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Drenched and shaken

The last six weeks have seen an unusually severe combination of natural disasters sweeping across Mexico, the United States, and large sections of the Caribbean. What are the economic implications, and the lessons for the future?

Earthquakes, tropical storms and hurricanes have lashed the region back-to-back in the past month. Starting on 25 August, Hurricane Harvey caused massive flooding in Texas and Louisiana, leaving an estimated toll of 82 deaths and economic losses of over US$70bn. On 7 September, an 8.1 magnitude earthquake struck off Mexico's Pacific coast, leaving a death toll of over 98, mainly in the states of Oaxaca and Chiapas. On 9-10 September, Hurricane Irma (which reached the highest 'Category 5' level of intensity) battered Barbados, Anguilla & Barbuda, the Virgin Islands, Cuba, Haiti and Saint Martin before making landfall in Florida. Overall, Irma's toll is estimated at 84 deaths, with material damage of US$60bn.

In the days after 18 September, Hurricane María also underwent a sharp intensification of wind speeds to Category 5, causing major damage in Dominica, the Dominican Republic, Haiti and Puerto Rico. The death toll was reported to be 65, mostly concentrated in Dominica and Puerto Rico. On 19 September, Mexico was hit by a second, lower intensity (7.1) but more destructive earthquake, given that its epicentre, in Atencingo in Chiapas state, was closer to Mexico City, where over 40 buildings collapsed, with the death toll put at 360 in late September.

A briefing paper prepared by the Inter-American Development Bank (IDB) provides some economic context for these latest disasters. Encouragingly, it notes that the evidence to date is that most countries are able to rebuild and recover quite rapidly from natural disasters. The exceptions include the December 1972 earthquake in Nicaragua and the December 1978 earthquake in Iran, where economic growth did not properly recover for a decade. However, in both cases, the natural catastrophes were followed by revolutionary political change and major economic upheaval – which was also a factor.

Latin American and Caribbean countries are particularly vulnerable to earthquakes, hurricanes and storms. According to a risk index published by the United Nations (UN) in 2015, and which tries to take into account both exposure to natural events on the one hand, and the ability of societies to respond to them on the other, four countries in the region are particularly vulnerable: Guatemala, Costa Rica, El Salvador and Nicaragua. It is important to consider that not all natural disasters are catastrophic. For countries most vulnerable to hurricanes, a category that includes many of the Caribbean islands, the statistics suggest that every year they face only a 2-5% chance of a catastrophe entailing output falls of 4% or more without the prospect of short-

term recovery. That said, the IDB acknowledges that when a catastrophe does strike, it can set off an extremely damaging economic chain reaction. Both industry and agriculture can be wiped out and basic activities needed to ensure a functioning government – such as tax collection – can be paralysed.

Also of particular relevance to the Caribbean is the finding that it is more difficult for smaller economies to mobilise post-disaster relief. One example: Sri Lanka has had more difficulty dealing with cyclone reconstruction than neighbouring India, because India, as the much larger country, has been able to mobilise resources from distant and unaffected areas of its own territory, as well as having options to use them for the resettlement of those left homeless. Small countries tend to have less diversified economies, which also hampers recovery.

Being better prepared for the future is an important objective. The IDB says that countries with a higher internal savings rate tend to have greater internal 'fiscal space' to allow emergency spending. It also stresses the importance of good governance and the rule of law. It gives the example of the 8.8 intensity earthquake and tsunami suffered by Chile in 2010, which left over 500 dead and caused some US$30bn in material losses (equivalent to 19% of GDP). To overcome this major setback, it was critically important that Chile had been able to increased its internal savings rate by 11 percentage points (it achieved this gradually in the 1985-2012 period), thereby giving it the necessary fiscal room to rebuild without having to rely on foreign aid. Also important was a legal framework that enforced strict building codes, as well as a decentralised network of emergency services able to operate even when communications with the capital were limited. The IDB makes the interesting point that emergency foreign aid has generally played a comparatively small role in disaster recovery. A study of 98 natural catastrophes in 1970-2008 showed that foreign aid received was equivalent to only 0.25% of GDP and only 3% of the total estimated economic damage.

While government-contracted disaster insurance is seen by many not very cost effective, the IDB does suggest that tradeable catastrophe bonds (known as cat bonds) issued by governments and re-insurers can be helpful to cover some key expenses, although typically they pay out only a small fraction of total damages. Mexico was one of the pioneers in this form of disaster insurance, issuing a US$160m cat bond in 2006 to cover earthquake risks; it was subsequently expanded to US$360m.

Mexico earthquake damage around US$2bn: The preliminary assessment of material losses caused by the two earthquakes on 7 and 19 September is around US$2bn, the Mexican government said on 28 September. In total, it reported that 150,000 residences had been damaged, with 250,000 people made homeless. The death toll, not yet finalised, stood at 435 as of end-September. President Enrique Peña Nieto said that MXN13bn (US$712m) would be needed to rebuild schools, plus MXN16.5bn (US$ 904m) for homes; and MXN8bn (US$438m) for infrastructure and cultural assets. The president added that the draft 2018 budget, already submitted to congress, likely would undergo some reallocation of resources to deal with the relief and reconstruction efforts. The federal government will also draw down from its existing disaster fund – Fondo de Desastres Naturales (Foden) – which currently amounts to MXN6.036bn (US$330m). This will not be enough to cover the work needed. Private sector estimates of the total damage caused by the two earthquakes are significantly higher, ranging between US$4bn and US$8bn.

Given that the country's presidential election is due in only nine months' time (June 2018), there is a possibility that the handling of the earthquakes and the quality of the emergency response will become a hot political topic. A number of critics have already suggested that after three years of budget cuts, Mexico's ability to respond was constrained. In fact, the disaster response

budget has been cut by around 50% in recent years, as part of the fiscal austerity triggered by the fall in oil and gas revenues after 2014. The 2017 budget reduced available funds for civil protection by 25.6% to MXN6.4bn (US$351m). According to a UN assessment, every dollar spent on disaster preparation ends up saving seven dollars-worth of rescue and recovery expenditure. A number of officials and experts are therefore arguing that Mexico cut its preparation and disaster readiness spending by too much.

Enrique Guevara, a former director of the disaster prevention centre (Centro Nacional de Prevención de Desastres de México, Cenapred) commented: "My concern is that more should be invested in prevention. First, because it saves lives. And second because it saves money during the reconstruction phase".

Cenapred itself, set up after the 1985 earthquake in Mexico City, suffered a 20% budget cut in 2012-2016. An early warning system, known as Centro de Instrumentación y Registro Sísmico, Cires) did send early warnings to many Mexico City residents. It is funded mainly by the Mexico City authorities and the state of Oaxaca and operates on just MXN30m (US$1.6m) a year. However officials say it needs to be expanded and upgraded. Cires director Juan Manuel Espinosa says that with some extra investment the system could have alerted citizens of the impending quake at least 5 seconds earlier, but that repeated requests for extra funding submitted to President Peña Nieto had been met with "silence".

REGIONAL ECONOMY REVIEW

MEXICO

Uphill work on NAFTA renegotiation

Despite talk of progress, there was no evident breakthroughs in the third round of NAFTA renegotiation talks held by Canadian, Mexican and US negotiators in Ottawa on 23-27 September. The fourth round is set for Washington DC on 11-15 October.

It is hard to judge how the NAFTA renegotiation talks are progressing. The broad approach has been to identify potential areas of agreement to deal with first, before moving on to more contentious issues later. Accordingly, officials said they had completed the chapter on small and medium-sized enterprises (SMEs), and advanced in other areas including competition policy, digital trade, state-owned enterprises, sanitary and phytosanitary measures, customs and telecoms.

Mexico's Economy Minister Idelfonso Guajardo says at least a dozen difficult chapters remain to be tackled, and that there are also "elephants in the room" – in reference to big issues of contention such as local content rules in the auto industry and the US push to cut its trade deficit – which have not yet been addressed. This has led one industry observer, Nate Herman of the American Apparel and Footwear Association, to conclude, rather inscrutably, that "things will either really get moving or come to a halt".

There are some who claim that whether there is a deal or not doesn't matter that much. Two thirds of 38 banks and institutions surveyed by *Reuters* said the outcome of the NAFTA talks would be largely neutral or positive for Mexico and Canada. The consensus appeared to be that Washington would not ultimately follow through on President Donald Trump's protectionist rhetoric. According to Brett Ryan of Deutsche Bank in New York, "Any changes will likely be incremental. US corporations, particularly automakers, would be at substantial risk of supply chain disruptions. The US farm lobby would also be opposed". Admittedly, of the *Reuters* poll respondents, 60%

said they remained "somewhat concerned" that Trump might pull the US out of NAFTA. Seeking to minimise the impact of a breakdown in talks, Mexico's Foreign Minister Luis Videgaray told the US Council on Foreign Relations that there would be "life after NAFTA" and that Mexico would bounce back.

But there are still serious risks. Given their sheer complexity, completing the negotiations before the end of this year – so as to avoid overlapping with the Mexican presidential election campaign in the first half of 2018, and the US mid-term congressional election campaign in the second half of 2018, is looking increasingly difficult. There are also raised tensions between Canada and the US, after a US trade panel said it would impose punitive tariffs on Canadian jet manufacturer Bombardier, after a complaint from its US competitor Boeing that it was benefiting from Canadian government subsidies. This could impact the next round of talks, which includes dispute resolution (Chapter 19) and rules of origin. The US delegation has also presented a potentially contentious draft text on labour standards within NAFTA countries; Canada is eager to improve labour conditions, while Mexico may be wary of measures that might too-sharply reduce its competitive advantage in wages (which are the lowest of the three countries).

Playing the China card?

During the second round of NAFTA talks, held in Mexico City in early September, President Peña Nieto was conspicuously absent. He was attending an event on the margins of a summit of the BRICS emerging economies group in Xiamen, China. The trip to China was widely seen as an attempt to show that Mexico can diversify its trade relations away from its current dependency on the US (which takes over 80% of Mexican exports) to new partners such as China. Some economists argue that this is difficult on the grounds that the Mexican and Chinese economies are not complementary, and are competitors for access to the US market.

But there is indisputable evidence of increased links between the two countries. Peña Nieto has visited China four times since his election in 2012. China is now Mexico's third largest trading partner, although trade flows remain somewhat unbalanced. In 2016, Mexico exported US$5.4bn to China, with imports from China worth 12 times that, at US$65bn. Jorge Guajardo, the former Mexican ambassador to China, has commented that prospects for increasing Mexican exports to the country are limited. Because both countries are manufacturing powerhouses "We are competing against each other: sure, there is an interesting market in China for Mexican agricultural products, like avocados and berries, but that is a very, very, protected market". Notably however, Mexico is also beginning to attract significantly more foreign direct investment (FDI) from China, which could deliver alternative gains for Mexico from its relationship with Asia's economic giant.

Questions over growth

Despite the continuing weakness of the oil sector, and the shock of the 'Trump factor', Mexico's overall economic growth, driven by a resilient consumer market, has held up much better than most private economists had predicted. Indeed, the central bank (Banxico) recently nudged up its GDP forecasts for 2017-2018, and struck a positive tone on the NAFTA negotiations.

The country's key industrial sector, however, is flatlining for the third consecutive year, dragged down by the stagnant oil sector, as well as reduced public sector capital investment as the Peña Nieto government seeks to chip away at the fiscal deficit. The index of industrial production (IP) contracted by 1.6% year on year in July, the national statistics institute (INEGI) reported, following a 0.3% drop in June. The result, the worst since April (-3.9%), was led by an 8.7% drop in mining (which includes the oil sector), followed by construction (-3.7%) and electricity & water (-2.9%), reflecting the still largely subdued domestic economic activity.

In the closely-watched manufacturing sector, which is by far the main component of the IP index, sectors linked to oil, chemicals and heavy engineering and construction have been persistently weak, against which export-oriented manufacturing has been thriving on stronger US demand – latterly boosted by a favourable exchange rate. The US has been taking in more transport and machinery, electronics, computing equipment and cars and trucks from its southern neighbour. Mexico's automotive exports rose 13% in the first seven months, for example, with 76.4% of those US-bound. Yet the latest overall manufacturing growth figure in July – of +2.2% year on year – was notably less dynamic than in previous months, prompting concern about a slower performance over the second half. A weak July result for INEGI's index of economic activity (IGAE), a proxy for overall GDP, added to fears about a second half slowdown, with the primary, secondary and tertiary sectors all posting month-on-month falls, for an overall result of -0.7%, which was the worst monthly result since April 2016.

Overall, the year to date IP result of -0.5% (corresponding to January-July 2017) was still better than the year-earlier result of -1.0%, and business confidence indices are inching towards the turning point of 50 (anything above 50 indicates optimism). Nonetheless, a continuing volatile industrial performance is the most likely scenario for the rest of this year and well into 2018 – until the future status of NAFTA is clear, and the outcome of the July 2018 presidential election is known.

Following its optimistic public statement in mid-September, Banxico on 28 September opted to leave the benchmark interest rate unchanged at 7%. It had last increased rates in June in a drive against inflation. While inflation hit 6.7% in August, the highest since May 2001, Banxico nonetheless expects lower inflation to year-end and into 2018, chiefly thanks to a stronger peso rate in recent months. The inflation decline will be very gradual, however; Banxico only expects the headline rate to get back down to 3%, the mid-point of its target band, ii late 2018, meaning that it likely will only embark on an interest rate cutting cycle as of 2019.

There are other factors at play in the meantime – chiefly the NAFTA talks and Mexico's 2018 presidential election, as well as a potential increase in US (and global) interest rates – all of which could lead to renewed exchange rate volatility in coming months –the Mexican peso being the most-traded emerging market currency. Against that uncertain backdrop, and despite some private sector concerns about economic growth and investment prospects should AMLO be elected, Banxico – soon to bid farewell to the steady hand of Governor Augustín Carstens after a decade at the helm – faces another challenging period in the near term in which it may prefer to temporarily concentrate on protecting domestic financial solidity and exchange-rate stability over any monetary stimulus in support of faster economic growth.

New bond issue underlines Meade's responsible management

Meanwhile, José Antonio Meade, who has presidential ambitions for the ruling PRI, continues to demonstrate impeccable managerial credentials as finance minister, with a new external bond issue, the second since March, aiming to mitigate risk ahead of 2018. The sovereign on 2 October issued USD1.88 billion in bonds in a refinancing operation designed to repay a January 2020 bond in more favourable conditions. The new 30-year reference bond, due February 2048, has a 4.6% coupon (and a similar yield), versus a 5.125% coupon on the 2020 bond.

Underscoring strong foreign investor confidence in Mexico, the issue had the highest demand ever registered for a Mexican foreign currency bond. A statement from the finance ministry said the issue was 4.3 per cent oversubscribed, with 300 orders registered from the Americas, Europe, Asia and the Middle East.

It also stressed that the new issue covers 51% of external debt due in 2020 without incurring additional indebtedness, as per Meade's strategy to reduce the public sector borrowing requirement to 48% of GDP by-year end, from 50.1% in 2016.

This strategy not only improves the debt-to-GDP ratio but also makes the debt position more sustainable, and less vulnerable to factors including the NAFTA talks, the July 2018 presidential election and normalising global interest rates, which risk volatility in the highly-traded peso.

Corruption and competitiveness linger as issues

Mexico failed to make any gains on the latest (2017) Global Competitiveness Index compiled by the World Economic Forum (WEF). Its global ranking was unchanged at 51 (of 137 economies included in the index for 2017) and it dipped to fourth in the regional table, overtaken in third place by Costa Rica. The WEF pointed to a decline in the recent pace of reform – after the dynamism of the first couple of years of the current administration, as well as a slower pace too in the country's economic growth.

Corruption, however, continues to stand out as the most problematic factor by far for doing business in Mexico. Closely related is institutional weakness, and not only public, with weak corporate ethics and responsibility also weighing on private institutions. Despite reforms to legal and judicial frameworks, progress against corruption on the ground remains to be seen, with much depending on enforcement – typically by institutions and agencies of varying quality. The recent earthquakes unmasked both corruption and enforcement failings. Mexico City's attorney general has now opened 40 criminal investigations relating to building collapses (both public and private). It is looking into alleged fraud and document falsification, but has said that manslaughter charges could also be a possibility.

BRAZIL

Positive signs on the economy

Despite the ongoing political crisis and record low popularity ratings for President Michel Temer, there are some modestly-positive signals emerging about the state of the Brazilian recovery.

London-based consultancy Capital Economics (CE) notes that the consensus view on the Brazilian economy has been quietly improving. Recent economic activity data has been good, and points to a strong start to the third quarter. Some months back, the consensus view among economists was marginal GDP growth of 0.3% this year and no more than 1% in 2018. Now, the consensus is for growth of 0.7% this year, strengthening to 2.3% in 2018.

CE points out that the economy has been boosted by a series of tailwinds. One such assist was a policy change in March allowing households to access previously dormant pension funds and thereby gave a boost to consumer spending. This stimulus will fade, but consumption is expected to continue growing. Another temporary stimulus is the fall in inflation, which is boosting purchasing power. Capital Economics estimates that inflation will begin to edge up in the next 6-12 months, reflecting the renewed life in the economy, but crucially, it expects price growth to remain below the 4.5% mid-point of the Central bank's target band, thereby allowing for a more sustainable recovery.

A key factor determining the strength of the recovery will be what happens to investment, which remains weak and subject to the ongoing political uncertainty. But even here, signs of a slower rate of contraction can be interpreted as a positive. CE comments: "Given that the contraction in investment shaved off 1% from GDP in Q2, simply getting to a point where it is flat would help the overall GDP numbers."

It is in this area that the government's privatisation programme may help generate some momentum. On 27 September, the government successfully auctioned four hydropower generators in the state of Minas Gerais for nearly US$4bn, roughly 10% higher than expected. The winning bids came from China's State Power Investment Corp (for the São Simão plant), Engie of France (for the Jaguara and Miranda plants) and Enel of Italy (for Volta Grande).

On the same day, there were mixed but on balance positive results from an auction of offshore oil and gas licences. With international prices still relatively depressed at around US$55 a barrel, there were doubts about the level of international interest, particularly as the blocks on offer did not include the potentially high-yield pre-salt offshore deposits. The authorities were indeed only able to allocate 37 out of 287 blocks on offer, well below their hoped-for target of over 100.

But this disappointment was offset by some high bids on the blocks that were allocated. A total of 17 companies made successful offers, attracting around US$1.2bn in initial payments. Exxon Mobil returned to Brazil winning eight blocks, mostly in partnership with the state-controlled oil company Petrobras. China National Offshore Oil Corp (CNOOC) and Repsol of Spain also made winning bids.

High-value bids by Exxon and Petrobras in the Campos Basin, adjacent to pre-salt blocks, likewise encouraged the government. "We hope we have turned the page", stated the minister of mines and energy Fernando Coelho Filho, adding, "We want to promote a competitive exploration and production market in Brazil". Pre-salt blocks will be included in two further licensing rounds due to be announced in October, which officials hope will give a sense of continuing momentum.

U-turn on Amazon mining reserve: Faced with opposition from a range of environmental groups, President Temer has decided not to open up a key area of the Amazon to mining. The government said it was revoking an earlier decree designed to open up the vast area, known as the Reserva Nacional de Cobre e Asociados (Renca). The ministry of energy and mines nevertheless commented that the factors underpinning the proposal remained valid and would be debated "on a separate occasion" and in "as democratic a fashion as possible". In a statement, it emphasised that "the country must grow and create new jobs, attracting investments in the mineral sector, especially so that the economic potential in the region can be exploited."

Greenpeace, the environmental lobby group, stated: "No president is completely immune to public pressure", describing the policy U-turn as "a victory of society over those who want to destroy and sell the forest." Renca, covering 46,100 square kilometres (an area slightly larger than Denmark) was created in 1984 and is known to contain significant gold, iron, and copper deposits.

ARGENTINA

On the recovery track

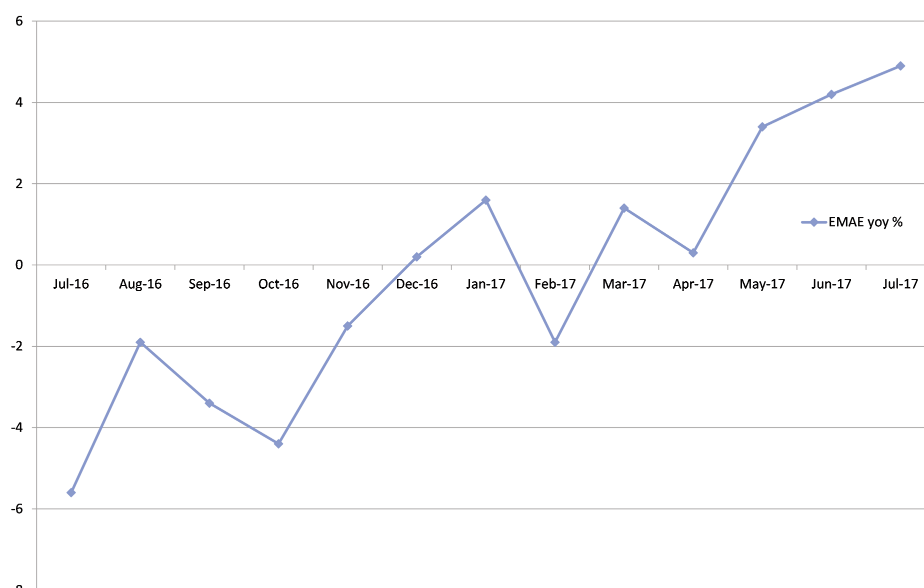
President Mauricio Macri's much-promised economic recovery may be finally emerging, albeit in a slightly lop-sided way. The national statistics institute (INDEC) reported GDP growth of 2.7% year-on-year in the second quarter, up from 0.3% in the first.

Both investment and consumption played a prominent role in moving the economy forward in Q217. Fixed investment grew by 7.7% y-on-y, while private consumption was up by 3.8% on the same basis. This surge in demand is attributed at least in part to government pump-priming in the run

up to the mid-term congressional elections due on 22 October. But it has also laid bare a continuing weakness: Argentina's trade performance remains poor and the desired export-led boom is just not happening. Trade continued to make a negative contribution to GDP, with exports falling by 1.1% y-o-y in the second quarter, while imports ballooned, growing by 9.1%.

GDP back in positive territory

% change year-on-year EMAE economic activity indicator



Source: *INDEC*

According to INDEC's GDP proxy, Estimador Mensual de la Actividad Económica (EMAE), the recovery has continued into Q317. In July, the EMAE index rose by 4.9% on a year-on-year basis, the highest such monthly increase in the past two years. The average EMAE reading for the first seven months of 2017 was up by 2.1% on the comparable year-earlier period. Local economists noted that the seasonally adjusted EMAE index had come back up to virtually equal the last peak achieved in June 2015, towards the end of the kirchnerista administration of President Cristina Fernández de Kirchner (2007-2015). The daily *La Nación* observed that taking December 2015 as the basis of comparison (which is when Macri took office) it could now be said, as of July 2017, that "the macrista economy has now overtaken the kirchnerista economy, on the official data."

The July EMAE data showed that 13 out of 15 economic sectors were growing in y-o-y terms. The two exceptions were electricity gas & water (-1.9%), and mines & quarries (-4.6%). Among the growth sectors, construction led the way (+15.7%), followed by financial intermediation (+6.9%), industry (+5.4%), trade (+5.3%), and real estate, business & rentals (+3.5%). In a research note by the local consultancy Labour, Capital & Growth (LCG), Melisa Sala argued that if the current rate of expansion remained steady for the rest of the year, Argentina would post real GDP growth of 2.6% in calendar 2017; and she projected a rise to 3.0% in 2018. According to Sala, base period effects explain the rebound, coupled with private sector investment and spending on public works.

Separately, ratings agency Moody's said it expected the Argentine economy to grow by 3% this year and by 3.5% in 2018. In a September report, it said it expected the Macri government to tighten up fiscal policy after the elections, reducing the deficit by around one percentage point of GDP. Moody's said that the deficit in 2017 would be in excess of 6% of GDP, with a public debt to GDP ratio of 53%, rising to 56% in 2018. Moody's warned of continuing high inflation and stated that a high proportion of dollar-denominated debt exposed the government to exchange rate risk.

PERU

Claudia Cooper's in-tray

Claudia Cooper became Peru's latest minister of economy and finance on 17 September, following a cabinet reshuffle forced by a congressional vote of no confidence in the cabinet led by Prime Minister Fernando Zavala. Cooper becomes the third minister in charge of the economy in the last 14 months. She inherits a full in-tray.

At one level, Cooper's task is simple: to deliver on the promises of growth and recovery made by her two ministerial predecessors to date under the presidency of Pedro Pablo Kuczynski. These were Alfredo Thorne (July 2016 – June 2017) and Fernando Zavala (June-September 2017, a period when he doubled up as both prime minister and economy and finance minister). Both men were forced to step down as a result of no-confidence votes delivered by the opposition Fuerza Popular (FP, Fujimorista) party, which holds an outright majority in the legislature, so Cooper is taking on a politically sensitive role.

She is no newcomer to the ministry (known by its Spanish acronym, MEF). In fact, she served as deputy minister to Thorne and Zavala, as well as being a MEF adviser back in 2008-2009. As part of Thorne's team last year, she was directly involved in implementing his project to cut the rate of VAT by one percentage point to 17%. Cooper studied economics at the Universidad del Pacífico and took a Master's degree at New York University (NYU). She has worked for Banco de Crédito del Perú (BCP) and as a consultant for a range of organisations.

According to Carlos Oliva, a former deputy at MEF, Cooper will face at least five major challenges. The first, as he puts it, is just keeping on top of the "day to day" job, since the minister has a whole range of extra duties including presiding over the national investment agency Proinversión and the development fund Fonafe, as well as sitting on the board of the (troubled) state oil company Petroperú.

The MEF role also entails the politically-tricky task of trying to secure congressional support for economic policy. This leads to Cooper's second and immediate challenge, which is to steer the 2018 budget through the Fujimorista-controlled congress. Zavala, her immediate predecessor, had just submitted the draft budget earlier in September. Contemplating a 10.3% increase in the total public sector spend to PEN157.16bn (US$48.2bn), the draft plan prioritises health, education, security and reconstruction (following the floods and mudslides caused by the *El Niño Costero* weather pattern earlier this year). In some of her first statements as minister, Cooper said she would maintain fiscal stability, despite pressures from within and without the government.

The new minister's third challenge is to consolidate the new system for managing the pipeline of major public and private investments, known as Invierte.pe. This is of great importance, as maintaining a good flow of major investment projects is one of the keys to securing a good rate of GDP growth.

A big part of the slowdown in GDP growth this year (to an expected 2.8%) is being attributed to delays in the investment pipeline, such as the postponement of the US$7bn Gasoducto del Sur Peruano (GSP) and the US$520m Cusco airport project, both affected by claims of corruption and other irregularities. The new minister says she plans to pick up the pace, making US$9bn worth of investment projects viable this year.

Cooper has also indicated that she may revisit the issue tax reform, suggesting that tax breaks for small and micro-enterprises are inefficient and

are being abused. Congress rejected a first attempt to eliminate these tax concessions, but Cooper says she will take up the issue again.

The fourth big task is to try and revert the long slump in private sector investment – set to contract for the fourth year running in 2017. The difficulty here is that both her predecessors promised that an investment recovery was just around the corner. Cooper risks sounding like a broken record, and will have to do something to make this claim more credible. That said, she has admitted that private sector investment will fall by 2.3% this year, before growing by 3.5% in 2018. The economy posted GDP growth of 2.4% year-on-year in the second quarter, up from 2.1% registered in the first quarter, according to the national statistics institute (Inei). This was largely driven by reconstruction work to deal with the El Niño-related damage, but apart from this investment remained stagnant.

Finally, according to Costa, amid all these short- to medium-term challenges, Cooper will also need to find the time to think long-term, in particular about one of the most important issues facing the country – the need to improve productivity and competitiveness.

Mining recovers

Peru could receive US$11.4bn between now and 2020 in investment in new mining projects according to Magali Arellano, manager at a local trade journal publisher, *Peru Top Publications*, who was speaking at a recent mining convention in the southern city of Arequipa. This is expected to come from 15 new projects (some of which expand existing ones) at five copper mines, one silver mine, two iron mines, one zinc mine, and one tin mine. Some of the main copper producing mines are the Ariana and Toromocho projects in the central Junín region, the Quellaveco project in southern Moquegua region, and the Toquepala project in the southern Tacna region.

Peru's mining sector is beginning to grow again following three years of contraction, Cooper told the convention. In the second quarter, mining sector activity rose by 1.9% year on year, on Inei data, reflecting not only higher metals prices but also improving investment confidence.

Peru targets service exports

Peru is the world's second largest producer of copper, silver, and zinc, and an important producer of a wide variety of agricultural crops, as well as fish and other traditional items. As such, it has long been known as a primary export country. However, according to Luis Torres Paz of Promperú, the Kuczynski government has decided to target the expansion of service exports, in a bid to diversify and add higher value to the country's export basket.

Service exports will be worth about US$6.76bn in 2017, according to Torres Paz, and the aim is to double this to US$13bn by 2021. Promperú reports average annual growth of 10.5% in service exports in in the 11 years between 2005 and 2016, going from US$2.3bn to almost US$5bn. Services exports accounted for 13% of total exports last year. (The country's total exports were valued at US$36bn in 2016.)

He makes the point that Peru, for instance, has developed an expert business and legal services sector in recent decades, firstly on the back of privatisation and more latterly centred round international infrastructure tenders – with a group of local companies now looking to export this expertise to third countries. It also has an expert tourism services sector, that the government also believes can be exported around the region.

In early October, the seventh 'Peru Service Summit' was held in Lima, attended by 100 Peruvian service export companies, along with 150 business people and investors from 19 countries. According to Promperú, which helps organise the forum, since its first event in 2011, the Peru Service Summit has

positioned itself as one of the main business services events in the region. The 2017 summit, running from 2-5 October, seeks to benefit Peruvian entrepreneurs exporting services including software, engineering, Business Process Outsourcing (BPO), marketing, graphic design, and editorial and graphics services. Buyers and investors from Argentina, Brazil, Bolivia, Canada, Chile, Colombia, Ecuador, Mexico, Spain, the US and Panama were attending. Opening the summit, the trade and tourism minister, Eduardo Ferreyros, said the organisers expected sales commitments worth some US$95m.

Torres noted that this year's summit started from a "an auspicious legal mark", following approval in July of a brand new law to promote services and tourism. He said he expected final sales commitments to exceed the projected US$95m. He also noted that Peruvian service companies increasingly are specialising in niche international market areas, such as specialist software for mining activities, environmental services, IT, and 3-D design and animation, to name just a few. These add to the 33 or so existing service categories including banking and financial services, business services, transport and tourism.

ECUADOR

A recovery yet to take root

Ecuador posted real GDP growth of 3.3% year on year in the second quarter, the third consecutive quarter of annualised growth, prompting much self-congratulation by the ruling left-wing Alianza Pais (AP). However, those private economists who more often than not tend to see the glass as half empty were much more cautious, noting that the result was less impressive than it appeared because it was largely a statistical correction from the sharp contraction in the equivalent quarter of 2016, when GDP had shrunk by another 2.5% (giving a full year of recession). As such, they suggest, it is too soon, as yet, to declare Ecuador's economy out of the woods.

In similar vein, according to the latest report from the internal revenue service (SRI), tax revenues rose by 10% year on year in August to US$1bn, the best result for the month in four years and the ninth consecutive month of recovery in SRI-administered tax earnings.

Overall SRI-administered revenues for the January-August period came to US$9bn, a rise of 11% year on year, and also the best result for the period in four years according to the SRI report. This US$9bn figure excludes the temporary 'solidarity contributions' imposed after the 7.8 magnitude earthquake hit Ecuador's Pacific coastal regions in April 2016, killing around 600 and causing an estimated US$3bn in damages. These solidarity tax earnings were worth an additional US$875m in January-August, thereby bringing the total tax take for the first eight months of 2017 to just under US$10bn.

However, this rise in tax revenues this year is somewhat misleading. While a rebound in the tax take typically indicates recovering economic activity, Ecuador has yet to demonstrate signs of a sustained recovery.

To a considerable degree, the year-to-date result in SRI administered taxes is the result of a one-off windfall in revenues, following removal of the global import surcharges (the so-called 'balance of payments safeguards') imposed by the Correa government in March 2015 to protect the dollarised economy during the downturn. These surcharges, ranging from 5% to 45% on some 3,000 tariff lines, were due to be removed as of March-July 2016, but following the earthquake they were extended temporarily for another 12 months, and were gradually dismantled to July 2017 instead, as per a WTO-agreed schedule.

Repressed import demand has thus rebounded in 2017, with a spike in associated tax revenues. While the VAT rate went back down to 12% from 14% as of 1 June – as a temporary increase imposed after the earthquake also expired – overall VAT revenues rose by 13% in the eight months to August to US$4.2bn. This included internal VAT revenues of US$3.16bn, up 9% year on year, with VAT earnings from imports of US$1.04bn, up 24%. Meanwhile, revenues from the special consumption tax (ICE), a progressive 5%-35% duty imposed on certain domestic and imported goods, rose by 53%. As such, the SRI now expects total revenues of US$13.4bn this year, above its internal target of US$13.2bn.

As we noted last month, the Moreno government's revised 2017 budget US$36.82bn plan appeared contradictory on several levels. First off, despite Moreno insisting on retaining an expansive expenditure stance, it envisages a sharp reduction in the fiscal deficit to 4.7% of GDP in 2017 (or roughly US$ 4.8bn), from a record 7.5% of GDP in 2016 (albeit the new finance ministry only recognises a deficit of about 5.6% of GDP). With oil revenues still subdued, the government said it was banking on increased tax revenues to fill that gap.

Total tax income – which includes the income administered by the SRI plus other fiscal earnings, such as royalties etc – was budgeted at US$14.76bn, a year on year increase of 7% from 2016, even though the GDP growth estimate for 2017 was slashed to 0.7% in the revised budget, from 1.4% previously. This budget assumption almost certainly will prove unfeasible, and the fiscal improvement impossible without fresh government borrowing.

As we had reported in our September edition, private economists in late August had estimated a 1.7% drop in overall tax revenues (SRI-administered and others) in the first eight months. Given the latest SRI results, these estimates look way too cautious. But while the windfall in SRI-administered taxes will certainly be supportive of the fiscal position, realistically the Moreno government will only be able to deliver a limited improvement in the fiscal deficit this year, largely financed not by taxes, but by additional indebtedness.

Meanwhile, the private sector is pressing the government for some tax incentive measures in Moreno's pending new economic program, due October. On 26 September, the consultative council set by the president to engage with the private sector, submitted 1,400 proposals, gathered from almost 400 working tables around the country since July. The council, led by the minister for industries and productivity, Eva García, was given a mission to come up with ways to stimulate private sector activity and investment.

These submitted proposals included a call for VAT rebates for exporters, a change in the advance corporate income tax payment (levied in July and September regardless of earnings levels), and the removal of the remittance tax on financial transfers abroad. Again, it is difficult to see how Moreno will be able to reconcile these demands for tax reform in support of private-sector led economic growth with the government's tricky fiscal predicament, not to mention the tense difficulties within the ruling AP, which is forced a delay in policy making. Moreno, in his apparent wont to please all sides, may end up disgruntling everyone.

Moreno looks to make savings in the public sector

The new government is leaving no stone unturned in its efforts to lower the fiscal deficit. Moreno in early September took aim at the bloated public sector, with Executive Decree No. 135, dated 1 September, aiming to 'reinforce austerity' and 'optimise expenditure'. Measures included a 10% across-the-board salary cut for senior public servants, including ministers, as of 1 September, and the suspension of some bonus payments. Labour Minister Raúl Ledesma said 7,242 public servants would be affected, saving US$34m a year.

In addition to a public sector hiring freeze, all public bodies, including state companies like Petroamazonas, have been ordered to review staff numbers, meaning possible job losses. Other cuts affect over-time, living, travel and security expenses, and advertising and communications outlays. A portfolio of state assets valued at US$300m will also be sold off, with the proceeds put towards Moreno's flagship public housing scheme, 'Casa para Todos' which aims to construct 325,000 new houses, two-thirds of which will be provided for free to poor and vulnerable families.

State media estimated total savings of US$400m from Executive Decree No. 135, albeit Finance Minister Carlos de la Torre struck a more cautious note. Moreno recognised a "complex" economic situation, but equally, he was at pains to stress that a 'paquetazo' – in reference to a major fiscal adjustment – was not on the new government's agenda.

Notably, cuts to the public sector risk slower budget execution, meaning a weaker government stimulus to the economy. Local consultancy Cordes calculates that the budget execution to end August was already down by 10.4% over the year-earlier period. Almost certainly, a more extensive fiscal adjustment would prolong the country's recession, which Moreno and his finance team desperately want to avoid.

VENEZUELA

Stakes are high as debt repayments loom

Speculation about whether the Venezuelan government will continue to make scheduled repayments on its external debt has been ongoing all year, but tensions are rising as several large repayments fall due in late October and early November. In total, over US$3.5bn falls due in October and November – which may be more than the central bank (BCV) holds in liquid reserves. The government has continued to repeat that it intends to make the repayments, indicating an ongoing desire to avoid default, but with the economy in such bad shape, it is unclear whether it actually has the funds.

The repayments are spread over the course of the next two months, with just over US$320m falling due on 12-13 October (relating to the PDVSA 2027 and 2037 bonds, as well as two sovereign instruments, maturing in 2019 and 2024). This is followed by US$237m on 21 October for two sovereign issues, before large repayments of just under US1.1bn on 27-28 October, relating to the PDVSA 2020 and 2022 bonds.

The 2020 repayment is particularly high because it includes US$842m in capital repayments. Another large repayment, again incorporating both capital and interest, falls due on 2 November, totalling just under US$1.2bn. The repayment schedule for the rest of November is lighter and involves six interest payments of around US$100m spread over a ten-day period starting on 7 November.

Gold versus cash

According to the latest BCV data, international reserves stood at just US$9.8bn at the end of September. The authorities have long kept most of this in gold, rather than in cash dollar holdings, with the ratio of gold to cash a long-running uncertainty.

The central bank publishes monthly balance sheets with this breakdown, but publishes with a significant time-lag (the latest relates to August) and also provides the breakdown in local currency, but the exchange rate used as the basis for these calculations is also unclear.

According to these balance sheets, international reserves more than doubled between the start of the year (BsF113trn) and August (BsF260trn), even though its headline US-dollar figure for reserves fell slightly over this period and the official exchange rate remained unchanged.

In that respect, the headline figures provided in the BCV balance sheets cannot be used as an accurate indication of US dollar versus cash holdings. However, the balance is interesting and provides insight about repayment capacity: in January, gold accounted for more than four times the value of cash holdings, but in August this had reversed, with cash accounting for over twice the value of gold. This potentially indicates that the monetary authorities have been selling gold, to free up liquid reserves to help make the repayments.

Indeed, the minister for ecological mining development, Víctor Cano, stated in early October that 4,007 kilos of gold from the Amazon mining zone (Arco Minero) had been added to BCV reserves since April. The Arco Minero is expansive, covering 12% of Venezuelan territory across the states of Amazonas, Delta Amacuro and Bolívar. The area is rich in gold, diamonds, coltan and other rare earth minerals. Output in the Arco Minero, long since stagnant amid nationalisation, international contractual disputes and disinvestment, has latterly been ramping up, after the Maduro government did a deal with Chinese companies to develop the area.

Undoubtedly, the Caracas authorities will be looking to monetise this freshly-mined ore as fast as possible in order to turn it into much-needed cash. The question is whether they will be able to cash in these shiny new gold bars. Amid US sanctions, international financial institutions increasingly are reluctant to deal with Venezuela. Citibank, involved in a gold swap in 2015, is among those that no longer deals with the Maduro administration, for example, having latterly withdrawn its correspondent banking services from the government (and Pdvsa).

There may also be other legal and reputational risks involved for mainstream financial institutions. There has been a lot of negative coverage of the Arco Minero in recent months; and the recent detention by the Venezuela security forces of a Dutch journalist has place a critical international spotlight on Venezuela's revived mining activity. The Arco Minero covers several protected areas, including indigenous reserves, as well as the Canaima UNSECO World Heritage site, which boasts a unique topography and is hugely biodiverse, with many native species. The area also contains 70% of Venezuela's freshwater supply. Environmental and rights activists have been making noise about deforestation and potential humans rights abuses in the area, including against indigenous communities. For its part, while the Venezuelan government insists that is complying with best practice and international treaty obligations, it has nonetheless been less than transparent about current activity in the Arco Minero. And, as with all government activity these days, there is a complete dearth of official data. Any indication that the Maduro administration is trying to cash in on gold mined in 'irregular circumstances' to service external debt almost certainly would deter some international institutions.

Seeking Russian support

Meanwhile, President Nicolás Maduro was due in Russia in early October to attend an international energy conference (Russia Energy Week, 3-7 October), where he was expected to meet his Russian counterpart, Vladimir Putin.

Maduro stated that his meeting with Putin would focus on financial, technological and military co-operation. However, the bilateral encounter almost certainly will serve as an opportunity for Maduro to seek further assistance from Moscow ahead of the looming repayments.

This may not take the form of direct foreign currency loans, but it may well involve a restructuring of Venezuelan obligations to Russia, which would indirectly help ease immediate liquidity constraints for the Venezuela

government. (In fact, Venezuelan media have been reporting about ongoing debt restructuring talks between Venezuela and Russia since August.) This, in turn, would increase the likelihood that Venezuela will make the large October-November repayments.

Aside from the debate about the government's capacity to pay, there are ongoing worries about an 'accidental default', triggered by bureaucratic delays in making payments. The Venezuelan authorities have been late in making payments before, but have subsequently made the payments within a 30-day grace period.

However, the large October-November repayments have no such leniency built into the clauses. Moreover, the large payment on the PDVSA 2020 bond on 27 October is backed by the US oil refining arm of PDVSA, Citgo, as collateral. This raises the stakes if Venezuela defaulted, as bondholders could look to seize Citgo's assets – in effect, compromising Venezuela's ability to trade oil. These concerns will add to the uncertainty as October progresses, making the economic situation even tenser.

PUERTO RICO

US dependency takes a battering

Puerto Rico sustained massive damage when the category-four strength Hurricane Maria hit the island on 20 September. The hurricane took down almost all electricity lines, as well as most communications networks, and deprived most Puerto Ricans of potable water. Not only will the damage prove extremely costly to repair, which will further cripple the already-stricken local economy, but the aftermath has aggravated relations between Puerto Rico and the US federal government.

The economy was already in a dismal state prior to Hurricane Maria, having been mired in recession for over a decade. The island economy is now only around the same size as it was in 2000. By comparison, on mainland US, the economy is 35% larger. This has spurred migration, with the island's population falling by over 10% between 2004 and 2016 to about 3.4m currently. Unemployment has fallen as people have migrated, but it remains high, at around 10%.

Economy was already in desperate straits

Part of the reason that the economy has been in recession for so long is the removal of tax concessions by the US federal government for US companies that set up in Puerto Rico: these were phased out gradually from 1996 but lifted entirely in 2006, prompting corporate disinvestment. The Puerto Rican authorities had become reliant on the income and investment generated by these companies and, in response to their departure, began accumulating debt.

Problems mounted in 2014, when Puerto Rican bonds were downgraded by several of the sovereign ratings agencies, losing their investment-grade status, which in turn triggered clauses in some bonds that meant the government had to repay them more rapidly than originally scheduled. A series of defaults followed, over the course of 2015-16, on several of Puerto Rico's bonds. The US government responded by establishing a Financial Oversight and Management Board (FOMB) that essentially controls fiscal policy on the island.

Who will fund reconstruction?

The main problem is that prescribed fiscal austerity in incompatible with the significant demands on expenditure in the wake of the extensive damage inflicted by Hurricane Maria. There are no official estimates of

reconstruction costs, aside from an acknowledgement that they will be huge, but estimates from the private-sector indicate costs of around US$30bn—representing around one-third of the island's GDP. The US government has made US$3bn available in relief aid, but at the same time President Donald Trump has said that "big decisions will have to be made" over reconstruction costs, heavily implying that the US authorities remain reluctant to foot a significant portion of the bill.

There has been significant criticism about Trump's response to the developments in Puerto Rico, relating both to the comparatively late response (it took some time to lift shipping restrictions to allow aid to arrive more quickly and the president is only set to visit the island in early October), as well as the fact that he appeared more preoccupied by a domestic spat over whether NFL players must stand during the national anthem. Comments from the president that Puerto Ricans seem to want everything to be done for them, when it should be a community effort, were received very poorly in Puerto Rico. Even Oxfam, which rarely criticises national governments, has come out and stated that the organisation was "outraged at the slow and inadequate response" from the US government, which, it said, was offering "excuses and criticism instead of a cohesive and compassionate response".

In for the long haul

Even assuming that both the US federal authorities and the Puerto Rican government get their act together with regard to the disaster response, it is likely to take several months to restore power to the island, which will also complicate the restoration of clean drinking water. Urban areas are likely to see the electricity networks reconnected within two months, but remote rural areas may be without power for up to ten months, on estimates by sector experts. With power networks out of action for so long, there will be a much greater reliance on diesel-fuelled generators, but this will prove expensive over such a prolonged period. Meanwhile, some communications networks have been reconnected, with around one-third of residents now having mobile phone coverage, but there is little indication of when the rest will be reconnected.

The scale of destruction will inevitably take a toll on virtually all areas of the economy, with the recession likely to deepen this year as economic activity remains paralysed and inflation likely to rise as a result of supply-side interruptions. Fiscal consolidation efforts will be derailed, with the deficit likely to increase, with knock-on effects on the already-high public debt stock, which already stands at around 70% of GDP. The only potential positive may relate to the negotiations with bondholders after the 2015-16 defaults, with investors potentially likely to concede more ground than otherwise would have been the case, which may allow Puerto Rico to exit technical default more rapidly than previously expected. However, this will come as little comfort to the Puerto Rican population, many of whom will be tempted to join the exodus of islanders who have left for the US mainland.

JAMAICA

IMF seal of approval

Following a 10-day trip in early September, the IMF has praised the Jamaican government's ongoing efforts to consolidate the public finances, improvement monetary policy management and reduce external vulnerabilities through reserve accumulation. The Fund only raised one main area of concern, highlighting the need to press ahead with public-sector reform, including job cuts and lower wage hikes. These challenges will test Prime Minister Andrew Holness and his government in the coming months.

Jamaica's impressive progress under IMF guidance – initially under an Extended Credit Facility (ECF) agreement and now under a Stand-By Loan Arrangement (SBA) – has continued. The Fund highlighted that the government had met all of its end-June qualitative and quantitative targets under the SBA, which will make an extra US$180m available to the Jamaican authorities, bringing total accessible credit to US$790m.

Primary surplus will ease debt burden

Out of all of the programme targets, the primary fiscal surplus is one of the most important, given that the Fund views a large surplus as crucial to reducing eye-watering level of public debt, which stands at around 115% of GDP. The government not only met its primary fiscal surplus target – which has remained at an extremely-high 7% of GDP in recent years – in the 2016/17 financial year, but the Fund has stated that the authorities exceeded this target by some margin, thanks to rising corporate tax revenue.

This is likely to result in the public debt to GDP ratio falling slightly faster than the IMF projects, potentially meaning that debt will fall below the 100% mark in 2018/19, rather than 2019/20, assuming fiscal consolidation continues.

To date, the main problem has been that prolonged fiscal austerity has taken a toll on the pace of GDP growth, which has been either negative or barely positive for several years. However, the IMF noted that GDP was strengthening, highlighting that economic growth has been positive for nine consecutive quarters, with a firmer overall rate of 1.6% projected for the 2017/18 financial year. Moreover, the outlook for medium-term trend growth is much stronger, at 2.5%-3%, as structural economic reforms boost investment.

External vulnerabilities have also eased, thanks to ongoing accumulation of foreign reserves, which now exceed US$3bn. Meanwhile, inflation has risen from last year's lows, but remains contained at around 4.5% year on year in recent months (well within the central bank's 4%-6% target range).

Controversial reforms on the way

The main area of concern remains forthcoming planned reforms to the public sector, including job cuts – which the IMF diplomatically referred to as a "scaling back of roles" – as well as a reduction of public-sector wages and pensions reform.

These will be politically-difficult for the Jamaica Labour Party (JLP) government. It has a narrow parliamentary majority and has so far benefitted from the fact that the opposition People's National Party (PNP) has been preoccupied by internal leadership issues, but there is a danger that the public will tire of ongoing fiscal reforms, particularly given that unemployment remains high, at 12.2% in April, according to the latest available data.

REGIONAL BUSINESS OVERVIEW

REGION

Not so clean technology?

Latin America, together with the rest of the world, may be approaching a tipping point that will bring together new production techniques together with cleaner, less carbon intensive and more renewable energy. Batteries, smart phones and other devices will be at the heart of the 'Fourth Industrial Revolution'. But this new Revolution looks to be repeating some of the sins of its predecessors, including child labour, poor working conditions, pollution, and waste.

There is a less-than-clean side of 'new technology'. The Global Battery Alliance (GBA), a public-private partnership launched on 19 September with the support of the World Economic Forum (WEF), intends to subject it to scrutiny and reform. The WEF defines the Fourth Industrial Revolution as an explosion of new technologies including robotics, artificial intelligence, the Internet of Things (IoT), 3D printing and autonomous vehicles. Together, these technologies are ushering in a revolution of productivity and what could be a decisive shift to low-carbon energy. While the change offers great and positive potential for the economies of the future, it also brings uncertainty and some negatives. The Global Battery Alliance acknowledges that there are downsides to the booming trade in batteries for smart-phones, gadgets, electric vehicles and renewable energy storage systems in households and cities.

Human rights group Amnesty International (AI) has highlighted the prevailing use of child labour in the mining of cobalt, used in smartphones. Benedikt Sobotka of Eurasian Resources Group (a mining company that has joined the GBA) says, "Unfortunately, there is an almost 100% chance that your smartphone or electric vehicle contains cobalt that comes from child workers in artisanal mines." Other metals used in the new devices such as lithium, nickel, manganese and graphite have been linked to pollution and water shortages.

These issues are likely to become more prominent. It is already calculated that a 12-fold increase in battery capacity will be needed to meet the demands of a low-carbon economy. The global battery market will be worth US$100bn by 2025, and batteries will account for 57% of world energy storage by 2040. There is a boom in high-performance lithium-ion batteries, but inadequate infrastructure to recycle them. Around US$52bn worth of electronic devices are discarded every year. Dominic Waughray of WEF points out the fact that, on average, people use a smartphone or tablet for just 26 months "and then throw it away, battery and all."

Cobalt is mainly mined in Africa, in the Democratic Republic of Congo (DRC), where child labour is frequently used, and in Zambia. But various Latin American countries also produce both cobalt and nickel (among them Cuba, the Dominican Republic, Colombia, and Brazil). The region is likely to play a major role in meeting booming demand for lithium. The salt flats of Uyuni in Bolivia, Atacama in Chile, and Hombre Muerto in Argentina form the so-called 'lithium triangle', which is reputed to hold 75% of the world's known lithium deposits. In Colombia, it has been calculated that 70% of existing mining activity is illegal, with an estimated worth of US$2.0bn a year. Metals mined in Colombia include gold, tungsten and coltan (columbite-tantalite, also used in a range of electronic devices).

CENTRAL AMERICA

Mixed prospects for customs union

El Salvador and possibly Nicaragua are considering whether to join the Guatemala – Honduras customs union.

Guatemala and Honduras have been running a small customs union experiment since 27 June this year. Three border posts on the common border, at El Florido, Agua Caliente-Corinto and Entre Ríos, have been upgraded. At these customs points around 80% of bilateral trade is allowed to cross on a tariff free basis (the zero-rated list excludes 38 products, including live animals, some meat cuts, palm oil and motor vehicles).

Eduardo Espinoza of the think-tank Centro de Estudios para la Integración Económica (CEIE) says the impact will remain limited until third countries get involved. "The logical trade corridor for Central American merchandise is the

Pacific, and it runs through El Salvador" he says. "No cargo specialist is going to transit goods through Honduras as a way of getting to Guatemala. So, it is only when El Salvador joins that we'll see real benefits for Central American trade".

El Salvador has indeed begun the process of joining the customs union. On 16-18 October, it will participate in a first round of negotiations with Guatemala and Honduras. The process is expected to take at least a year, however. One of the issues is that more border customs posts will need to be upgraded – El Salvador shares four with Guatemala and two with Honduras.

William García of the regional Secretaría de Integración Económica Centroamericana (Sieca), which is coordinating the customs union, says it took eight months for Guatemala and Honduras to harmonise their customs procedures. He notes it will take somewhat longer to bring El Salvador into the union, because the trade flows involved are more complex.

Another cause for caution is that there are teething troubles in the Guatemala-Honduras union. Freight transport companies are supposed to use a new common web-based receipt and statement of goods form, known as the Factura y Declaración Única Centroamericana (Fyduca), but the software has been crashing; there are also problems in the treatment of value-added tax (VAT). Using Fyduca for cross-border trade will become obligatory in January 2018, so the authorities are under some pressure to iron out these administrative problems and get the system working properly.

Nevertheless, Sieca argues that a full Central American customs union could lead to 21-25% overall increase in intra-Central American trade in the long run. It has also been pointed out that a 'Northern Triangle' customs union (in reference to El Salvador, Honduras and Guatemala) would cover 57% of Central America in terms of territory, and create a market of 31m people, or 73% of the regional total. The total GDP of the three countries is around US$118m.

An important issue is that two of the wealthiest Central American republics, Costa Rica and Panama, so far have not engaged with the Northern Triangle customs union negotiations. Jhon Fonseca, Costa Rica's deputy minister for foreign trade, says that the Guatemala-Honduras experiment is not really a customs union at all, but simply a project to ease trade in low-risk products which have similar tax treatment on either side of the frontier.

From his point of view, Costa Rica and Panama are seeking to take part in a much deeper and technologically more robust customs union, incorporating best practice developed by countries like The Netherlands, Singapore and South Korea, and which will only begin to be implemented further ahead, in around 2021. Fonseca further notes that border customs infrastructure – the issue currently occupying Guatemala and Honduras – represents only about 25% of the obstacles to free trade in the region, with the other 75% of obstacle stemming from a wide range of other procedural issues (for example, taxation, quality standards, visas and migration). Fonseca also argues that the challenge is not just to harmonise processes, but to harmonise them using best practice – "otherwise we will be harmonising bad practices".

BRAZIL

Rescue package for Rio

Faced with the impact of lower oil prices, corruption, a state budget crisis, and a spike in violence, the city of Rio de Janeiro is struggling. The government has just announced a new package of measures designed to improve the city's economy, by stimulating tourism.

Shortly after the end of the latest Rock in Rio festival, a group of senior ministers and officials announced a new plan to rescue the city from growing urban blight. Three federal ministers (Government Secretary General Wellington Moreira Franco, Tourism Minister Max Beltrão and Culture Minister Sergio Sá Leitão) together with State Governor Luiz Fernando Pezão and Rio City Mayor Marcelo Crivella, announced that a total of BRL200m (US$65m) would be spent on various projects in an attempt to achieve a 20% recovery in local tourism revenues, injecting an additional BRL6.1bn (US$1.9bn) into the local economy. The key aim is to launch around 100 new events, spread throughout the year, to achieve this revenue stream, with the aim of generating up to 170,000 new jobs eventually.

Just a year after hosting the Summer Olympic Games (August 2016), Rio remains in serious trouble. State and city funds are depleted, not only because of the downturn in the oil sector, the lifeline of the state, but also because the previous state government stands accused of large-scale corruption. Just before the 2016 Games, the state was declared in "financial calamity".

Meanwhile, a resurgence in violence involving drug trafficking gangs is scaring off tourists, with the City's image newly in tatters internationally. Moreira Franco described the city's situation as "terrible, difficult and shameful". But Sá Leitão said that tourism and the 'creative economy' represented almost 8% of the city's GDP, and therefore could be used as an instrument of regeneration.

Violence has been on the rise, with a total of over 4,000 homicide victims in the first seven months of this year. Gang warfare has prompted the federal government to send an additional force of 10,000 army and police officers to patrol Rio. In late September, over 1,000 officers moved into Rocinha, one of the city's largest shanty towns, following battles between rival drug gangs.

Crivella, the new city mayor elected last year, said that to improve security it would be necessary for Rio "to host the Olympic Games every month", recognising the massive resources that were poured into to Rio to guarantee security for the Games. While such a goal is obviously impossible, the strategy appears to be to spread out "strategic events" across the calendar, encompassing sports, culture, tourism and business events. Organisers hope that this relatively modest public spend will have a multiplier effect, leveraging significantly greater private sector investments.

REGION

Defeating corruption in Latin America

While last year's Odebrecht corruption scandal opened a Pandora's Box across the region, the response was also regional, marking an important step forward for Latin America. Moving forward, the hope is that integrated anti-corruption frameworks will become institutionalised across the region, making it more straightforward to 'follow the money'.

The IMF in its blog series recently considered the problem of corruption in Latin America. It examined measures that have worked well in other countries, in a bid to lay out a basic framework that could be adapted to regional characteristics.

At the outset, it notes that a lasting solution will require "sustained action on many fronts to create a major shift in societal expectations". While improving institutions and lowering corruption obviously go hand-in-hand, this is easier

said than done. Getting a better legal framework in place does not necessarily translate into results on the ground without stronger enforcement. In and of themselves, 'best-practice' rules and regulations are just a first step.

A lasting solution to corruption will require sustained action, across many fronts. The aim, as the Fund puts it, is to create a major fundamental shift in societal expectations that helps 'push' countries out of the corruption trap.

It's not as if Latin America has been a laggard in fighting corruption. The IMF notes that the region has been an international front runner in adopting an anti-corruption convention (adopted by the Organization of American States just over 20 years ago, back in 1996), which, apparently, has been a model for others. More recently, a string of countries have either upgraded or are in the process of upgrading their legal and judicial frameworks, including Argentina, Brazil, Chile, Ecuador, Guatemala, Mexico, Paraguay, and Peru. In addition, the Fund notes, several countries have introduced and enhanced asset declaration requirements (albeit these vary from country to country). Some countries are also taking measures to enhance fiscal transparency, both independently and with the support of multilaterals like the World Bank and the IMF.

The Fund expresses optimism that the enforcement of upgraded legal frameworks is in fact making firm progress, pointing out that Brazil's Lava Jato investigation (now coming to an end after almost three years), reflects "a more efficient judiciary, independent and adequately resourced prosecutors, and decisive support from the media and society". Similarly, it notes, Guatemala in recent years has successfully unmasked tax evasion, money laundering, and illegal funding through its UN-backed International Commission Against Impunity (CICIG). And in reference to the Odebrecht scandal, it notes that the likes of Peru and the Dominican Republic "have forcefully pursued allegations against former high-level officials associated with the Odebrecht scandal". Another question, not fully addressed by the IMF, is whether all these investigations actually led to successful prosecutions and sentencing – which has not always been the case.

"Combatting entrenched corruption requires ending a corruption trap where the existing structure of incentives are self-perpetuating", the IMF says. "Breaking this inefficient equilibrium requires solving a collective action problem (putting up a fight against vested interests) and overcoming formidable political economy hurdles".

International experience, it continues, suggests that an effective anti-corruption strategy requires "strong legal frameworks, intensity of enforcement and clean-up, and perseverance. Strong national ownership and leadership are also critical to ensure that public support by broad segments of society is sustained throughout this long fight".

The Fund suggest that key elements of a multi-pronged strategy might include the following:

1. A key role for task forces

A hurdle for any government fighting corruption is opposition from well-organised vested interests, the Fund observes. If public officials and political parties are complicit, efforts to curb corruption may require the establishment of independent special task forces, as in Guatemala.

2. Raising transparency and accountability

It goes without saying that more transparency is fundamentally important to

curbing corruption. The IMF notes that increased transparency increases the chances of detection for a given level of law enforcement. Traditional measures to increase transparency and accountability include, among others: freedom of information laws, income and asset declarations, random audits, strengthening public management and fiscal transparency, especially in resource rich economies, and improving governance of state-owned enterprises.

However, the Fund adds that more can be done to push the boundaries of transparency and accountability, as follows:

- To end corporate secrecy, beneficial ownership information for firms should be collected and can be made available through centralised registries. Public and private entities involved in public procurement and investment could create internal anti-corruption committees reporting directly to the Board, or the comptroller/auditor general to foster partnerships between internal stakeholders and external auditors.

- Conflicts of interest could be addressed by suspending business activities of elected officials where this is currently not required.

- Federal governments can help provide incentives for sub-national units to implement transparency best practices. In support of this, the IMF and other multilaterals are putting more focus on promoting fiscal transparency

3. Strengthening public procurement and investment processes

The Fund notes that otherwise sound legal frameworks in Latin America have been shown to have loopholes in public procurement, state-owned enterprises, and public-private partnerships. It notes that stronger contractual frameworks and implementation, eliminating ad hoc exceptions, and possibly ruling out contract renegotiations in the short term, could help close these fiscal loopholes and help establish a Transparency Framework.

It adds that efforts could also include: ensuring competitive auctions, mandatory bidding for any additional public spending needs, providing full information on awarded contracts and modifications, tracking of procurement spending, and developing policies to minimise the rent seeking corrupt practices.

4. Eliminating unnecessary rules

The Fund makes the point that too much regulation can create 'fertile ground' for corrupt behaviour, by creating artificial sources of revenues (for instance, rationed import licenses). Enhancing competition and lowering red tape are thus key ingredients to fighting corruption, it notes.

5. Dealing with the short run costs

Successful efforts to uncover corruption can create uncertainty in the short term – as very clearly evidenced by the case of Brazil. "This can hinder public sector decision making and forestall investment", the Fund notes. Again, Brazil provides an example. "While long-run benefits far exceed short-run costs when it comes to institution building, the latter can arguably prevent change from happening", the Fund admits. In this context, measures to curtail such 'transition costs' would help support the process. This might include: improving judicial frameworks to avoid lengthy legal procedures, a clear framework to handle leniency agreements and plea bargaining, and a flexible and efficient bankruptcy law – ensuring that assets remain operational. In addition, lending facilities could be carefully designed to soften a credit crunch during periods of heightened, uncertainty, it adds.

In conclusion, the IMF notes that defeating corruption ultimately requires standing up to powerful vested interests – both private and public – who benefit from the status quo. There is no fixed formula, no IMF 'recipe'.

While a rare window of opportunity has opened in Latin America to maintain the reform momentum, the Fund notes, "efforts are also needed to tackle transition costs toward achieving a more just society and stronger economy for all".

The case of Central America

Meanwhile, a new book by the Central American Institute for Fiscal Studies (Icefi, in the Spanish acronym) examine the paths to corruption in the Northern Triangle countries and proposes an agenda to combat it.

The book, entitled '*Corruption: Its Paths and Impact on Society and an Agenda to Combat It in the Northern Triangle of Central America*', studies the relationship between corruption and democracy, highlighting corruption in El Salvador, Guatemala and Honduras – having special characteristics derived from historical aspects, such as the construction of weak states, periods of authoritarianism, civil war and counterinsurgent systems and the undermining of judicial independence.

Icefi holds that these are all characteristic of weak and dysfunctional democracies. The book emphasises that corruption must be understood and combatted as a problem that is not exclusive to the public sector because it affects and is particularly relevant to the private corporate sector. The book demonstrates the systemic presence of private stakeholders involved in most cases analysed.

The institute identified eight principal paths that lead to corruption: outdated legislation; weak institutionality; limited capacities and resources in the systems for administration of justice; electoral systems and political parties with no democratic rigor; deficient access to public information; scarce citizen participation; conflicts of interest and impunity. It analyses each of these so-called paths to corruption, identifying particular characteristics in the three Northern Triangle countries.

The Icefi proposes an anti-corruption agenda for the Northern Triangle which includes legislative actions and institutional strengthening to achieve eight main objectives: 1) the preparation, discussion, approval and implementation of national policies or spaces for transparency, open government and anti-corruption policies; 2) fiscal policy prioritising transparency; 3) to ensure the honesty of public officials and employees, as well as a culture of accountability and open government; 4) to give guaranteed access to public information, including open data policies and protection of personal data; 5) to facilitate citizen participation through the promotion of spaces for collaboration between public administration and civil society; 6) to incorporate an analysis of private sector responsibility in efforts to combat corruption; 7) to recognise and combat the relationship between corruption and public electoral systems; 8) structural reform of the system for the administration of public justice, including actions to strengthen the capacity to combat corruption.

REGION

Corporate Radar

Oil companies amend Argentine labour contracts: CGP (part of Corporación América), Roch, and ENAP Sipetrol Argentina, three private sector oil companies operating in the state of Santa Cruz, have signed an

agreement with the three main oil workers' unions to introduce more flexible labour contracts. It follows a similar agreement in Neuquén province earlier this year and is part of a government-supported plan to improve competitiveness and protect employment levels. Since 2010, Argentina has been a net energy importer; the government of President Mauricio Macri wants to encourage private companies to boost domestic energy production.

Chilean bank profits up: Chilean bank profitability rose by 7.12% in the first eight months of the year, reflecting higher interest income and lower operating costs, the banking regulator Superintendencia de Bancos e Instituciones Financieras (SBIF) reported. Total profits in the period were US$2.45bn. Santander Chile, the largest bank in the country by asset value, also led the ranking by profits, with US$611m, followed in second place by Banco de Chile with US$610m. The growth of year-on-year bank lending slowed to 2.85% in August, reflecting a combined slowdown in the three main credit categories: consumer lending, mortgage lending and corporate lending.

Avianca dispute goes to arbitration: After a week-long strike by the majority of pilots employed by Colombia-based airline Avianca, on 29 September Colombia's labour minister Griselda Restrepo said she was imposing an obligatory arbitration process. Avianca and the pilot's union, Asociación Colombiana de Aviadores Civiles (ACDAC), are required to each nominate one representative to a three-person arbitration panel, and to choose the third by consensus. If the two sides cannot agree on the choice of the third panel member, one will be chosen at random from a short-list compiled by the Supreme Court. It was not immediately clear whether normal services would resume pending the arbitration order, or whether the ACDAC members would continue with their strike action. A total of around 700 of the airline's 1,300 pilots have been on strike, forcing cancellation of roughly half of Avianca's scheduled flights.

Ternium announces Mexico and Colombia investments: Latin American steel group Ternium says it is investing in a new hot rolling mill at its Pesquería plant in Mexico, along with a new reinforced steel bar facility in northern Colombia. The company said the new hot rolling mill in Mexico would upgrade and modernise the country's steel capacity and replace high-value steel imports. With a total investment of US$1.1bn, the plant will have annual capacity of 3.7m tonnes and come on-stream in the second half of 2020.

"The Colombia-based steel bar facility will enable us to expand our market share in the dynamic construction sector by offering an alternative to imports" said Ternium CEO, Daniel Novegil. The company is investing US$90m in the plant, taking overall reinforced bar capacity to 720,000 tonnes as of the second half of 2019. Ternium was formed in 2005 by the merger of Siderar of Argentina, Sidor of Venezuela and Hylsa of Mexico. It is the leading Latin American steel company, operating plants in Argentina, Mexico, Guatemala, Colombia and the US.

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