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CONTENTS

LEADER 1
Will privatisation kick-start the Brazilian economy?

REGIONAL ECONOMY REVIEW

Chile 4
Economic team shown the door

Colombia 5
Downturn shows signs of bottoming out

Mexico 5
Growth continues despite political noise

Venezuela 6
US hits Venezuela with more sanctions

Ecuador 8
Airy budget assumptions belie Moreno's tricky balancing act

Trinidad & Tobago 12
IMF confident that Trinidad & Tobago is turning a corner

Region 15
UNICEF calls for an end to child poverty in LAC

Dominican Republic 17
IMF praises 'dynamic' DR

Honduras 19
Big increase in 2018 budget, as Hernández bids for second term

REGIONAL BUSINESS REVIEW

Region 20
Fintech making an impact in Latin America

Region 20
Droughts driving Central American emigration

Region 22
The robots are arriving in Latin America

Region 22
Foreign Direct Investment still falling

Region 24
Corporate Radar

Latin American Newsletters since 1967

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Will privatisation kick-start the Brazilian economy?

The politically embattled government of President Michel Temer is turning to large-scale privatisation of public sector assets as a way of stimulating investment and growth. On 21August, the federal government announced that it would sell its stake in the power giant Eletrobras; two days later it said a further 57 state companies would also be put up for sale. While many investors and analysts have responded enthusiastically, opinions remain divided as to whether this will unleash the hoped-for economic rebound in Brazil.

The government's announcement that it intends to privatise Centrais Eléctricas Brasileiras (Eletrobras) was an unexpected but welcome surprise for the markets. Mines and Energy Minister Fernando Coelho Filho said the plan was to sell the federal government's 41% stake in the company by value (at present it also holds 51% of the voting rights). The National Development Bank (BNDES) separately holds an 18.7% stake in the company. The transaction to privatise the federal holding would be completed by mid-2018. The government would retain a 'golden share', giving it the right to veto some key decisions. Coelho Filho estimated that the operation could generate up to BRL20bn (US$6.3bn).

Common shares in Eletrobras jumped by 49% on the news, with Class B preferred shares (the most traded) rising by 32%. This helped push up the Bovespa BVSP index by 2%, rising above the 70,000-point mark for the first time in six years.

Hot on the heels of this announcement came the news that the government would also put up for sale its shares in 57 other state-controlled companies. The list includes 14 airports, 11 high-power electricity transmission lines and 15 port terminals. Also on the block are highways, Lotex (the lottery company owned by the state-run bank Caixa Económica Federal), and even the national mint, Casa de Moeda do Brasil. Officials hope that these sales will raise BRL44bn (US$14bn) for the treasury.

Along with offloading these assets, the Temer government announced some further investor-friendly decisions. A new market for debentures to finance infrastructure projects is to be launched. From January 2018, BNDES will base its loan rates on the five-year treasury rate average (a move that, in effect, will begin to phase out BNDES' use of subsidies for particular sectors). The government also said it would allow commercial mining projects to go ahead in a large area of the Amazon in which mining previously had been prohibited. (However, after protests from environmental groups, this

measure is now under review.) Some analysts have even seen a potential silver lining in a World Trade Organisation (WTO) ruling on 29 August that gave Brazil 90 days to withdraw seven industrial stimulus programmes judged to be examples of unfair competition. These programmes – judged to have provided around US$7.9bn worth of subsidies since 2010 – had been challenged by Japan and the European Union. While Brazil will appeal, the Temer administration may use the ruling to justify more market-friendly policies; some of the programmes already have been phased out.

A number of analysts argue that the privatisation push is good news. Ricardo Sennes of the São Paulo-based consultancy Prospectiva, commented: "The sale of Eletrobras goes in line with the liberal agenda the government is trying to push through. This will allow the government to have a golden share of Eletrobras, allowing it to make some of the company's important decisions."

Sennes and others drew parallels with what is arguably Brazil's most successful privatisation, the sale of the aerospace company Embraer in 1994. Embraer went on to become the world's third largest commercial jet maker. Goldman Sachs economist Alberto Ramos noted: "This is a combination of genuine inclination to reduce the weight of the public sector and reducing the footprint of inefficient public enterprises and also fiscal considerations. The extra revenue from these privatisations will come handy in times of intense fiscal pressure." Marcelo Caparoz of RC Consultores said that "the most important factor in these announcements is the signal the government is sending to the markets, giving them the incentive to identify state-run businesses with the potential to be put into private hands."

President Temer justified the move by saying that the privatisations would make Brazil a more modern country and help it emerge from economic crisis. Funds gained from the asset sales would be invested in things that "really mattered", like public health, security, infrastructure and education. Finance Minister Henrique Meirelles said the privatisations would help reassure the country that "the fiscal balance is being achieved".

Temer has also seen an opportunity to attract further Chinese investment. The privatisation announcements came shortly before he was due to attend a BRICS summit in China. The president's spokesman said he intended to use his visit to China to seek a diversification of Brazilian exports to that market, and to attract new investment, particularly in infrastructure. Bilateral trade between the two countries was almost US$60bn in 2016.

China's State Power Investment Corp (SPIC) has expressed interest in acquiring a licence to operate four hydroelectric dams (the Miranda, São Simão, Jaguara and Volta Grande dams) previously operated by Cía Energética de Minas Gerais (Cemig). These schemes are expected to raise around BRL11bn (US$3.5bn) at auction in September (this is additional to the expected revenues from the divestment of Eletrobras and the 57 other state companies).

Criticism of the privatisation programmes stems from two areas. First, there is concern over the details and timing of some of the divestments. Secondly, some observers say there are still unanswered questions about the overall macroeconomic impact of the sales.

For instance, some critics say it will be very difficult, in practice, to divest Eletrobras in just six months. They make the point that two key activities of the firm – the operation of the giant Itaipú hydroelectric complex, part of a government-to-government agreement with Paraguay, and the operation of

nuclear power plants, where there are special national security considerations – will not be privatised, and will need to be separated out from the overall transaction. That could be legally complex and cause delays.

Eletrobras operates 233 power plants and provides over one-third of the country's total electricity. Inevitably, there will be political resistance to its sale. Senator Edison Loboa from President's Temer's own Partido do Movimento Democrático Brasileiro (PMDB), has said that Eletrobras performs "a strategic function, which therefore should remain under state control". There are also concerns that the privatisation of Congonhas airport in São Paulo will cause financial problems for state-owned Infraero, which currently manages it. Some politicians also object to the privatisation of the national mint, on security grounds.

The big macroeconomic question is that while asset sales are intended to help narrow the fiscal deficit, the numbers may not actually add up in the way that officials would like. In an ideal world, asset sales provide once-off assistance to fiscal accounts that are already improving. Unfortunately, this is not yet the case in Brazil. The government is making efforts to control spending and boost revenue, but the recession has eroded tax revenues. For political reasons, savings from pension reform are looking smaller than hoped, and coming later than expected.

On 15 August, Finance Minister Meirelles announced less stringent targets for the primary fiscal deficit in 2017 and 2018. The deficit for both years has now been set at BRL159bn (US$50.5bn). This represents an increase of 14.4% on the prior 2017 target, and an increase of 23.3% on the 2018 target. It is clear that revenues from privatisation will be small this year and (particularly if there are delays) the proceeds may fail to entirely plug the primary gap in 2018. The fiscal deficit after debt servicing remains dauntingly large, at roughly 9% of Brazilian GDP.

Government officials may also be guilty of a degree of rhetorical over-selling – often the case with big privatisation programmes in Latin America. If once-off privatisation revenue is to be used primarily to narrow the fiscal deficit, it cannot also be simultaneously promised that it will go into "things that really matter", like public health and education. Against this pessimistic view, however, an inflow of new investment as part of the privatisation process will clearly have a positive impact on business expectations. Whether this momentum will offset more negative factors remains to be seen: an early indication will come when the level of interest in the latest divestments, the identity of the buyers, and the prices they are willing to pay, begins to emerge.

Second quarter GDP

The pace of Brazilian economic growth slowed a little in the second quarter of this year, with GDP expanding by 0.2% quarter-on-quarter, down on the 1.0% q-o-q recorded in Q117. The second quarter data showed continuing weakness in investment (-0.7% q-o-q), but a strong showing by private consumption (+1.4% q-o-q). This was attributed to lower inflation and the first signs of improvement in the labour market. However, on a year-on-year basis, growth was 0.3%, the first positive annual reading in over three years.

Analysts said the result was broadly in line with expectations: given the strong seasonal boost to the agricultural sector in Q117, a somewhat softer Q217 had always been on the cards. Some economists read the result as positive, since it showed that the ongoing political crisis had relatively little impact on the real economy.

CHILE

Economic team shown the door

Chile's economy showed a small recovery in the second quarter, but this item of good news was largely overshadowed by a dispute within the centre-left government led by President Michelle Bachelet, which in early September led to the replacement of the entire economic team. These cabinet tensions have increased the chances of a right-wing victory in the upcoming presidential election in November.

On a year-on-year basis, Chile's GDP grew by 0.9% in Q2 17, up from a low of 0.1% in Q1 17. On a seasonally adjusted quarterly basis, there was also an acceleration, to 0.7%, from 0.1% in the first quarter. The rebound may have been slightly overstated by these numbers however, because it reflected a big bounce-back in mining output, following the effects of a strike in the first quarter.

Elsewhere, there were some continuing signs of weakness, for example in investment – down 4.1% on a year-on-year basis. Non-mining activity was also relatively soft. In August, Chile's central bank left its policy interest rate unchanged at 2.50% for the third consecutive month running, amid signs that policymakers are divided. A number of analysts believe the Bank may end up cutting rates to try and stimulate the economy before the end of this year.

The big economic and political news item was that Finance Minister Rodrigo Valdes, his deputy Alejandro Micco, and Economy Minister Luis Carlos Cespedes all resigned on 31 August, after a disagreement within the government. President Bachelet and a majority of ministers voted to block a US$2.5bn iron ore mining project in northern Chile, on environmental grounds. The economic team was in a minority: it felt the project should go ahead to reduce the investment deficit and stimulate economic growth. There has been long-standing tension within the government between those who want to prioritise growth, and those – usually backed by Bachelet – who place relatively greater emphasis on other objectives, such as reducing income inequalities or protecting the environment. Valdes said that getting faster growth required "discipline and conviction in the government and the opening of new spaces where the private sector can use its initiative with clear and stable rules", adding pointedly, "I didn't manage to get everyone to share that conviction."

President Bachelet has named Nicolás Eyzaguirre and Jorge Rodríguez Grossi respectively as the new finance and economy ministers (they have both served in the same roles previously, during the 2000-2006 presidency of Ricardo Lagos). Their new team will have a difficult six-month transition period to manage.

Presidential elections are due in November and the newly elected government takes office in March. Before then, the economic team must complete reforms to the pension system; make changes to the banking and securities regulator; draw up and get the 2018 budget approved by congress; and negotiate public sector wage increases. This change in economic authorities at such a late stage in the Bachelet government is widely seen as increasing the chances of an electoral victory in November for the conservative candidate Sebastián Piñera (formerly Chile's president in 2010-2014). Kenneth

Bunker, an academic at Universidad Central, commented: "It is a political problem, which shows that the cracks in the centre-left are bigger than we thought. The ruling coalition is going to the polls divided, while the right is unified." Sebastián Ide, of the private sector Banco de Chile agreed. "It's the government's biggest own goal. To score an own goal in the last minute of a match you're already losing is tough."

COLOMBIA

Downturn shows signs of bottoming out

The Colombian economy grew by 1.3% year-on-year in the second quarter, a small acceleration on the first quarter result of 1.1%. This suggests that the trough of the business cycle has been passed and the outlook is improving. However, the recovery is likely to be slow.

In quarter-on-quarter terms, GDP growth was 0.7% in Q217, after a drop of 0.3% in Q117. Three factors lay behind the improvement. First, the contraction in the mining sector (which includes oil and gas) has slowed down. Colombia suffered in 2015 and 2016 because of low international hydrocarbons prices. With domestic oil production increasing again, 2017 may turn out to be a better year for production and revenues. Secondly, the transport and construction sectors began to grow again in Q2 17. Thirdly, the retail sector rebounded. Here, the negative effect of the three-percentage point increase in VAT in January is finally beginning to wear off. Falling inflation is also helping to boost purchasing power. However, manufacturing contracted quite sharply in Q2, while growth in the agriculture and finance sectors also slowed.

President Juan Manuel Santos admitted that economic performance in the first half was below expectations. Speaking on 22 August, the president said that the country had gone through "a bad patch". However, he stressed that everything was in place for Colombia to have a better second half, and for 2018 to be better than 2017. Santos argued that with the correct macroeconomic policies in place, the focus moving forward would be on ways to boost the microeconomic performance. The government's official real annual GDP forecast has been lowered to 2% for this year and to 3% in 2018. However, the central bank is more cautious again, predicting economic growth of just 1.6% this year, which would be Colombia's lowest-growth in nearly a decade.

In late August, the central bank cut its benchmark interest rate by 25bps to 5.25%. Four of the seven monetary policy board members backed the move, while two wanted a steeper 50bps cut, and just one member wanted the rate to be held unchanged at 5.5%. Juan José Echeverría, the bank governor, said the cut could be one of the last for the year, suggesting that the interest rate was now close to neutral level. In a statement the monetary policy board observed that "available economic activity figures suggest that the slowdown in the economy bottomed out and that higher growth can be expected during the second half". Inflation fell to 3.4% in July, within the 2-4% target range for the second consecutive month.

Some analysts suggest that the private sector should now take up some of the slack, boosting investment and consumption to add some impetus to a still-sluggish economy. Ricardo Rodríguez, president of Hewlett Packard Colombia, accepted that point in a recent interview with financial magazine *Portafolio*. "In Colombia, we complain of slower growth", he said. "But we have to understand that this is not just an issue for the government: private sector companies as well as public sector enterprises must assist the transformation process".

MEXICO

Growth continues despite political noise

These continue to be uncertain times for Mexico, with the 2018 presidential elections looming large and the fate of the North American Free Trade Agreement (NAFTA), the country's main trade pact with Canada and the US, undecided. But despite these clouds, the economy is still growing.

On a quarter-on-quarter basis, Mexican GDP rose by 0.6% in April-June, down from 0.7% in January-March, according to the national statistics institute (Inegi). In annual terms, second quarter growth was 1.8%. Although growth did slow marginally, the finance ministry said that expectations had improved based on a solid domestic market, good external demand, and "greater confidence in the strength of the relationship with our main trading partner".

On 30 August, the central bank (Banxico) revised up its growth forecasts, raising this year's prediction for GDP growth to a range of2.0-2.5% (up from 1.5-2.5% previously). It also boosted the 2018 growth prediction to a range of 2.0-3.0% (from 1.7-2.7% previously). Banxico noted that "the balance of risks for growth has improved, due to the perception that the probability of the most extreme downside risks materialising has diminished" – a statement described by the *Financial Times* as the closest thing the typically prudent central bank would come to "pumping its fist in the air".

Banxico held its benchmark interest rate steady at 7% in August, pausing a seven-month tightening cycle. This reflects confidence that inflation is being brought under control. The outgoing Banxico head Augustín Carstens, who leaves his post in November after eight years, said it was difficult to estimate the cost to Mexico if the US withdrew from NAFTA, but that a return to World Trade Organisation rules would not have major macroeconomic consequences. Meanwhile, there was good news on manufacturing output. The Markit Mexico Manufacturing Purchasing Managers' Index (MXPMIM) rose to 52.2 in August, up from 51.2 in July. A reading above 50 signals expansion. Output and new orders both picked up.

Uncertainty may recur, but so far, the evidence points to a degree of continuing resilience in the Mexican economy. In early September, the government was involved in the second round of the NAFTA renegotiation talks, while President Enrique Peña Nieto was visiting China to promote trade and investment opportunities. It remains to be seen if the resilience continues as the NAFTA talks reach a critical stage and the 2018 presidential race comes into closer focus.

VENEZUELA

US hits Venezuela with more sanctions

The US government pledged decisive action if the Venezuelan government went ahead with controversial elections for a constituent assembly at the end of July, and it is showing signs of following through on that promise. After expanding targeted sanctions against specific individuals in the aftermath of the elections, including against President Nicolás Maduro himself, the US government followed up with broader economic measures. On 25 August, the US levied financial sanctions that prevent Venezuela from issuing dollar-denominated bonds in international capital markets. The measures also complicate the trading of some existing bonds and thereby raises further questions about the government's ability to stave off default.

The US was widely expected to take some kind of economic action against the Venezuelan government. The options reportedly on the table included a blanket ban that would prevent US financial institutions from trading in all bonds issued by the Venezuelan public sector (which would apply to both primary issuance and secondary trading-on), as well as some form of energy sanctions, whereby the US would replace Venezuela with other source markets for oil imports.

In the end, the sanctions announced on 25 August were relatively moderate compared with the more radical policy options being mooted. Secondary trading of most bonds remains permitted, with US institutions and individuals prohibited only from direct financial transactions with the Venezuelan state, either in terms of primary debt issuance or repurchasing already-issued bonds (similar to the US bank Goldman Sachs' controversial purchase of bonds issued by the state oil company PDVSA in May, at a discounted price).

US imports of Venezuelan oil remain unaffected, although the US government is continuing to scale down its reliance on the Venezuelan market, with oil imports from Venezuela falling by 11% year on year in June, according to the latest US data.

Indirectly pushing Venezuela towards default

The US has attempted to carve out a middle way in terms of its policy response, steering clear of harsher measures that would bring the Venezuelan government to its knees (and also evoke criticism that the US government was deepening the humanitarian crisis), but seeking to introduce measures that will make it more difficult for the Maduro government to remain in office.

Given that it is proving extremely difficult for the opposition to dislodge Maduro by political means, the US is likely to be hoping that a further deterioration in Venezuela's creditworthiness will prompt a default, which would likely bring down the Maduro administration.

The newly-introduced sanctions are showing some success in this respect. Although secondary trading remains permitted in most cases, the perception that Venezuela is becoming more of an international pariah is prompting many brokers to steer clear of any trade in Venezuelan debt instruments. Reportedly, several US firms, including the financial service firms Depository Trust Company (DTC) and Cantor Fitzgerald, have introduced a ban on any Venezuelan bond trades, citing rising reputational risk.

The Venezuelan opposition coalition, Mesa de la Unidad Democrática (MUD), has repeatedly warned that newly-issued external debt would not be recognised by any successor opposition government, given that the current Maduro government has failed to request congressional approval in recent years, as required by law. This will add to investor concerns about holding Venezuelan debt.

Running out of financing options

These developments will complicate Venezuela's already-reduced financing options. Primary debt issuance is no longer an option, while another restructuring deal with bondholders would be extremely difficult given the ban on direct debt transactions between the US and the Venezuelan state. Some of the unusual financing deals struck in recent years, including the Goldman Sachs purchase and also a 2015 gold swap that allowed Venezuela to monetise some of its gold reserves, will also no longer be possible under the US sanctions.

This raises serious questions about how the government will be able to make scheduled sovereign debt repayments of US$1.6bn in October and US$1.9bn in November. Fitch Ratings has lowered Venezuela's junk bonds further into speculative territory, cutting the sovereign's long-term foreign and local currency ratings from CCC to CC, just two notches from default. The agency said the imposition of US sanctions reduced the government's financing options, making default "probable".

Russia and China to the rescue?

Yet just as an imminent default looks increasingly likely, there has been speculation about a last-minute bail-out by China and/or Russia. US President Donald Trump's aggressive rhetoric towards Venezuela, including a veiled threat of military action, and the imposition of financial sanctions has evoked criticism from several foreign leaders, including both the Chinese and Russian authorities.

The Chinese government, which extended tens of billions of dollars to the Venezuelan government under the Hugo Chávez's tenure as president (1999-2013), is not believed to have lent fresh funds to Venezuela for some time. However, there has been speculation that the Venezuelan government may be negotiating a fresh loan package, in the hope of securing a vital lifeline ahead of the large debt repayments in the fourth quarter of the year. Meanwhile, the Venezuelan energy minister, Eulogio del Pino, is set to visit Russia in September; this could potentially result in Russia providing what it describes as 'advance payments' to Venezuela for future oil supplies.

Venezuela's ability to continue servicing its debt will hinge in large part on whether this foreign assistance is forthcoming. Oil prices remain low, with Venezuelan oil selling for around US$45/barrel in recent weeks, little changed from earlier in the year. Oil production volumes have fallen, according to the International Energy Agency, which will also be dragging on overall government revenue. International reserves fell below US$9.8bn in late August, but with around three-quarters of this comprising illiquid gold, cash reserves remain insufficient to fund the scheduled debt repayments.

In the meantime, other economic indicators are continuing to deteriorate. The Venezuelan firm Ecoanalítica monitors inflation levels, constructing its own consumer price index based on the central bank's weightings for various goods and services. According to these calculations, monthly inflation hit a new high of 31.9% in August, driven by sharp rises in food and beverages prices. This was up from 26% month on month in July, and took accumulated inflation to 281% in the first eight months of the year. The firm believes that year-on-year inflation is well over 700% and could reach 1,500% by the end of the year.

Although this problem of hyperinflation has little direct impact on the government's ability to make debt repayments, it will continue to present a significant challenge to the government in the coming months, as it will worsen the humanitarian crisis and could spark renewed public protests.

ECUADOR

Airy budget assumptions belie Moreno's tricky balancing act

The national assembly (AN), controlled by the left-wing ruling Alianza Pais (AP), on 31 August approved the revised general state budget (PGE, in the Spanish acronym) for the remainder of 2017 by 75 votes, ignoring loud criticism by the opposition and private economists.

Public debt
According to Moreno, as of end-May Ecuador's total public debt (external and internal) stood at US$41.9bn (or 42% of GDP), up from the US$27.8bn reported by the outgoing Correa administration, which was based on its (questioned) methodology for debt calculation, introduced in December 2016.

In an election year, the budget from the previous year is carried over until the newly elected government takes up office (in May), after which the new administration prepares a revised plan to year end. In presenting the half-year budget, the new President Lenín Moreno had caused a storm by blaming his predecessor Rafael Correa (2007-2017) for the state of the economy and pledged "truthful and publicly accessible data". In the view of private economists however, there is little doubt that the half-year budget assumptions presented by the new government led by are at best unrealistic, and at worst totally irresponsible.

The US$36.82bn plan appears contradictory on several levels. First off, it envisages a sharp reduction in the fiscal deficit to 4.7% of GDP in 2017 (or roughly US$ 4.8bn), from a record 7.5% of GDP in 2016. With oil revenues still subdued, the government is banking on increased tax revenues to fill the gap. Total tax income is budgeted at US$14.76bn, a year on year increase of 7% from 2016, even though its latest GDP growth estimate for 2017 has now been slashed to 0.7%, from 1.4% previously.

While first half tax revenues rose by 7.6% year on year, this was from a low year-earlier base. Effectively, it was an adjustment that will not be repeated in the second half. Indeed, overall tax revenues in the first eight months (January-August) rose by a much more moderate 1.7%, with revenues falling in both July and August. The local consultancy Cordes calculates that in order to reach the US$14.76bn target, tax revenues in September-December will have to be 17.5% higher than in the same period of last year, unlikely given central bank projections for a contraction in private consumption.

Elsewhere, the revised budget anticipates capital donations and transfers – namely oil earnings – of US$3.24bn, up 54% on 2016, based on an average oil price of US$41.7/barrel. Yet Cordes estimates that oil earnings to end August were about 5.8% down on the same period of 2016. This relates to still-subdued prices and also reduced sales volumes as per the latest OPEC output quotas – which the new Moreno government in July announced it could no longer comply with for financial reasons. Given that, it is unlikely that the revised budget projection is attainable. Again, Cordes calculates that capital transfers would have to post growth of 142% in the last four months of the year to reach the target.

On the spending side, the revised budget avoids big capital expenditure cuts, on the grounds that continued public stimulus is needed to help Ecuador's economy to recover. Indeed, the revised plan of US$36.8bn now amounts to an 8.1% increase year on year. However, budget execution to date is wide of the mark, with just US$18.34bn spent to August, 10.4% *less* than in the equivalent period of 2016. To reach the full year target by December, the government will need to spend 36% more in the final four months of the year – which were already expansive in spending terms as the former AP-led administration ramped up spending ahead of the February 2017 election. Cordes calculates that sectors including health, education, and urban development & housing would need to see expenditure increases of between 28% and 70% in the final four months to reach the budget target. With the best will in the world, executing that expenditure is highly unlikely by the various ministries and responsible local authorities.

Cordes and others argue that the final approved budget demonstrates irresponsibility, not only by AN deputies who (predictably) approved the overall spending increase, but also the finance ministry. These alleged inconsistencies – including overestimation of both income and expenditure execution – are such that the final deficit may well be lower than projected, however, Cordes and others make the point that a national budget should also act as a reliable

policy indicator, and an important reference point for the country's economic agents. If it does not fulfil this role, then private sector investment decisions likewise become more difficult – affecting the overall economy.

Given this alleged failure by the new Moreno administration to present a 'truthful' statement of income and expenditure for what remains of 2017, private economists are now concerned about the shape of the 2018 budget, due imminently for approval by year-end, which will have to cover a full 12 months.

Moreno on 4 September rejected the idea of a 'paquetazo', as a fiscal adjustment package is commonly called in Latin America, albeit he recognised that the economic situation was complex. This reluctance to follow through on his earlier pledges to deal with the fiscal difficulties he inherited likely owes to the growing internal splits in the AP between supporters of Moreno and Correa. Ricardo Patiño, one of Correa's most senior ministers and an AP founding member, quit as an advisor to the Moreno administration in late August, along with two other high profile AP figures, Paulo Pabón and Virgilio Hernández.

Current account in surplus to March

The current account managed a fourth consecutive quarterly surplus in Q1 2017, on central bank data. The US$324.7m surplus owed to a stronger trade result. Higher oil export prices lifted the value of overall exports to US$4.9bn, against which imports remained softer at US$4.3bn, amid still-weak domestic demand.

With Correa supporters agitating, Moreno is in little position to impose a fiscal adjustment, and in truth he appears a lot less committed to it now than before his election, noting that his government would never take measures that risked affecting the poorest and most vulnerable. At the same time, he rejected the idea of reckless indebtedness. He mooted the idea of a 'consulta' – a national plebiscite – to gauge public support for a range of future economic measures.

Weak growth all the way to the next election

The revised 2017 budget projects real GDP growth of 0.4% in 2017, 1.6% in 2018, 2.4% in 2019 and 2.5% in 2020. This is some way beneath the expectations of the previous Correa administration, which had projected an oil boom in Ecuador starting from 2017, once the large new Yasuní reserve started to ramp up output. It is also well shy of the minimum growth rate of 5%-plus needed in Ecuador to meet the country's continued social and economic development needs. The next election falls in 2020, when many expect Correa to make a triumphant comeback to 'rescue' Ecuador with the promise of revived growth. Correa may get lucky and be able to return to office just as oil prices are expected tick up again in line with stronger global demand heading into the next decade.

Downstream troubles reflect the Correa-Moreno tensions

On 25 August, the hydrocarbons ministry announced that international auditors would be brought in to help formally revise the technical and financial terms of five major energy projects in the country. All the contracts were awarded by the Correa government.

These five projects include Ecuador's main Esmeraldas refinery, which faces closure for 45 days for essential repairs, according to Hydrocarbons Minister Carlos Pérez. Pérez in mid-August said that the refinery, recently upgraded at a cost of just over US$2bn, was in a "critical" state. Most critically, serious problems have been identified with the main catalytic cracking unit, the core of the refinery. Esmeraldas is also reportedly unable to process its sulphur emissions currently, risking environmental pollution, while there have also been rolling problems with the main electric power generator.

Esmeraldas has a refining capacity of 110,000 barrels per day (bpd). Its planned seven-week closure will cost up to US$1.4bn a day, according to Pérez. The stoppage will also oblige the state oil company Petroamazonas to purchase additional imports of oil derivatives to serve the domestic market, which will significantly push up the import bill for the duration.

Also facing audit is the planned Pacific refinery (on which over US$1.5bn has already been spent to date), as well as the US$85m Bajo Alto LNG plant, the US$623m Pascuales-Cuenca multi-use pipeline (awarded to the Brazilian construction firm Odebrecht), and the US$607m Monteverde-El Chorrillo LPG pipeline and gas terminal, 97km west of the coastal city of Guayaquil. In total, these five concessions have cost the state US$5bn to date. Depending on the audit, Ecuador may now seek compensation from those companies that carried out the work. This includes 10 local and foreign companies awarded contracts for the Esmeraldas upgrade. On 31 August, Pérez said that Odebrecht had a month to resolve the problems with the Pascuales-Cuenca pipeline or the state would unilaterally terminate its contract.

Along with the main investigation into Odebrecht's bribery of senior officials to secure major works contracts, plus other still-emerging suspected cases of public procurement-related corruption, foreign investors may remain wary of doing business in Ecuador. Foreign direct investment (FDI), which remained stagnant at less than 1% of GDP throughout Correa's decade in office, was just US$176m in the first quarter, according to preliminary balance of payments data from the central bank (BCE). Official efforts to drum up interest in the mining and manufacturing sectors have yet to bear fruit.

Foreign Trade Minister Pablo Campana set off on 31 August for a month-long-tour through China, the US and Europe in search of investment. Campana is seeking new markets for traditional and value-added products, as well as FDI and new sources of financing. The Moreno government is touting a US$33bn investment portfolio, spread across at least 29 potential projects in sectors including basic industries, cellulose and the agro industry, the Pacific refinery, the Paute-Cardenillo and Rio Santiago hydro-electric schemes, plus road projects and various other infrastructure works.

Campana was presenting this portfolio in China on 3-9 September, before continuing in the US on 11-16 September, where talks about an extension of the US Generalised System of Preferences, due to expire in December, is high on the minister's agenda. Some 300 Ecuadorean items benefit from the GPS. Campana has also mooted exploring talks on a new trade or commercial agreement with the US, albeit given the current protectionist hue of the US administration led by President Donald Trump, not to mention its generalised suspicion of Latin America's 'Bolivarian' governments, this may be an optimistic ambition. Thereafter, Campana will go Switzerland, the UK, Sweden and Norway, with financing for bioeconomy (and biotechnology) on the agenda. Campana will also look to progress commercial agreement talks with the European Free Trade Association (EFTA, comprised of Switzerland, Norway, Liechtenstein and Iceland).

Petroamazonas gets output up

Petroamazonas produced 444,000 bpd of oil on average in the first seven months, 78% of total national output. This reflected the company's sustained efforts to boost stagnant output by opening up new fields, including the Ishpingo-Tambococha-Tiputini (ITT) protected Amazon reserve. (By contrast, output by private producers remains in sustained decline).

Having announced that it would not stick to its OPEC commitment to lower output by 26,000 bpd to 522,000, Ecuador's total national output was 541,000 bpd in July, almost the 548,000 bpd it was producing before the OPEC quotas took effect in January. First half export data indicated why the new Moreno government opted to break with its OPEC quota. Oil export earnings came to US$3.3bn, lower than in the same periods of 2016 and 2015. In the first half of 2014, oil export earnings reachedUS$7.3bn (before the global oil price shock hit). Having inherited a fiscal deficit well in excess of 7% of GDP, the finance ministry argued that the government had no option but to increase oil sales beyond the agreed OPEC quota.

IMF confident that Trinidad & Tobago is turning a corner

The days of posting Chinese-style rates of GDP growth – which it did for much of the 1996-2006 period, when annual growth averaged well over 8% – are long gone for Trinidad & Tobago.

GDP growth has slowed sharply, with the drop in energy prices since 2014 driving the economy into recession – real GDP has contracted in each of the past three years. Yet the IMF was somewhat more positive about the country's prospects after its annual Article IV consultation, which took place on 20 July-2 August. It identified a nascent economic improvement and praised the government's fiscal policy adjustments, although cautioned that further work is necessary to arrest rising debt levels and address imbalances in the foreign exchange market.

At the heart of Trinidad & Tobago's problems is a heavy dependence on the energy sector (the sector accounts for 35% of GDP), with the country hit both by lower world prices, but also by a fall in domestic production volumes. According to data from BP's Statistical Review of World Energy, in 2016, natural gas production fell by 13.2%, to 3.3m cubic feet per day (cf/d), down from a peak of 4.3m cf/d in 2010, while oil production fell by 11.2% to 96,500 barrels per day (bpd), compared with a peak of 177,500 bpd in 2006. Local data from the central bank indicate that both natural gas and oil production remained relatively stable during the first half of 2017.

Still in recession, but bottoming out

There is no official data on real GDP from 2017, but the IMF noted that preliminary data showed that the economy continued to contract during the first half of the year, as these recent developments have continued to have a negative spill-over effect on the non-energy sector. However, the Fund stated that it believed the economic downturn has finally bottomed out, identifying a projected upturn in natural gas production as the main factor that will drive a recovery in economic performance later in 2017.

Meanwhile, recent exploration efforts on the part of the state oil company, Petrotrin, as well as a refinery upgrade, are expected to help reverse the slide in oil production. On the basis that energy sector production volumes begin to pick up, higher fiscal revenues would then help support public sector investment projects, which in turn would feed through to bolstering non-energy GDP growth.

The two main areas of concern flagged by the IMF, echoing previous policy assessments, are public debt levels and imbalances in the foreign exchange market. With relation to the first issue, concerns relate more to the pace of accumulation of public debt, rather than the level themselves.

As a share of GDP, the IMF estimated that public debt stood at just under 30% in its last full country report in mid-2016. But this has risen sharply in recent years (public debt averaged 17% of GDP in 2005-13) and, according to the IMF's baseline scenario, is expected to jump to 38.6% by the end of 2017 and to 78.7% of GDP in 2021. Although the IMF welcomed government efforts to boost revenue, it cautioned that the impact of things like asset sales will fade over time and that more extensive efforts to contain current spending were needed in order to reduce the fiscal deficit – which is already in double-digits as a share of GDP.

In late April both Moody's and Standard & Poor's ratings agencies downgraded Trinidad's credit rating. On 26 April, Moody's marked it down to Ba1 from Baa3, following S&P's 21 April markdown from A- to BBB+. The S&P rating is still considered to be investment grade; the Moody's rating is classified as junk-bond status. For Moody's, debt was the key issue.

Currency overvaluation

With relation to the second area of concern, the Fund highlighted the "paramount importance" of reducing imbalances in the foreign exchange market, that have been generated as a result of the sharp fall in energy receipts. The Trinidadian dollar had long been heavily managed around the TT$6.3:US$1 mark, but has been allowed to depreciate since late 2015 to address local currency overvaluation.

However, the authorities have continued to intervene heavily and the pace of depreciation has been mild (the Trinidadian dollar is currently trading at around TT$6.7:US$1). Assuming that the authorities do not sanction a more significant depreciation, the IMF recommended that the government look at ways to lift foreign currency earnings, through tabling structural reforms that would bolster investment in the non-energy sector. This would also help diversify the economy, supporting longer term growth in the event that energy prices remain relatively suppressed. The recommended reforms include changes to public procurement processes, reducing the costs associated with doing business and modernising financial supervision.

Material improvements unlikely in the short term

However, the government is likely to encounter difficulties in enacting some of the prescribed spending cuts and reform recommendations. The public is already frustrated by years of sub-par economic performance and opposition to some legislative proposals has already resulted in reforms being either delayed or suspended.

Assuming that the economy returns to growth later in 2017 or in early 2018, as expected by the IMF, this may boost public confidence in economic policy reforms, but rapid progress on the reform front is unlikely. The Fund expects real annual GDP growth of just 0.3% in 2017, rising to 3.4% in 2018, with inflation of 3.7% in 2017 and 4.7% in 2018.

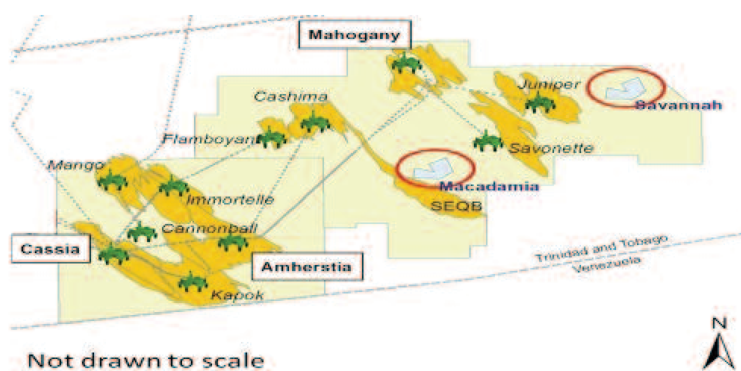
Moreover, efforts to diversify the economy – even if successful – will take several years to have a significant impact on the economy, given the feed-through times from higher investor interest to actual investment inflows and, finally, rising production. In the meantime, the underlying economic situation is likely to remain relatively weak, characterised by fairly low GDP growth, still-high fiscal deficits and rising public debt levels.

New offshore prospects offer hope

In June, BP Trinidad and Tobago (BBTT), 70% owned by BP, with Spain's Repsol holding the other 30%, announced two significant discoveries of approximately 2trn cubic feet (tcf) of gas. The discoveries were made in the Savannah and Macadamia exploration wells, some 80km off Trinidad, for which BBTT has a 100% working interest.

According to a report from the specialist website *offshoretechnology.com*, the Savannah exploration well was drilled "at water depths of over 500 feet into an untested fault block east of the Juniper field, a US$2bn BBTT project sanctioned in 2014". According to the report, based on the success of the Savannah well, "the company expects to develop the reservoirs via a future tieback to the Juniper platform, which is due to come online in mid-2017", while the Macadamia discovery "is expected to support a new platform post-2020".

BBTT president Norman Christie was reported as saying that the find represented "the start of a rejuvenated exploration program on the Trinidad shelf". "Even after 55 years of operations the Columbus Basin still has more to give with the right technology being applied", he added.



BPTT operates 904,000 acres off Trinidad's east coast and has 14 offshore platforms and two onshore processing facilities. In May, it pledged to invest an additional US$56bn in Trinidad over five years, which comes on top of an approved investment pipeline of US$10bn for the 2012-2022 period.

Offshoretechnology.com also noted that the company had secured approval for the development of its Angelin offshore gas project, noting that this will involve the construction of a new platform 60km off the south-east coast of Trinidad, in water depths of approximately 65m. "The development will include four wells and will have a production capacity of some 600 million standard cubic feet of gas a day (mmscfd). Drilling is due to commence in 2018, with first gas from the facility expected in 2019", it noted.

Elsewhere, in January BHP Billiton reported that its LeClerc discovery, also located in deep water off Trinidad's south east coast, contained a potentially large resource of natural gas and oil.

In August, BPTT announced the first gas from its Juniper development, the fifth of BP's seven Upstream major project start-ups planned for 2017. Juniper began production on schedule and under budget, a company announcement boasted.

According to the company, the project is expected to boost BPTT's gas production capacity by an estimated 590 million standard cubic feet a day (mmscfd). With a US$2bn investment, Juniper is BP's first subsea field development in Trinidad. It produces gas from the Corallita and Lantana fields via the new Juniper platform, 50 miles off the south-east coast of Trinidad in water approximately 110 metres deep. The gas then flows to the Mahogany B hub via a new 10-km flowline installed in 2016.

Bernard Looney, chief executive of BPTT Upstream, noted that, "Juniper is a major milestone in BP's more than 50 years of investment in Trinidad and Tobago. It is the largest new project brought into production in Trinidad for several years and the second major project we have started here this year". (The Trinidad Onshore Compression project, another large gas scheme, began operations in April).

Separately, Royal Dutch Shell will acquire the Trinidad and Tobago assets of the US oil company Chevron. The US$250m deal will allow Shell to "optimise its developments across the East Coast Marine Area, a core component of Shell's interests in Trinidad and Tobago, through which it is supplying gas to both the domestic market and Atlantic LNG", the company said in a statement in June.

UNICEF calls for an end to child poverty in LAC

There are 195m children in Latin America and the Caribbean (LAC), a high 31% of the population. In its latest annual overview of child poverty in the region, UNICEF notes that despite progress, four of every ten children are still considered poor from a human rights and multidimensional perspective, while one in six are considered 'extremely poor'. In all, a staggering 70m children in the region are categorised as living in poverty.

According to Marita Perceval, UNICEF's regional director, Latin America and the Caribbean not only has the greatest global social inequality but is also marked by severe violence. The figures make for very grim reading. On UNICEF data, the region has the highest child and adolescent homicide rate worldwide, causing 25,000 deaths per year. One in every four child and adolescent homicides in the world takes place in Latin America and the Caribbean. Two out of three children under the age of 15 suffer physical or psychological violence at home.

The situation of young women is particularly vulnerable. It is estimated that 1.1m adolescent women between the ages of 15-19 are victims of sexual abuse. Four of every 10 young women aged 15-19 have already experienced partner violence in their short lifetimes – and one of every four are married before the age of 18, which UNICEF describes as "a fundamental violation of human rights". Early marriage "compromises a girl's development by potentially resulting in early pregnancy and social isolation, interrupting her schooling, limiting her opportunities for pursuing a career, greater risk during pregnancy, etc. Also, married or cohabiting women before 18 years old are at increased risk of domestic violence," it notes.

With 79% of the regional population living in urban areas, there is a crucial need for decent housing as a basic starting point in the battle against poverty. UNICEF notes that those most affected by poverty and in the most vulnerable situations are those living in so-called 'peri-urban' areas. These children and adolescents "become displaced, affecting their rights to health, education, protection and social participation". Some 14m children and adolescents in the region are not attending school, for example, including 3.6m of primary school age, 2.8m of lower secondary school age and a high 7.6m of upper secondary school age.

The report also makes the point that the negative impact of phenomena related to climate change is greater on children and adolescents. It estimates that "13.4m children and adolescents live in regions with high or extremely high risk of drought. 13.1 million live in areas at high risk of flooding".

On the positive side, UNICEF emphasises the "substantive progress" in the economic and social development of Latin America and the Caribbean in the past two decades. This progress, it notes, "has positively influenced the well-being of millions of children and their families", with many more children able to exercise their rights. Nonetheless, progress has been uneven. The region is still one of the most unequal in the world, and "there are still many disadvantaged and excluded girls and boys, who continue to face barriers preventing them from accessing social services and protection".

UNICEF notes that by agreeing to the 2030 Agenda and the Sustainable Development Goals and to other international and sub-regional commitments, as well as the Convention on the Elimination of all Forms of Discrimination Against Women, it is the responsibility of all regional authorities to ensure universal access to such services. It urges governments at both

the national and sub-national level "to continue strengthening policies and programmes and ensure an equity focus". At the same time, it adds, "civil society, media, opinion leaders and businesses, among others, also need to take action to ensure that all children can exercise their rights". Furthermore, it advises that "girls, boys and adolescents must be empowered to actively participate in policy formulation and decision making, as well as in the implementation and monitoring of policies".

Finally, the report calls for stronger efforts in the collection of disaggregated data to make informed decisions and formulate and implement inclusive policies and programmes.

UNICEF calls for actions to ensure that all children can exercise their rights, so that all young girls and boys:

- Can move out of the inter-generational cycle of multi-dimensional poverty;
- Can survive and not die from preventable causes;
- Are learning and benefit from quality education; and
- Are prevented from being a victim of any form of violence.

Marita Perceval notes that "2030 not just another number. It is more than an agenda; it is an ethical horizon, a social challenge, an economic necessity, and an environmental imperative."

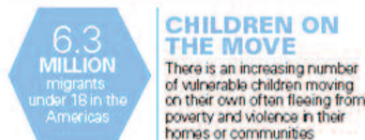
ADDRESSING THE RIGHTS OF 195 MILLION CHILDREN

IN LATIN AMERICA AND THE CARIBBEAN

END CHILD POVERTY

195 million CHILDREN LIVE IN THE REGION

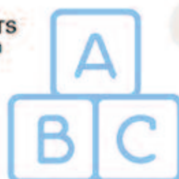
Poverty and its consequences are suffered more by rural, peri-urban, indigenous and Afro-descendant populations



ALL CHILDREN LEARNING

14 MILLION CHILDREN AND ADOLESCENTS are outside the education system

1.6 MILLION CHILDREN are excluded from pre-primary education



END CHILD DEATHS

196,000 CHILDREN under the age of five die each year

6 MILLION CHILDREN under five are affected by chronic malnutrition, mostly in rural areas

3.9 MILLION CHILDREN under five are overweight

END VIOLENCE

25,000 CHILDREN AND ADOLESCENTS in LAC are victims of homicides each year

1 OUT OF 2 CHILDREN under 15 years old is subject to CORPORAL PUNISHMENT at home

IMPACT OF CLIMATE CHANGE IN CHILDREN

13.4 million children live in high or extremely high drought risk areas

13.1 million children live in extremely high flood risk areas

unicef

IMF praises 'dynamic' DR

Despite a lot of political noise from the Odebrecht scandal, the Dominican economy continues to grow at a robust pace, buoyed in the past few years by low energy prices, strengthening labour markets, dynamic investment, and the US recovery, the IMF noted in its latest country report, released in mid-August.

Odebrecht investigation continues apace

As reported by *LatinNews Daily*, the last of the 14 defendants charged in relation to the bribery scheme run by the Brazilian engineering firm appeared before a local supreme court judge on 5 August, completing the first phase of the Odebrecht investigations in the DR.

In plea bargain testimony to Brazilian, US and Swiss officials, Odebrecht said it had paid out an estimated US$92m in bribes to Dominican officials between 2001 and 2014 in order to secure public works contracts. Payments were funnelled to officials under the successive governments led by Hipólito Mejía (Partido Revolucionario Dominicano [PRD], 2000-2004), Leonel Fernández (Partido de la Liberación Dominicana [PLD] 2004-2012) and the incumbent president Danilo Medina, first elected for the PLD in 2012 and re-elected in 2016.

The Dominican peso closed at DOP47.3/US$ on 5 September, continuing a gradual depreciation from an average of DOP45-46/US$ in 2015-2016.

The country's attorney general, Jean Alain Rodríguez, in May had announced charges against the 14 for crimes including asset laundering, bribery, illicit enrichment, embezzlement and perversion of justice. Those facing trial include senior officials such as Temístocles Montás, the former industry & trade minister (and economy minister from 2010-2016); a former public works minister, Víctor Díaz Rúa (2007-2012); a senior member of the ruling Partido de la Liberación Dominicana (PLD) political committee, Radhamés Segura; and the president of the main opposition Partido Revolucionario Moderno (PRM), Andrés Bautista.

Of the 14 charged, only Víctor Díaz Rúa and a local businessman, Angel Rondón Rijo, were remanded in prison. Moreover, the lower chamber of congress refused to lift immunity from prosecution of PRM Deputy Alfredo Pacheco (among the 14 defendants), while the party ratified him as its spokesman. The senate, meanwhile, refused to lift immunity from two PLD senators, Julio César Valentín and Tommy Galán.

Supreme Court Judge Francisco Ortega on 5 August issued various coercive measures, including a travel ban and bail, against Bernardo Castellanos, who served as technical director of the state-run electricity generation firm, Empresa de Generación Hidroeléctrica Dominicana (Egehid), in 2000-2004. Castellanos, accused of taking bribes to award a contract to Odebrecht for construction of the Pinalito hydroelectric dam, in the north-western province of Santiago, was arrested on 2 August at the Aila international airport to the east of the capital, Santo Domingo, upon arrival on a flight from Panama, two months after an international arrest warrant was issued for him. In the second phase of the Odebrecht case, the attorney general's office will widen its investigations, which Judge Ortega said must conclude within the next six months.

As in other Latin American countries, public anger at pervasive official corruption has reached new peaks in the wake of the Odebrecht scandal. On 20 August, hundreds took to the streets in the southern province of Peravia, calling for the cancellation of the contract awarded to Odebrecht for the Punta Catalina coal-fired electricity generation plant, and for the firm to be expelled from the country. The demonstration was called by the anti-corruption protest group Marcha Verde, which has led civil society activism calling

for justice for the Odebrecht scandal. As well as calling for the Punta Catalina contract to be cancelled, Marcha Verde also demanded that local and provincial officials be investigated in relation to the contract, citing Senator Wilton Guerrero (PLD) and the mayors of the local municipalities of Baní and Catalina, Chacho Landestoy, and Juan (Caballón) Lugo respectively.

The Punta Catalina project was the only major public contract awarded to Odebrecht by the Medina administration (in 2013). The show of unrest illustrates broad public dissatisfaction with the findings of a report issued in July by a commission set up by Medina in January to review the tender process. The report found that the tender had "broadly adhered to the law" and said that Odebrecht's winning bid had been "reasonable". Marcha Verde slammed the report, on the grounds that the findings were based on a technical report commissioned to FTI Consulting, an international consultancy firm with links to Odebrecht.

Economic fall-out appears minimal to date

The IMF in its latest report said the economic outlook was "favourable", with the pace of real GDP growth – which has averaged a robust 7% since 2014 – outperforming most emerging markets and all the economies in the Americas, buoyed by domestic demand.

Real GDP expanded by 6.6% year on year in 2016, with both consumption and investment easing in the second half as financing conditions tightened. Labour markets and social indicators are steadily improving, the Fund noted, with real wages starting to catch up to strong productivity growth in 2015-2016, after remaining stagnant for over a decade. Strong growth was accompanied by low inflation (as lower oil prices kept pressures at bay), with headline and core inflation averaging 1.75% in 2016, below the central banks' inflation target range of 4% +/-1% for another year.

Lower oil prices, along with continued strong growth in tourism, and remittances, more than offset what the Fund described as 'an underlying weakness in goods exports', thereby allowing the current account deficit to narrow significantly, to an estimated 1.5% in 2016.

Meanwhile, the Fund noted that both fiscal and monetary policies tightened slightly in 2016, "providing a countercyclical offset to the positive output gap". The fiscal position improved marginally despite increasing spending pressures, "as the authorities' strong revenue administration effort begun to pay off". The consolidated public sector posted a deficit of 4.3% of GDP in 2016, the Fund reported. This took public debt to an estimated 49.7% of GDP at year-end. Monetary policy was tightened in November 2016, having been on hold for over a year, with the policy interest rate increased from 5% to 5.5% to deter any inflationary pressures as global commodity prices began to unwind "against a backdrop of a positive output gap and robust credit growth" in the domestic market. The Fund noted that a "healthy" local financial sector remained "well poised to support growth". Banking sector soundness indicators are strong, with healthy capitalisation, low asset impairment and strong provisioning, it noted.

Looking ahead, the Fund said it expected real GDP growth to moderate towards the potential rate of around 5% from 2017, with slightly higher fuel prices pushing inflation to target, and also widening the current account deficit moderately.

Risks around the baseline outlook were "balanced". The Fund identified the key risks to the DR as: the uncertainty surrounding the economic and policy outlook for external trading partners, particularly the US; the outlook for global oil prices; higher than expected global interest rates; and potential US dollar appreciation.

HONDURAS

Big increase in 2018 budget, as Hernández bids for second term

Finance Minister Wilfredo Cerrato will send congress an expansive 2018 budget on 14 September, with a planned overall annual increase of up to 8%. The budget is clearly pre-electoral, with Cerrato emphasising increased funding for health and education, citizen security, road and electricity infrastructure and various social welfare programs.

According to Cerrato, the 2018 budget will be in the region of HNL247bn, or approximately US$10.6bn at the current exchange rate. The 2017 plan was approximately US$9.8bn, up from roughly US$8.8bn in 2016. Cerrato added that the government expected to generate a full 80% of budget revenues from taxes, with the rest from donations.

The Honduran economy has recovered in recent years, spurred by renewed demand from its main trade and investment partner, the US, and helped along also by low oil prices. Honduras, like its Central American neighbours, is heavily dependent on oil imports for much of its fuel and energy needs.

Improvements in internal security have also helped, as noted by the World Bank's country representative, Giorgio Valentini, in late August, who said the defence and security strategies implemented by the current government were "vital factors" to economic growth in the country. Valentini was speaking at a ceremony to present a new Armed Forces report on the impact of security and defence on Honduran development.

Echoing Valentini, the deputy finance minister, Rocío Tábora, reported "very good" indicators from sectors such as agro industry, construction and manufacturing, noting also "important growth" in newer, non-traditional sectors. She claimed that the economy was on course for real annual GDP growth of 4% this year, up from 3.7% in 2016. She acknowledged, however, that growth needed to be some way higher, at around 7%-8%, so as to eliminate poverty in the country. According to the World Bank itself, poverty still affected over 66% of the population (of 8m) in 2016.

Nevertheless, "we are on the right road, this means confidence, security and justice, stability, low interest rates, [and] public and private investment", she stated. The IMF is on board with all of this, praising the country for its continued economic strengthening, as well as advances in the security situation, at the conclusion of a recent staff mission visit in June. Honduras in December 2014 signed a three-year US$187m stand-by program with the IMF.

Amid expanding economic activity and stronger business confidence, credit to the private sector was expected to grow by 10% in nominal terms, the IMF said after the June staff visit. Annual inflation through May edged up to 4.1%, on recovering domestic demand and slightly higher oil prices, but this remained within the central bank target band, and was consistent with Fund's year-end projection of 4.75%.

In a statement, the mission said the outlook for 2017 remained favourable, following estimated first quarter real GDP growth of 4-4.5% year on year, driven by "a steady expansion of private consumption" and strong export growth. Growth was also being driven by "scaled up public infrastructure investment and active monetary policy", it observed. Meanwhile on the fiscal side, the non-financial public sector deficit was expected to increase to accommodate planned investment in infrastructure – but remaining below the 1.5% of GDP ceiling established in the Fiscal Responsibility Law. The mission encouraged the government to press forward with its current macroeconomic, financial and tax administration policies, noting that its discussions with the local authorities had been "productive".

This will be music to the ears of President Juan Orlando Hernández, who appears on course to win a second term in office in the November general election. While his bid for re-election is not without some controversy, the US (and thus the IMF and key donors like the World Bank) appear to have accepted the April 2015 supreme court ruling lifting the ban on re-election, and therefore the prospect of Hernández remaining in power.

REGION

Fintech making an impact in Latin America

A wave of new technology-based financial companies (known as FinTechs) is spreading through Latin America and the Caribbean (LAC). A study published in August notes that they are bringing innovation and change, and potentially reaching parts of the population previously not served by traditional financial products. However, they also pose regulatory challenges.

Fintech Startups in Latin America, a report jointly written by the Inter-American Development Bank (IDB) and Finnovista, a regional Fintech association, identifies 703 start-up companies operating across 15 countries in the region. Three of every five of these companies were set up between 2014 and 2016, underlining their recent arrival and hoped-for high potential.

One in four of these can be described as alternative financial platforms, offering loans, crowd funding or factoring. Another quarter specialise in payments systems. The remaining focus on activities such as enterprise and personal financial management, wealth management, insurance and digital banking. Most of the start-ups are based in Brazil (230), followed by Mexico (180). Then come Colombia (84), Argentina (72), and Chile (65). Together, these five countries account for nearly 90% of total FinTech activity in the region.

The existing FinTech start-ups have a strong focus on improving financial inclusion. Four out of ten said their mission included serving those who are excluded or underserved by the traditional financial services sector. "We are witnessing a revolution in the way in which people and businesses manage their finances", commented Gabriela Andrade, an IDB financial markets specialist. "In addition to achieving lower costs by adopting digital channels, FinTechs use different sources of information and new techniques to evaluate customers, their behaviour and their risk, which allows them to reach excluded segments in a more affordable way."

These new companies do pose regulatory challenges, however. Central Banks and financial superintendencies do not yet necessarily have the expertise to understand exactly how they operate and what credit risks they might pose for the wider financial system. The report suggests creating regulatory 'sandboxes' – or trial areas, where new FinTechs can operate, evaluate their business models, and offer their products in monitored environments. This would allow a smooth transition "towards an adequate regulation and supervision". The report recommends that governments should support the development of FinTechs and nominate a public figure or institution to promote dialogue between the emerging industry and the regulatory authorities. Andrés Fontao, a managing partner of Finnovista, observed that "regulation is a factor that needs to be addressed by governments and legislators, not with a restrictive purpose and stricter controls, but from a perspective that promotes competitiveness and innovation and the national and regional level."

REGION

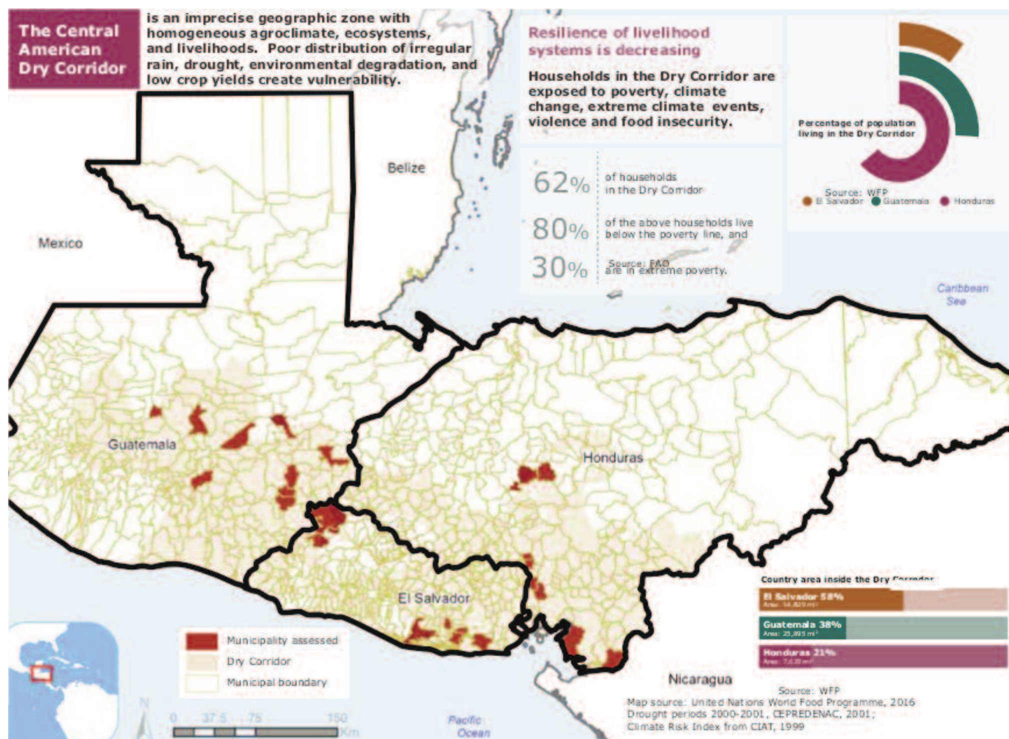
Droughts driving Central American emigration

In recent years, there has been heavy emigration from the so-called Northern Triangle countries of Central America – El Salvador, Guatemala and Honduras. Much of the media coverage has focused on the political and social factors pushing people to leave, including issues such as persecution, extortion and threats from criminal gangs. But a new United Nations study also highlights the economic factors at work.

A key part of the problem according to a UN multi-agency study, *Food Security and Emigration*, is the role of the Central American 'Dry Corridor'. This corridor is defined as an "imprecise geographic zone, with homogeneous agro climate, ecosystems, and livelihoods" that runs through all three Northern Triangle countries in a broadly east-west strip. The study has found that there is a correlation between prolonged droughts across the corridor, which were intensified by the El Niño weather pattern in 2014-2016, and the increase in irregular migration from these three countries to the US. Rainfall levels in the Northern Triangle countries were above average before 2014, but below average in 2015 and 2016. Migration was lower before 2014, but higher after. According to US Customs and Border Protection (CBP), the number of 'illegal aliens' detained in the south-western border area of the US rose steadily from around 50,000 in Fiscal Year (FY) 2010 to over 250,000 in FY2014. After reaching 210,000 in FY2015, the numbers then surged again to 408,870 in FY2016. Border apprehensions are considered a reliable proxy for overall migration flows.

The Dry Corridor is characterised by high unemployment, limited and seasonally fluctuating labour demand, and low and intermittent payment of wages. Local households spend as much as two thirds of their income on food. Their own production of foodstuffs has fallen because of droughts and lower rainfall. Outside of the Corridor, the coffee rust disease has also hit coffee production. The report notes that "adverse climactic conditions in the Dry Corridor affect food security by curbing agricultural productivity in commercial and subsistence farming as well as agricultural work opportunities. The El Niño drought conditions that started in 2014 caused a significant increase in irregular migration to the US."

The study says that there is a trend by younger and more vulnerable people to leave food-insecure areas, especially those in the Dry Corridor. Family members who stay behind face the additional problem of having to pay off the debts of those who left. The study interviewed a wide group of families; 47% of those they spoke to were defined as food-insecure, one of the highest levels recorded over the last three years of regular assessments made in the Dry Corridor. An even larger proportion – 72% – of Dry Corridor families said they had to use emergency survival strategies, such as selling their land, farm animals, or tools to buy food.



Source: *World Food Programme*

What is clear is that emigration is seen as an economic survival strategy; when members of a family emigrate successfully, they provide essential support for their relatives by regularly sending remittances back home. The study found that in cases of successful emigration 78% of households in the home country said they were receiving remittances; 42% said the remittances were their only source of income. Over half of the funds were used for buying food, followed by investments in farming and small businesses; remittances were also spent on education and health care.

REGION

The robots are arriving in Latin America

A big global debate is in progress over the use and impact of robots and advanced technology in production processes. Much of the discussion concerns the fear that many traditional jobs will be lost. A new publication from the Inter-American Development Bank (IDB) tries to assess how far the robots have advanced in Latin America.

Robotlution: The Future of Work in Latin American Integration 4.0 is a collection of articles discussing the impact of technology on employment. The subject is fascinating, vast and highly complex, all of which means it is difficult to draw hard and fast early conclusions. In his introduction, the IDB's Antoni Estevadeordal lists the wave of changes already happening as part of what is called the Fourth Industrial Revolution: the Internet of Things (IoT), cloud computing, big data, artificial intelligence (AI), blockchain, and 3D printing among them. He points out that "Artificial intelligence and automation can increase productivity and incentivise reshoring, but there are many questions about their impact on trade, employment, and social equality. While some jobs are being automated, new professions are appearing and new skills are changing and updating traditional jobs".

Marcelo Cabrol, another IDB official, takes an optimistic stance. He argues that if Latin America and the Caribbean (LAC) responds with the right combination of reforms, strategic investment and skills development, it will create an opportunity not just for new business ventures, but also to close some of its social and economic inequality gaps. The challenge, he argues, is to build innovative eco-systems and emulate what is being done by entrepreneurial public authorities, like those in South Korea and Israel.

The publication captures the fact that the "robot revolution" is just beginning, meaning that it is still hard to assess its true magnitude. Existing global estimates say the share of jobs that could be replaced by robots ranges from 5% to 47%, depending on the method of calculation used. Against this, it is estimated that each new technology job can generate 4.9 other jobs as part of a spill over effect. The threat of job losses through technology varies from country to country and sector to sector. For the agricultural sector in Uruguay, the risk is said to be as high as 82%, and is particularly acute for those with low levels of formal education, for the young, and for men. In the transport sector in Argentina, the risk is calculated at 76%. There is some early information on robot numbers. Switzerland, Germany, Japan, and South Korea currently have the highest number of robots per industrial worker – more than 20 per thousand. In the LAC region, Mexico and Brazil have the most robots, but at 1-2 per thousand industrial workers, they are still far behind the more developed countries.

REGION

Foreign Direct Investment still falling

The UN Economic Commission for Latin America and the Caribbean (ECLAC) has published its annual report on Foreign Direct Investment (FDI), according to which total inflows fell again in 2016, declining by 7.9% to US$167.04bn. A further 5% decline is expected this year.

Regional FDI inflows reached a peak in 2011, at the height of the commodities boom, and since then have been contracting. The report cites three main reasons for this fall. One is the end of the commodities super-cycle. Lower international prices for commodities have led to a downward shift in foreign investment in the natural resources sector. The second reason is connected to the first: since 2011, economic growth in LAC has slowed down substantially

in a number of countries, therefore making them less attractive as destinations for new investment across all sectors.

The third reason is particularly interesting. ECLAC says that the global boom in new technologies and the digital transformation of production processes is tending to concentrate transnational investment in developed economies. As a result, there is less capital available to flow out to the world's developing and emerging economies.

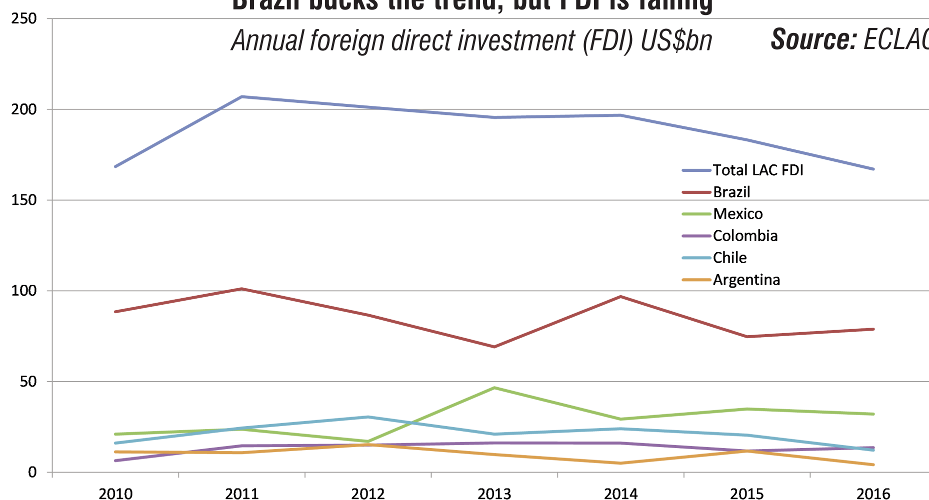
ECLAC executive secretary Alicia Bárcena put it as follows: "Foreign Direct Investment has been an important factor for the development of export activities that are key to the growth of Latin America and the Caribbean, as well as for the creation of new sectors. But the big productivity gaps that persist in the region and the new technological scenarios that the fourth industrial revolution poses requires new policies to harness the benefits of FDI in national processes of sustainable development" she said.

In 2016, the LAC region received 10% of global FDI, similar to 2015, but below the 14% average achieved in 2011-2014. The total was equivalent to 3.6% of regional GDP, showing that Latin America still attracts more FDI than the global average, which stands at 2.0% of GDP.

Another interesting point in the ECLAC report is that despite suffering its second year of steep recession, Brazil, the region's largest economy, experienced a 5.7% increase in FDI last year, taking the total to US$78.9bn. The suggestion is that international companies still see long-term potential in Brazil, despite its current recession and political crisis. Brazil attracts the lion's share of LAC FDI – nearly half the total (47%). Mexico, the second largest economy in the region, experienced a 7.9% fall in FDI, which came down to US$32.1bn, representing 19% of the LAC total. Colombia was the third-largest destination for FDI, taking 8% of the regional total. Inflows there rose by a strong 15.9% to reach US$13.6bn. Chile was in fourth place, attracting US$12.2bn (7% of the total). In Central America, the biggest FDI destinations were Panama and Costa Rica. In the Caribbean, the largest FDI flows went to the Dominican Republic and Jamaica.

By economic sectors the share of total FDI going into natural resources fell from an average of 18% in 2010-2015 down to 13% in 2016. The share of manufacturing and services rose respectively to 40% and 47% in 2016. Investments last year were concentrated in renewable energy, telecommunications and the automotive sector. Renewable energy investments represented 18% of total FDI last year and were particularly strong in Chile and Mexico.

As for the sources of FDI, there is little evidence of diversification. More than half (53%) of total investment continued to come from the US, with 20% from the European Union (EU). According to the official figures, FDI from China remains surprisingly low, at only 1.1% of the total. However, ECLAC suggests that the statistics under-represent the real level of Chinese FDI. An analysis of LAC mergers and acquisitions involving Chinese companies last year suggests that the real level of Chinese investment must be higher. Deals announced by Chinese companies in the first half of 2017 also suggest that the country's share of LAC FDI must be on the increase.



The data suggests that Latin American transnational compa-

nies – the so-called *multilatinas* – had a quiet year in 2016. FDI outflows from LAC countries dropped by 50% to US$24.6bn, suggesting that the *multilatinas* were a lot less active in M&A terms outside their home markets.

This latest report has a section on Mexico's automotive industry, which in recent years has experienced rapid investment-led development, but which faces uncertainty amid the protectionist stance adopted by US President Donald Trump, who is trying to ensure that more jobs are generated on the US side of the border. ECLAC notes that after the global financial crisis of 2008, Mexico's auto industry saw a rapid transformation, evolving from being a low-cost platform for the assembly of low-end vehicles to become "a more integrated and diversified productive chain in terms of products and technological sophistication." The Mexican auto industry now accounts for 3% of the country's total GDP, 18% of manufacturing GDP, has a US$52bn per annum trade surplus, and has accumulated FDI worth US$51.2bn since 1999. The sector is responsible for 900,000 direct jobs. Eighty per cent of output is exported, and 86% of those exports go to Canada and the US. Mexico has become the world's seventh largest vehicles producer and the fourth-largest exporter.

While this can be read as an unqualified success story, it is also true that the industry faces big future challenges. The automotive industry faces unprecedented change with the move to electric and self-driving vehicles, the advent of tighter energy-use and environmental regulations, and the uncertainties around Trump's policies and the future of NAFTA.

REGION

Corporate Radar

Pemex denies Odebrecht bribes: In Mexico, former Pemex chief executive Emilio Lozoya denied taking bribery payments from the Brazilian construction company Odebrecht and channelling them President Enrique Peña Nieto's 2012 election campaign. The claims were made by the Brazilian newspaper *O Globo*, citing Odebrecht executive Alberto de Meneses Weyll, who said the company had paid Lozoya US$10m in bribes to secure a US$115m contract for work at the Tula refinery. Lozoya, who left Pemex in 2016 said he "categorically denied" the claims; they were also rejected by Eduardo Sánchez, chief spokesman for President Peña Nieto.

New Mexican stock exchange: Mexico's main financial regulator has approved the launch of a new stock exchange, to be called the Bolsa Institucional de Valores (BIVA), which is to operate alongside and compete with the existing Bolsa Mexican de Valores (BMV). The BMV has only 144 listed companies (less than half the number in Brazil or Chile). Santiago Urquiza, president of brokers Central de Corretaje (Cencor), is launching the new venture, which he says will use Nasdaq's X-stream Trading platform. Urquiza says BIVA will seek to attract companies with annual sales of between MXN500m and MXN1bn (US$28056m), as well as a new wave of start-ups. Overall, it is targeting a 30% increase in the number of listed companies in the country over the next three years, to take the total up to over 200.

Petrobras in China deal: On 2 September, Brazil's state-owned oil company Petrobras said that it had signed a strategic agreement with the China Development Bank (CDB) allowing it to explore opportunities on China's financial markets. Newspaper *Valor Económico* said that the agreement, signed by President Michel Temer during a visit to China, would allow the Brazilian company to raise finance and use the second half of a US$10bn credit line opened by CDB in 2016 and guaranteed by Brazilian oil exports. Areas of collaboration would include the financing and leasing of oil platforms. Petrobras has a heavy debt load and has been hard hit by corruption scandals. The current management is seeking to sell assets and cut spending as part of a recovery plan.

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