presidential palace (and which in fact runs for two hours). The president said that the government's opponents at home and abroad were seeding false rumours that the country was on the verge of a debt default. He also suggested that Citi might deliberately have delayed processing of the coupon payments as part of this.

Noting that he had asked Del Pino to look into legal options, Maduro noted that "the least JPMorgan can do is apologise to the Venezuelan people". "I would tell the bondholders to call up Citibank and ask why they are delaying payment of money that is already in their accounts," said Del Pino, likewise accusing Citi of taking part in "attacks" on Venezuela.

The Maduro government has made patently clear that its main policy priority is to avoid default on Venezuela's US$68bn in external bonds – and it has gone to extreme lengths this year to remain current on its obligations. The central bank (BCV) had US$10.9bn in international reserves as of 18 November. Despite Pdvsa's latest bond swap, total combined debt obligations by the sovereign and Pdvsa for 2017 are still high, at US$8.1bn. Their joint debt service commitments to 2020 average US$8.7bn a year.

Despite Venezuela's willingness to pay its debt obligations, the main question is over its ability to do so. With international oil prices set to recover only moderately, swaps traders are still assigning a 51% probability to a Pdvsa default in the next 12 months.

Black-market FX rate breaches 2,000/US$

The (illegal) black market exchange rate had soared to over Bs2,300/US$ as of 22 November, according to websites that track it, most notably including *DolarToday.com*, which claims to base its daily information from the exchange rates reported from traders in Cucuta, on the Venezuela-Colombia border. The site, run out of the US, is a major bugbear of the Maduro government, which accuses it of being part of the economic and financial 'war' on Venezuela. An estimated US$15m changes hands on the black market every day, and the rate reported by DolarToday has a direct bearing on price setting by importers across the country, who use it as a reference – to the extent that the central bank has twice (unsuccessfully) filed suit against the site in US courts, a recent report in the *Wall Street Journal* noted.

According to *DolarToday*, the black market rate has fallen by 44.8% in the past month and is now over three times the secondary official rate of Bs660/US$, which is used for imports of non-essential items (food and medicines come in at a special primary rate of Bs10/US$).

This continuing depreciation not only reflects the severe shortage of dollars for import purposes, but more notably runaway local money supply, as the central bank prints Bolivares in unprecedented volumes in support of the government's efforts to sustain domestic spending. According to the BCV's own data, money supply rose by just over 14% in the month of October alone.

BRAZIL

Odebrecht on the cusp

Odebrecht, the giant construction and civil engineering company, is on the cusp of major changes. Deeply involved in Brazil's Petrolão corruption scandal, it is currently negotiating what is described as the world's biggest leniency deal. It is not just the survival of the heavily leveraged group that is at stake: there are also important implications for Brazilian politicians, for the country's economic recovery, and for Peruvian gas pipelines, among other things.

Odebrecht matters. It is Brazil's largest construction company, with 2015 revenues of BRL132bn (US$42.2bn). At its peak, it employed just over 180,000 people around the world. It is active in civil engineering projects in 27 countries across the Americas, Europe and the Middle East, and also has a presence in Africa. It owns Braskem, one of the world's top ten petrochemicals groups. However, the company is dealing with its most serious crisis since its foundation by Norberto Odebrecht in the early 1940s, as it faces a multitude of corruption accusations. The core charges are that it took part in an illegal cartel to share out multi-billion dollar contracts from the state-run oil giant Petrobras. As part of that arrangement, it paid bribes to a wide range of Brazilian politicians.

The firm has therefore been at the centre of the *Lava Jato* (car wash) anti-corruption investigation, led by the pioneering young federal judge, Sergio Moro. Marcelo Odebrecht, the CEO and grandson of the company's founder, was arrested in July 2015; in March this year, he was found guilty of paying roughly US$30m in bribes and sentenced to 19 years in prison.

Meanwhile, the company's financial situation has nose-dived. Because of the *Lava Jato* probe, Odebrecht has been banned from competing for any government contracts, negatively impacting its revenue streams. Its debt load has grown to nearly BRL100bn (US$32bn). It has had to lay off an estimated 50,000 workers, and is having difficulty obtaining new bank credit.

Clearly, the company needs to dig itself out of a hole. The first priority is to try and settle all outstanding legal cases. This has led to negotiations on what has been described as potentially the world's largest corporate leniency deal.

Because of its international operations, talks have involved Odebrecht and Brazilian, US and Swiss prosecutors. Over 80 company employees including Marcelo Odebrecht are seeking leniency in exchange for volunteering more information about the bribery schemes – information which could incriminate roughly a further 100 politicians, including members of the current federal government of Brazil led by President Michel Temer of the Partido do Movimento Democrático Brasileiro (PMDB).

According to sources close to the investigations, each executive must make a written statement of what they are prepared to disclose and then testify before prosecutors. The evidence will then be submitted to Brazilian Supreme Court Justice Teori Zavascki, who will decide whether to accept the individual plea-bargains. Judge Moro will also need to approve any deals. It is not clear whether the process will be completed before the end of this year or will gave to wait until after the end of the Brazilian Supreme Court's January holidays.

The largest leniency deal recorded to date was in 2008, when the German engineering company Siemens paid US$1.6bn in fines to US and European

authorities for bribing officials to win government contracts. What kind of fine Odebrecht may end up paying is not confirmed. However, the daily *Folha de S. Paulo*, quoting US investigators, says the total could be around BRL6bn (UD$1.9bn). Another Brazilian publication, *Valor Económico*, put it at a higher BRL7bn (US$2.2bn). Over half would be paid to the Brazilian authorities, with the rest being split between the US and Switzerland, reflecting illicit activity in both those jurisdictions. However, Odebrecht's lawyers are reported to be arguing that the Brazilian portion of the fine is disproportionate, since the largest domestic leniency deal struck to date with another construction company, Andrade Gutierrez, was a much lower BRL1bn (US$320bn), and Odebrecht, they claim, has so far done more to cooperate with investigators than Andrade did.

While Judge Moro is known to want a high-value fine, so as to send a strong signal that corruption does not pay, others are concerned that too great a penalty might nudge the struggling conglomerate onto a path ultimately leading to bankruptcy.

The company is dealing with threats on other fronts too: its plan to raise cash by selling a 55% stake in a Peruvian natural gas pipeline for US$5bn was reported to have collapsed in November, after a deal with a consortium led by Sempra Energy of the US broke down. Odebrecht won the concession to build the pipeline in 2014, but that too is now under investigation, amid allegations of potential wrongdoing in the bidding process.

In October, Torquato Jardim, Brazil's transparency minister, said he was keen to get construction companies back to work after paying fines, so that they can help get the much-needed economic recovery underway in the country. Construction is labour-intensive and therefore important for a government trying to boost activity levels. The ministry has to decide whether companies that have struck leniency deals should be barred from bidding for public works for up to five years. It takes the decision after analysing the nature of their deals.

Three companies: Mendes Junior, IESA Oil & Gas, and the local subsidiary of Swedish builder Skanska AB, have had their leniency deals rejected as insufficient and will remain banned from bidding for contracts for up to two years. Skanska is appealing against the decision. Jardim said a fourth company that he did not name also remained barred, despite having reached a leniency deal. "There will be no amnesty, no forgiveness, and they will all have to pay the fines established by law. But the companies must be reinserted in the market for their technical expertise and the people they employ" Jardim was quoted as saying.

MEXICO

Soft drink companies fight the diabetes wars

Mexico's soft drinks companies say the extra one peso per litre tax introduced in 2014 to combat obesity and diabetes has failed. But in the light of recent research findings on the prevalence of diabetes in Mexico, the debate is far from over.

The soft drinks producers' association (Asociación Nacional de Productores de Refrescos y Aguas Carbonatadas, ANPRAC) says the extra tax introduced on its products in 2014 has been a failure. At the time, the government led by President Enrique Peña Nieto said it was applying a special one-peso (US$0.05) per litre tax to reduce the consumption of high-calorie drinks and in that way combat obesity and diabetes, particularly among children. The extra revenue would be used to educate and raise awareness of the need for healthier lifestyles.

But ANPRAC, whose members include the local subsidiaries of global companies such as Coca Cola and Pepsico, claims all that has been achieved is a regressive tax on low-income households, who are now paying more, but still consuming the same amount of soft drinks. It points put that including VAT and the special tax, soft drinks are paying a total sales tax of 30%. "We are against the satanisation of any type of product. There aren't good or bad foodstuffs and beverages, this is a problem which concerns everyone" says Jorge Terrazas, director general of ANPRAC.

ANPRAC says that soft drinks producers are being unfairly blamed for the prevalence of type 2 diabetes, which is caused by genetic and lifestyle factors. But one key point is in dispute. According to ANPRAC, soft drinks consumption hasn't fallen since the tax was introduced. It says that in the first half of this year total sales amounted to 9.2m litres, up from 9m litres in the same period of 2015 (a gain of 2.2%), proving the ineffectiveness of the tax. Against this, the Instituto Nacional de Salud Pública (INSP), part of Mexico's public health system, claims that ANPRAC's numbers are misleading. Only crude data is being used, which does not take proper account of per capita drink consumption trends. The INSP concludes that average per capita soft drink consumption was 13.6 litres per month in the 2007-June 2016 period, and that based on its calculations, per capita consumption fell by 6% in 2014, by 8% in 2015, and by 11.1% in the first half of 2016, relative to what it would have been without the additional tax.

Meanwhile, concern over the incidence of diabetes in Mexico, estimated to have caused 94,000 deaths in 2014 (and to have ranked the country sixth in the world in terms of prevalence of the condition), is likely to rise following the publication of a new study. Researchers led by Jesus Alegre Díaz of the Universidad Nacional Autónoma de México (UNAM) has shown that at least one-third of all deaths among Mexicans aged 35 to 74 are related to poorly-controlled diabetes. The researchers had expected the incidence of diabetes in a middle-income country like Mexico to be higher than in wealthier countries, but according to one member of the research team, Dr. Jonathan Emberson of Oxford University, "We did not expect the difference to be this large… this is twice previous estimates for Mexico". The difference is being attributed to inadequate medical care and poor glycaemic control. The soft drinks companies, while questioning the extra tax, nevertheless acknowledge rising consumer concerns. Coca Cola is marketing 'Zero" and 'Light" versions of its soft drinks, while Pepsico says that by 2025 two thirds of its products will contain less than 100 calories of added sweeteners.

BRAZIL

Oi still awaiting salvation

Oi, Brazil's fourth largest mobile operator, reported a narrower third quarter loss as it struggles to emerge from bankruptcy protection. The government has so far said it will not intervene to bail out the company.

Oi said it had a third quarter loss of BRL1.015bn (US$298.7m), a small reduction on the comparable year-earlier period. Its CEO, Marco Schroeder, said that there had been a 10% cut in operating costs, although revenues were also down by over 6% to BRL6.4bn (US$1.88bn). The fall in revenue reflected a purge of the client base, particularly in the pre-paid mobile and fixed line segments. The company was able to boost pay-TV and broadband subscribers however, part of a strategy to build higher-value services.

Since seeking bankruptcy protection in June, the company has been trying to restore profitability, so as to attract potential buyers. Schroeder says that cash

flow has improved, partly because the company has stopped servicing its debt (part of the bankruptcy protection process), and partly because it is reducing operating costs. Total debt stands at BRL41.2bn (US$12.13bn) and the company has been in talks with its creditors over a rescheduling programme.

Brazil's communications minister Gilberto Kassab has said that the federal government led by President Michel Temer is keen to see Oi emerge from bankruptcy, but is not yet considering any form of intervention, as it favours a "market-based solution". In September, Mexico-based América Móvil expressed an interest in acquiring some or all of Oi's assets. The Egyptian telecoms entrepreneur Naguib Sawiris has also expressed an interest.

REGION

Xi Jinping reasserts China's strategic interest in Latin America

Fresh from attending the Asia-Pacific Economic Forum (APEC) summit in Lima, Peru, China's president Xi Jinping was in Santiago, Chile, on 22 November, where he reasserted China's comprehensive strategic partnership with Latin America at the headquarters of the United Nations' Commission for Latin America and the Caribbean (ECLAC).

To mark the occasion, ECLAC released a new Spanish-language report on economic relations between Latin America & The Caribbean and China. Entitled, '*Relaciones económicas entre América Latina y el Caribe y China – Oportunidades y Desafíos*', the report is freely available at http://repositorio.cepal.org/bitstream/handle/11362/40743/1/S1601155_es.pdf

Giving a summary of the report, ECLAC's executive secretary, Alícia Barcena, noted that trade in goods between Latin America & The Caribbean and China has grown 22 times over since 2000. It reached a historic peak of US$278bn in 2013, but declined thereafter.

Between 2013 and 2015, the value of the region's exports to China fell by 23%, amid the deceleration in China's growth. This, Barcena noted, had repercussions in terms of lower demand and sharp price drops for the commodities that make up the bulk of the regional export basket to that market.

América Latina y el Caribe (20 países): exportaciones de bienes a China, 2013-2015

(En millones de dólares y porcentajes)

País	2013	2014	2015	Variación 2013-2015
	(en millones de dólares)			*(en porcentajes)*
Argentina	5 512	4 460	5 174	-6,1
Bolivia (Estado Plurinacional de)	320	434	466	45,7
Brasil	46 026	40 616	35 608	-22,6
Chile	19 090	18 828	16 671	-12,7
Colombia	5 102	5 755	2 264	-55,6
Costa Rica	378	338	80	-78,8
Ecuador	569	485	723	27,1
El Salvador	5	6	44	713,1
Guatemala	167	43	207	23,9
Guyana	7	23	20	175,7
Honduras	135	92	21	-84,4
Jamaica	7	33	29	295,2
México	6 468	5 964	4 873	-24,7
Nicaragua	21	28	22	3,4
Panamá	51	69	41	-20,2
Paraguay	57	49	30	-47,4
Perú	7 354	7 025	7 333	-0,3
República Dominicana	232	170	123	-47,0
Uruguay	1 291	1 220	1 068	-17,3
Venezuela (República Bolivariana de)	13 374	11 320	6 888	-48,5

Fuente: Comisión Económica para América Latina y el Caribe (CEPAL), sobre la base de Naciones Unidas, Base de Datos Estadísticos de las Naciones Unidas sobre el Comercio de Productos Básicos (COMTRADE).

Meanwhile, regional imports from China only fell by 3% in the same period, meaning that China's trade surplus with the region – and Latin America's trade deficit with China – was valued at US$84bn last year. Much of this deficit comes from the very unbalanced trade between China and Mexico and Central America; by contrast, the trade relationship between China and South America has been more equitable. But overall, the trade pattern between the Asian giant and the region remain unchanged – Latin America sells

América Latina y el Caribe: flujos estimados de IED china, 1990-2015

(En millones de dólares)

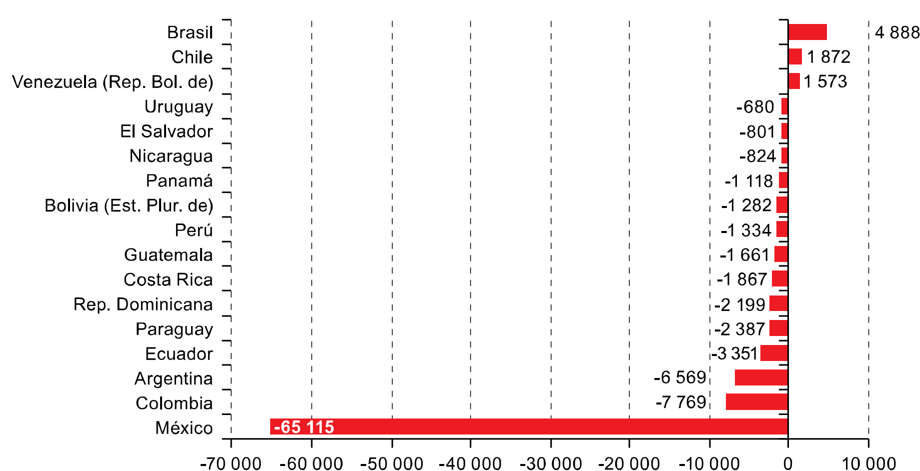
País	1990-2009	2010	2011	2012	2013	2014	2015
Brasil	255	9 563	5 676	6 067	2 094	1 161	4 719
Argentina	143	3 100	2 450	600	n.d.	n.d.	n.d.
Perú	2 262	84	829	1 307	2 154	9 605	2 142
Ecuador	1 619	45	59	86	88	79	94
Venezuela (República Bolivariana de)	240	900	n.d.	n.d.	1 400	n.d.	n.d.
Colombia	1 677	6	293	996	n.d.	n.d.	n.d.
Otros	1 146	14	867	150	34	70	n.d.
América Latina y el Caribe	**7 342**	**13 712**	**10 174**	**9 206**	**5 770**	**10 915**	**6 955**

Fuente: Miguel Pérez Ludeña, *"Chinese Foreign Direct Investment in Latin America"*, 2016, inédito, sobre la base de información de las empresas, Bloomberg, estadísticas oficiales de los países y China Global Investment Tracker.

Nota: n.d.=no disponible.

América Latina y el Caribe (países seleccionados): saldo comercial con China, 2015

(En millones de dólares)



Fuente: Comisión Económica para América Latina y el Caribe (CEPAL), sobre la base de fuentes oficiales nacionales. Los datos de El Salvador y Panamá provienen de Naciones Unidas, Base de Datos Estadísticos de las Naciones Unidas sobre el Comercio de Productos Básicos (COMTRADE).

China raw materials in return for manufactured goods, with the overall balance firmly in favour of China.

While China displaced the European Union (EU) in 2014 as the region's second-largest trading partner, Barcena noted that the export basket from Latin America & The Caribbean to the Asian giant is still much less sophisticated than what is sent to the rest of the world.

By way of illustration, five products alone represented 69% of the value of regional shipments to China in 2015, while manufactured goods made up only 8% of regional sales to China. Likewise, 90% of Chinese FDI in Latin America between 2010-2015 was destined for extractive industries, led by mining and hydrocarbons (oil and gas). In 2015, moreover, just three countries – Brazil, Mexico and Chile – accounted for 70% of regional exports to China.

The need to build and diversify

Barcena emphasised that there are "significant opportunities for improving the quality of Latin America and the Caribbean's global insertion and moving forward with the Cooperation Plan 2015-2019—approved during the First Ministerial Meeting of the China-CELAC Forum, held in Beijing in January 2015—which includes US$500bn in trade and US$250bn of reciprocal Foreign Direct Investment (FDI) stock".

She stressed that "these opportunities entail jointly rethinking globalization to achieve better economic and financial governance, trade multilateralism without protectionism, and greater climate security, peace and stability; establishing innovation as a pillar of development, with the stimulus of science and technology, providing incentives for productive diversification and adding value to exports; promoting an inclusive and sustainable economy, strengthening open regionalism with more trade and investment, with cooperation on matters of energy, natural resources, infrastructure, industry, innovation and connectivity, as well as with the circular economy, accompanied by an environmental big push and low-carbon development; improving the distribution of gains (income and capital); and increasing cooperation and cultural exchange between both sides".

For his part, President Xi, reaffirmed "the comprehensive strategic partnership between China and Latin America & The Caribbean to foster their people's development in the current global circumstances". He advocated "bolstering trust to contribute to new progress and objectively explaining the complementary advantages of both sides, while also promoting cooperation models that

have an innovative spirit". Bárcena indicated that the visit by the Chinese premier allowed for a joint rethinking of the traits of globalization and a broadening of the view of the relationship between both sides. "It is time to build bridges, not walls, to open markets, not close them, to respect differences and build a shared home for the generations to come," she stressed.

REGION

Corporate Radar

Tough at the top in Brazil. According to a report by the *Bloomberg* news agency, the Brazilian recession is taking its toll on chief executives. At least 40 of the CEOs of 110 Brazil-based companies with assets of US$1bn or more have been replaced over the last two years, the report said. "Periods of crisis tend to drive up the exits of C-levels. This was intensified this year by a series of events in which you have a serious conflict between the interest of the company and the ones of shareholders and boards", said Adeopato Volpi Netto, head of capital markets at Eleven Financial Research.

In October, Roberto Oliveira de Lima resigned abruptly as CEO of the beauty products company Natura Cosméticos after earnings missed analysts' forecasts. Amos Genish of Telefónica Brasil has said he is stepping down for personal reasons at the end of this year. Bayardo Gontijo stepped down from Oi, the telecoms company in bankruptcy protection, after disagreements over how to reduce its heavy debt load. Education supplier Estacio Participaçoes has had no less than five different CEOs this year as part of a battle for control of the company. Itaú Unibanco, Brazil's largest bank, has announced that Candido Bracher will take over from Roberto Setubal as chief executive in April 2017. Aerospace group Embraer said in June that CEO Frederico Curado was stepping down for personal reasons: less than two months later, its shares slumped after announcing a surprise second quarter loss and the fact that it was under investigation under the US Foreign Corrupt Practices Act. In October, Embraer announced that it was paying a US$205m fine to the US authorities to settle the investigation.

Chinese investment in Mexico. The first major foreign investment in Mexico after the US elections has a significant Chinese component. On 16 November, the government led by President Enrique Peña Nieto announced that the 20-year contract to build and operate a wholesale mobile communications network, which eventually could be worth up to US$7bn, had been awarded to the only bidder: the Atlán consortium. This is led by a Spanish telecoms businessman Eugenio Galdón, an infrastructure fund managed by Morgan Stanley, and the China-Mexico Fund, managed by a unit of the World Bank.

The China-Mexico Fund is the second largest shareholder in the venture with a 23.36% stake, after Morgan Stanley with 33.38%. The network was conceived as part of Mexico's 2014 telecoms reforms, designed to reduce market dominance by América Móvil and promote greater competition and more competitive interconnection charges.

The deal is considered something of a risky investment however, given some uncertainty over telecoms demand in future years, and the requirement to offer low-cost service in isolated rural areas of the country. Rivada, a US-based company that was disqualified from the bidding on the grounds that it failed to provide financial guarantees by a 20 October deadline, has said it plans a legal appeal.

Mexico postpones oil and gas auction results. Mexico's oil and gas regulator, the Comisión Nacional de Hidrocarburos (CNH), has approved a govern-

ment proposal to delay the results of the second phase of the Round Two auctions of oil and gas exploration and production (E&P) contracts. The announcement will be pushed forward from 5 April to 12 July next year. This will allow the 12 E&P contracts to be announced on the same day as a further 14, which are due in the third phase of Round Two.

Contracts from these two phases are mainly for onshore gas prospects in the Burgos basin, in Tampico-Misantla, Veracruz, and in the southeast basin, in Tabasco and Chiapas. The auctions are part of the government's policy to attract investment for international oil companies to help it reverse falling oil and gas output from mature fields.

The results of an earlier phase of E&P auctions are due to be announced on 5 December – these involve deep water blocks in the Gulf of Mexico close to the US border, as well as a call by state-owned oil company Pemex for partners to help it develop the deepwater Trión block.

Viacom makes Argentina move. US media company Viacom has agreed to buy Televisión Federal (known as Telefe), Argentina's largest TV network, for a cash payment of US$345m. The seller is Spain's Telefónica, which has been following a programme of asset sales to reduce its levels of debt. Significantly, the deal will make Viacom the first US company to operate a free-to-air TV network in Argentina in almost 50 years. Apart from the main network, Viacom is also acquiring eight Telefe provincial networks, an international pay-TV channel, online platforms, and, importantly, 12 production studios and some 33,000 hours of existing Spanish-language content.

According to media specialist Martín Becerra, "If it is true that they want to create a production centre for all of Latin America, this would be a very good place to do that. Telefe has a very significant archive of content, but what Viacom is really buying is the production capacity".

The deal may be followed by other US companies, as both Turner (a division of Time Warner) and Fox (owned by News Corporation) are reported in talks to buy *Fútbol para Todos* (FTP), a state-owned sports programme which holds football match broadcasting rights.

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