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CONTENTS

Does poverty drive protest?

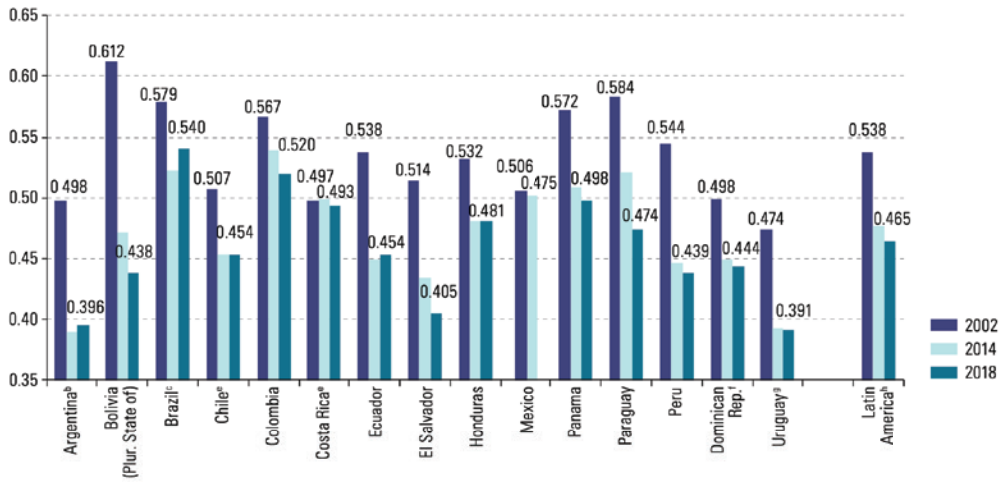
Protests in Ecuador, an abrupt change of government in Bolivia, strikes in Peru, demonstrations in Colombia and the ongoing political crisis in Venezuela suggest the Andean region as a whole is in the throes of an upheaval. While different factors are in play in each country, could there be a shared diagnosis that rising poverty and inequality has been a contributing factor?

The relationship between economic factors and social unrest is never simple. But there is a potentially over-arching narrative that after the rising living standards of the commodities boom, the expansion of the middle class has slowed, inequality has once more begun to increase, and some people are slipping back into poverty. The latest *Social Panorama of Latin America*, a statistical and analytic compendium published by the United Nations Economic Commission for Latin America and the Caribbean (Eclac) gives some qualified support for that hypothesis at a continent-wide level.

In its report released in November 2019, Eclac says poor and low-income groups fell from 70.9% to 55.9%, as proportion of the total population in 2002-2017. The middle classes on the other hand, expanded from 26.9% to 41.1% of the population, while high income groups also expanded from 2.2% to 3% of the total. Yet the new middle classes are fragile: many have informal and precarious jobs and inadequate health and pension provision. As economic growth has slowed, the risk of them falling back into poverty is substantial. For Latin America as a whole the fall in poverty rates bottomed out in 2015 and has begun to rise again. Eclac calculates that the proportion of the population living below the poverty line will have increased from 30.1% last year to 30.8% in 2019. Those in extreme poverty will have risen from 10.7% to 11.5%. Overall, there was a 2.3 percentage point increase in Latin American poverty in 2014-2018, due mainly to the statistical impact of rising poverty in Brazil and Venezuela.

After falling for over a decade, income inequality has also begun to increase again. The Gini coefficient, a measure of inequality of income that goes from high (1.0) to low (zero), fell across 15 countries from 0.538 in 2002 to 0.465 in 2018. However, the downward trend has slowed, and other indicators of inequality are rising. While the Gini coefficient is based on household surveys, Eclac shows that if other indicators such as information from tax records and relating to net wealth are taken account, the picture becomes more concerning. In Brazil in 2014 the household survey suggested the richest 1% received 9.1% of the country's total income, but when tax information was taken into account this rose to 27.5%. The same calculation carried out in Colombia showed that, according to household surveys, the top 1% of the Colombian population takes 6.7% of the total income. When tax information is taken into account, that surges to 20.5%.

Latin America (15 countries): Gini inequality index, 2002–2018[a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Household Survey Data Bank (BADEHOG).
[a] The Gini index was calculated on the basis of income equal to zero.
[b] Urban total.
[c] The figures for 2002 and 2014 were adjusted for the difference between the National Household Sample Survey (PNAD) and the Continuous National Household Sample Survey (PNAD Continua) of 2014, to make them comparable with 2018 figures.
[d] Figures for 2002, 2014 and 2018 refer to 2003, 2015 and 2017, respectively.
[e] Figures from 2010 onward are not comparable with those of previous years.
[f] Figures for 2018 are not strictly comparable with those of 2002 and 2014.
[g] Figures for 2002 refer to urban areas.
[h] Simple average based on the data available for the nearest year for each of the 15 countries.

How do the Andean countries fit into the wider Latin American picture? In terms of the Gini index Bolivia, Ecuador, and Peru are below the Latin American average of 0.465, meaning they have a more equal distribution of income. Colombia is above the average (less equal) and there are no up-to-date figures for Venezuela. Perhaps more significant than the regional comparison, however, is the rate of change in each country over time. In 2002-2018 Latin America achieved a 13.6% reduction in inequality as measured by the change in the Gini index. Over the same period Bolivia, Peru, and Ecuador have done better, reducing inequality by 28.4%, by 19.3%, and by 15.6% respectively. Colombia has done worse - achieving a reduction of only 8.3%. Again, there is no comparable data for Venezuela. These numbers are interesting: they suggest that whatever the combination of political factors that led to the overthrow of former president Evo Morales (2006-2019) in Bolivia, his administration delivered one of the sharpest reductions in inequality recently experienced anywhere in Latin America.

Peru focus

According to Peru's development & social inclusion minister, Ariela Luna, around 9m of her fellow citizens, out of a total population of 32m, are poor or vulnerable. Earlier data from Peru's national statistics institute (Inei) had indicated that in 2017, a total of 21.7% of the population, or 6.9m people were living below the 'monetary poverty line'. A recent article by Omar Coronel for BBC Mundo sought to answer the question why, at least in recent months, Peru seems to have witnessed less intense political protests than its immediate neighbours such as Ecuador to the north or Chile to the south. Coronel argues that the combination of poverty, inequality, and corruption is just as potentially potent in Peru as in its neighbours. At least 40% of Peru's middle class is economically "vulnerable". And Peruvians do protest: according to the Defensoría del Pueblo (ombudsman's office) there were 11,600 protests in the decade to 2018, of which 23% involved some level of violence. However, Coronel identified three "safety valves" that may ease underlying socio-economic tensions. First, informal employment can offer some short-term relief to the gaps in government social service provision. Second, the campaign against corruption – which in Peru has involved voting in referenda and placing well-known politicians on trial – can give a sense that something is being done. Third, the government of President Martín Vizcarra has been relatively weak, has avoided excessive use of the security forces, and has made concessions to protestors. Paradoxically perhaps, this has given it an extra degree of resilience. It might also be added that while there has been an economic slowdown, Peru still has one of the stronger GDP growth rates in the region (around 2.5%, below 3.5% in Bolivia and 3.2% in Colombia, but ahead of 1.8% in Chile, 0% in Ecuador, and a massive 25.5% fall in Venezuela, according to Eclac estimates for 2019).

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The costs of protest: Ecuador digs itself into a deeper economic hole

On 28 December 2019 Verónica Artola, the general manager of Ecuador's central bank (BCE) announced during a radio interview that its forecasts for the country's economic growth in 2019 had been downwardly revised due to the impact of the October protests. While Artola did not declare the revised growth prediction, she did state that growth would be negative, down from the previous forecast of 0.2%, due to losses of between US$700m and US$800m during the protests.

The 11 days of disruption and demonstrations from 3-13 October 2019, protesting the elimination of fuel subsidies had significant short-term economic consequences, especially affecting the oil and tourism sectors. Nonetheless, the more durable high costs of loss of investor confidence and the reinstatement of fuel subsidies pose a more significant challenge for the struggling Ecuadorean economy.

The protests, which were led by indigenous groups and transport unions, were the most significant faced by Ecuador in decades. The extent of the pressure exerted on the Ecuadorean government was demonstrated not only by the eventual concessions it made to protesters, but also by the decision to temporarily transfer the seat of government from Quito to Guayaquil, Ecuador's second largest city.

"In March 2019 the International Monetary Fund (IMF) approved a US$4.2bn loan for Ecuador to support the government as it attempts to reduce its large fiscal deficit. The elimination of fuel subsidies formed an important part of the wider package of economic reform measures that seek to comply with IMF lending conditions".

The protests were triggered by President Lenín Moreno's announcement of decree 883 on 1 October, which came into force on 3 October and eliminated the state subsidy for diesel and 'Extra' and 'Ecopaís' petrol types, the most used fuels in Ecuador. The Moreno administration justified the removal of these subsidies, which have been present in the country for four decades, by citing the prevalence of the contraband of subsidised fuel to neighbouring countries, and most significantly, the economic reality that the country currently finds itself in.

In March 2019 the International Monetary Fund (IMF) approved a US$4.2bn loan for Ecuador to support the government as it attempts to reduce its large fiscal deficit. The elimination of fuel subsidies formed an important part of the wider package of economic reform measures that seek to comply with IMF lending conditions.

The cost of such subsidies for the Ecuadorean government has been high - a study by the Inter-American Development Bank (IDB) published in June 2019 found that in the past decade fuel subsidies have accounted for an average of 7% of public spending in Ecuador, equal to two-thirds of the fiscal deficit.

The removal of subsidies would therefore have played an important role in the Moreno administration's efforts to reduce the deficit, delivering annual savings estimated by Finance Minister Richard Martínez of approximately US$1.4bn.

Significant short-term disruption

As highlighted by the BCE's downward revision of growth forecasts, the short-term disruption of the protests was serious enough to significantly impact the estimated overall growth of Ecuador's economy in 2019, especially in the oil and tourism industries.

The state-owned oil company Petroamazonas declared production losses of 1.5m barrels during the protests, equivalent to US$83.4m in oil revenues, and reported damages to private companies amounting to over 500,000 barrels. These losses were attributed to the paralysation of operations and the disruption in the supply of fuel to consumers.

An exemplary case of the former was the disabling of the trans-Ecuadorean oil pipeline system (Sote), a crucial part of the country's oil infrastructure which transports oil from the eastern Oriente region to the three major coastal refineries. The temporary suspension of the Sote on 7 October was caused by forced entry in the system's critical infrastructure in Lago Agrio, Sucumbíos province.

Regarding the challenges in the transportation of fuel during the protests, Petroamazonas said that in 11 provinces supply of fuel was categorised as 'critical' at some point during the protests, due to the blocking of roads by demonstrators. The state-owned firm also reported a number of attempted and successful break-ins into oil camps and the sabotage of 101 oil wells, with damage to infrastructure owned by Petroamazonas set to cost the state an estimated US$48.4m in repair work.

The tourism sector suffered from significant decreases in both internal and external tourism with a total loss of US$52.7m in immediate revenues, as calculated by the tourism ministry. For the 11 days of protests, the ministry reported a reduction of 31.9% in international arrivals compared to the same period in 2018, equivalent to 16,070 fewer visitors and a loss of US$20.7m in revenue.

In terms of internal tourism, the industry was especially affected by the timing of the protests, which encompassed the bank holiday of 11 October, with the blocking of roads making travel impossible for Ecuadoreans.

"The president of Ecuador's chamber of industry and production, Pablo Zambrano, estimated daily losses of US$261m for businesses during the protests, due to the paralysation of activity".

Finally, regarding the damages suffered by the private sector as a whole, the president of Ecuador's chamber of industry and production, Pablo Zambrano, estimated daily losses of US$261m for businesses during the protests, due to the paralysation of activity.

Impact of the reinstatement of fuel subsidies and loss of investor confidence

On 13 October, following sustained pressure on his administration, President Moreno announced an agreement with protest groups to revoke decree 883 and replace it with new targeted subsidies. As of yet no such plan has been declared, however on 20 December Moreno stated in a radio interview that he expected the new measures to come into effect in early 2020.

The savings made by the government through any agreed reduction in fuel subsidies will be significantly less than those calculated for the comprehensive elimination of subsidies. Not only is this problematic for the Ecuadorean government's efforts to reduce the fiscal deficit, but it will also negatively impact investor confidence regarding the government's ability to implement other pending aspects of its economic reform package.

While it is still early to draw conclusions regarding the extent of the negative impact of the protests on investment, there is already some evidence demonstrating its significance. According to a study published in November 2019 by the multinational consultancy firm, Deloitte, investor confidence in Ecuador had decreased by 17.8% in October compared with the previous month, a fall Deloitte attributed to the demonstrations.

Although the extent of the overall damage to Ecuador's economy is yet to be borne out, it is safe to say that as a result of the protests, the Moreno administration will face increased challenges in its efforts to turn the economy around, with a strengthened opposition and diminished investor confidence.

Chinese companies win Bogotá Metro contract

Colombian politicians have taken their time discussing a light passenger railway system for the capital, Bogotá. In fact, the Bogotá Metro has been discussed for no less than 70 years (the first proposal was made in the early 1940s) and there have been innumerable false starts. This time, however, it looks as if it really is happening. Contracts with a consortium formed by China Harbour Engineering Company (CHEC) and Xi'an Metro worth just under US$4.5bn were signed on 27 November 2019.

There were originally five consortia in the running for the contract, a number that was eventually whittled down to only two. In October 2019 the authorities selected the winning Chinese group ahead of a Spanish-Mexican consortium that included FCC Concesiones de Infraestructuras and Grupo Carso. On the technical assessment the winning group which had come in with a lower overall price, scored 100/100 versus 94.54/100 for the runner up. The Chinese-led group has now formed a local company, Sociedad Metro 1 SAS, to deliver the project; it includes sub-contractors Changchun do Brasil and Bombardier of Canada, who will provide the trains and equipment. The contract is to build Line 1 - a 24km overhead metro line, longer than currently operated by various other Latin American cities (the Mexico City's metro system, for example, is 19km).

Metro

Existing research shows city residents currently take 12.7m trips a day, of which 50.1% are by public transport and 25.1% are on foot or on bicycles (the remainder are by privately owned cars and taxis). The Metro is designed to link up to the existing bus rapid transit system known as the Transmilenio, and to some of Bogotá's cycle routes. In total, Metro stations will offer the capacity to park up to 10,000 bicycles.

The work will be funded by public money (a 70%-30% split between the central government and the municipality of Bogotá), and multilateral banks. Work is expected to start this year with the construction of a trainyard and rail siding. The line will run on a largely north-south axis with a total of 16 stops. The route has been designed to pass through some of the most densely populated areas of the city. There will be a fleet of 23 trains. End-to-end travel time will be 27 minutes at an average speed of 43kph. The trains will be electric and will include energy-saving features such as the use of natural light and ventilation.

The Metro has been the subject of much controversy over the years. Former mayor Enrique Peñalosa (1998-2001; 2016–2019) argued that it would be more cost effective to extend the Transmilenio bus rapid transit system. Some stakeholders wanted an underground rail system rather than an overhead Metro but that was estimated to add at least US$2bn to the cost. Peñalosa's predecessor, Gustavo Petro (2014-2015), announced the start of work on the Metro in 2015, but these stalled as Colombia's economy took a downturn and estimates of the cost pushed up. Corruption has also been a concern. In 2011 another mayor, Samuel Moreno (2008-2011), was suspended and imprisoned over allegedly corrupt public works contracts including some involving the Metro. Because of this Peñalosa asked for the accounts to be audited by the comptroller general.

Politics has also played a part. Bogotá's new mayor, Claudia López, who took office this month, is on the centre left and an environmentalist. López favours re-introducing trams and further extending the Metro, downgrading plans to increase the role of carbon emitting Transmilenio buses. She wants to extend Line 1 to run further and is ready to move ahead with plans for Line 2. The Line 1 contract will also be scrutinised as one of the largest infrastructure projects yet undertaken by Chinese companies in Colombia.

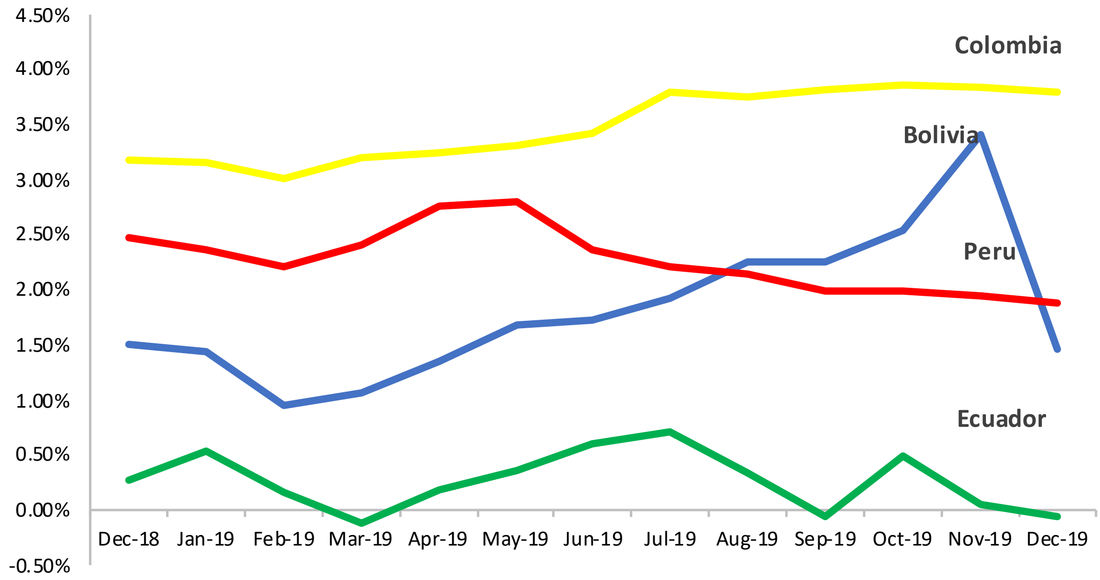
That means that the operating companies will come in for particular scrutiny. CHEC is already building a highway in Colombia's Caribbean coast. Apart from projects in India, the group has relatively little light railway experience. It is also involved in the controversial Colombo International Financial City mega-project in Sri Lanka which has been criticised because of its environmental impact on the Indian Ocean. The minority partner, Xi'an Metro, built the metro system in the Chinese city of the same name, where it was accused of using sub-standard cables. A senior executive in the company was sanctioned on charges of bribe-taking.

ECONOMIC HIGHLIGHTS

PERU | **Oil expansion targeted**. On 10 January, Peru's energy & mining minister Juan Carlos Liu announced the goal of producing 100,000 barrels of oil per day by 2023. This represents a significant increase on the 53,000 barrels per day averaged in 2019, but Liu expects this rapid acceleration to be facilitated by the discovery of new deposits, and through infrastructural investment to consolidate existing production. Liu confirmed that drilling will begin soon in the promising Block Z-64, off the coast of the northwestern Tumbes region, and insisted that this will be conducted "with respect to the environment", although he offered no further details. Hopes of improving existing infrastructure have been encouraged by the apparent success of the Talara refinery modernisation project, a US$5bn expansion of Peru's second largest oil refinery, in the northwestern region of Piura. State-owned oil company Petroperú say the project, intended to increase the refinery's processing capacity from 65,000 to 95,000 barrels a day, will be completed ahead of schedule, within the first half of 2020.

BOLIVIA | **Natural gas deal agreed**. On 10 January, Bolivia's state-owned oil company Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) received authorisation from Brazil's ministry of mining & energy to increase its exportation of natural gas through the Bolivia-Brazil pipeline (known as 'Gasbol'). A previous contract allowing Brazil's state-owned oil company Petrobras to dominate access to YPFB exports expired on 31 December 2019, and as Brazil's President Jair Bolsonaro seeks to lower gas prices by increasing competition, a new agreement will allow YPFB to sell to other companies. The deal will allow YPFB to export 1.2m cubic metres of natural gas per day in 2020, increasing to 2.6m per day in 2021, and finally 3.6m per day until 2024. However, Petrobras are likely to remain YPFB's main partner in Brazil, and while a new deal is negotiated between the two, a transition agreement lasting until 10 March will see YPFB deliver Petrobras up to 19.25m cubic metres per day.

Andean Countries: Inflation Rate
Percentage variation (year-on-year)



Source: *Local central banks. No reliable data availiable for Venezuela*

Andean Countries: GDP growth (%)						
Quarterly figures are year-on-year growth						
GDP	**end 2019***	**2020 forecast***	**Q4 2018**	**Q1 2019**	**Q2 2019**	**Q3 2019**
Bolivia	3.0	3.0	4.2	3.9	3.4	Not yet available
Colombia	3.2	3.5	2.8	2.8	3.0	3.3
Ecuador	-0.2	0.1	0.6	0.6	0.3	-0.1
Peru	2.3	3.2	4.8	2.3	1.2	3.0
Venezuela	-25.5	-14.0	No data	Not data	No data	No data
**Figures from the United Nations Economic Commission for Latin America & Caribbean Dec 2019*						
Quarterly growth based on figures from the local central banks						

Alberto Fernández gets off to a reasonably good start

Having inherited a major economic crisis in a notoriously volatile economy, the Argentine government of President Alberto Fernández which took over on 10 December 2019 is not doing too badly. There may be trouble further ahead, but modest progress is being made on the government's two top priorities: 're-profiling' the country's foreign debt and seeking domestic stabilisation and recovery.

Not for the first time, Argentina has a near-unpayable level of foreign debt. It cannot afford capital and interest payments falling due this year. The country's total debt stands at around US$332bn, more than half of annual GDP. Some US$100bn of that is the immediate focus of renegotiation. Also up for discussion is eventual repayment of the US$57bn emergency Stand-by Arrangement (SBA) agreed with the International Monetary Fund (IMF) in 2018 under former president Mauricio Macri (2015-2019).

For the new Fernández government, the only way forward is to negotiate some kind of debt reprofiling deal. Reprofiling can be a euphemism. Depending on who is using it, the word can cover both the relatively routine business of stretching out loan repayment dates on the one hand, and the more challenging question of a 'haircut' on the other. From the creditors' point of view, a haircut is the painful process of writing off a proportion of debt principal as a complete loss. Many analysts believe Argentina's current crisis cannot be resolved without some kind of a haircut. A reasonable policy objective would be to make any eventual haircut a lot less traumatic than the one endured after Argentina's default of 2001-2002 (*see sidebar*).

One month in, the new government has had preliminary negotiations with the IMF and other creditors. On 20 December 2019 it announced it was delaying repayment of US$9bn due on US-dollar denominated Letes treasury bills for five months until 31 August. The move was seen as largely unavoidable. Ratings agencies described it as a restricted default (Fitch) and as a "selective default" (Standard & Poor's). However, acknowledging negotiations, Standard & Poor's later raised Argentina's long-term foreign currency rating to 'CC', one notch above selective default (SD). Nevertheless, Nikhil Sanghani of Capital Economics, a consultancy, says that "The government has merely kicked the can down the road and maturity extensions alone will not be enough to resolve the debt problem. We think that it will have to pursue a large debt write-down".

President Fernández has described preliminary talks with the IMF as "constructive". He is sticking to his claim, however, that by agreeing to extend the SBA in 2018 the IMF lent money irresponsibly to his predecessor, at a time of high capital flight. Fernández said therefore that the IMF "cannot pretend to collect on the agreed terms". But the talks do seem to have made a reasonably good start. Commenting on the new government's domestic economic policy announcements, the IMF's Western Hemisphere director, Alejandro Werner, has said it is "moving in a positive direction". Werner noted the attempt to shield lower income sectors from the effects of the crisis, which he supported on condition that the fiscal accounts be protected.

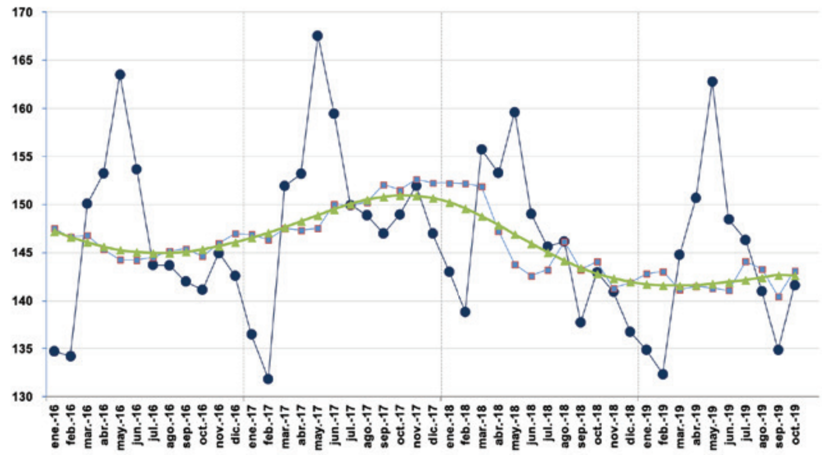
The government rejects what it calls 'neoliberal' austerity and describes its approach as being more heterodox and pro-poor (Economy Minister Martín Guzmán has worked with Nobel Prize winning US economist Joseph Stiglitz). However, its domestic policy moves have been quite cautious. In December 2019, congress approved a wide-ranging bill giving the government emergency economic powers. The main measures in the bill include increased taxes on agricultural exports known as 'retenciones' (they are raised to 33% on soya, 12% on maize, and 15% on wheat). Another big tax-raising change is the imposition

Argentina's traumatic default

On the occasion of Argentina's last default, in 2001-2002, bondholders took a loss of up to 75% on the face value of their loans, and Argentina was shut out of global capital markets for over a decade. The country was also exposed to costly litigation in the US courts: hedge funds made massive profits by using distressed Argentine debt papers for speculative trading.

of a five-year, 30% tax on foreign currency purchases such as overseas holidays and online purchases of goods and services. Revenues from this new tax will be split 70% for social programmes and 30% for infrastructure projects and other initiatives. A monthly US$200 cap on foreign currency purchases by individuals is also in place. Personal property taxes will be raised. There are tax incentives to encourage people to save in pesos, such as waiving income tax on peso-denominated financial instruments.

Picking up? Argentina's monthly indicator of economic activity



Note: original, seasonally adjusted, and cyclical trend indices

The government says it is restricting public sector spending in areas such as the hiring of political advisers and the use of official vehicles. There is also a promise to roll back overly generous pension provision for public sector workers including judges and diplomats. According to the Argentine Institute of Fiscal Analysis (Iaraf), Fernández inherited from the previous government a primary fiscal deficit of 0.8% of GDP in 2019, set to rise to 1.6% in 2020. However, the Iaraf calculates that the last set of policy changes by both the former and current governments could reduce the primary deficit to 0.1% of GDP in 2020. But here too, things could change with the deficit widening further depending on energy prices and pension decisions.

A number of measures have been announced to help low income sectors, but on close examination they too are marked by a significant dose of caution. One of the headline-grabbing measures announced on 3 January was an Ar$4,000 (US$63) lump sum salary increase for all private sector employees. The lump-sum approach means the lower paid of the country's 6.7m private sector workers get proportionately more of a boost. It is intended to at least partly compensate for falls in purchasing power caused by inflation reaching 53.8% last year. However, the increase and a similar measure expected for public sector workers is "on account" of future 'paritarias' (tripartite salary negotiations) and there are signs that the government is trying to use its influence with the trade unions to moderate and delay the next round of salary increases. Similarly, while planned public utility tariff increases have been frozen for 180 days, so too have pension adjustments. Officials say that after a six-month freeze, pensions will be subject to a new quarterly cost-of-living adjustment mechanism with special measures to protect the poor.

On the prices front, the government has relaunched the 'Precios Cuidados' ('monitored prices') programme. The first version of the programme had been launched in 2013 and it was kept in place, with some variations, by the previous two governments. In the latest version, the programme covers an expanded basket of 310 supermarket products with indicator prices. It is a voluntary agreement between the government, supermarkets, and their suppliers. Cabinet chief, Santiago Cafiero, has described it as a way of helping rebuild purchasing power. The new administration has deliberately stopped short of obligatory price controls which would squeeze margins and alienate the business community.

Another initiative in preparation is the issuance of 2m ‘food cards’ to poor families designed to fight hunger and make basic foodstuffs more affordable.

Fernández has given an upbeat assessment of his first month in office. Of course, all politicians are happy to take the opportunity to pat themselves on the back, but in this case his description was not necessarily unrealistic. “We have been able to tranquilise the economy and we are beginning to put in place some initiatives to boost employment and investment”, he said. Guzmán took a similar line, saying that “each decision we have taken in this month has been aimed at stabilising the economy and getting Argentina back on its feet”. As might be expected, centre-right critics have been wary, but relatively muted (this may be due in part to the traditional political lull associated with the annual summer holidays). There have been two relatively small ‘tractorcade’ protests by farmers opposed to export taxes. Walter Castro of the conservative think-tank Fundación Libertad has dismissed the government’s attempt to stimulate savings in pesos as unrealistic. Esteban Regueira, from political consultancy Clivajes Consultores, says that while some of the wealthiest in Argentine society will always oppose a Peronist centre-left government, an important sector of the non-Peronist middle classes “may value some of the recent changes in the country’s economic model”.

ARGENTINA | ENERGY

Can a dead cow save the country?

“There are reasons to be optimistic about Vaca Muerta. It is the second largest shale gas field in the world, and the fourth largest shale oil one. [...] Argentina is now once more able to cover its own energy needs and to consider exporting a surplus”.

Once more the ‘Vaca Muerta’ shale oil and gas deposits in Patagonia are being touted as the solution to Argentina’s recurring economic troubles. They represent an undoubted opportunity, but there are also many practical and political problems to solve along the way.

There are reasons to be optimistic about Vaca Muerta. It is the second largest shale gas field in the world, and the fourth largest shale oil deposit. Over the last eight years production has surged from zero to 100,000 barrels per day (bpd) of oil and to 35m cubic metres per day (cmd) of gas. Only about 10% of the field has been developed, so there is a lot more to come. Thanks to Vaca Muerta, Argentina’s total oil production has gone from a 20-year low of 479,000 bpd in 2017 to 514,000 bpd last year. There has been a similar dramatic turnaround in gas production. Argentina is now once more able to cover its own energy needs and to consider exporting a surplus.

Developing Vaca Muerta at an accelerated pace could be key to plans by President Alberto Fernández and Guillermo Nielsen, the newly appointed head of the state-run oil company YPF, to steer a way out of the foreign debt crisis and get the country onto a more sustainable economic growth path. Mariano Gargiulo, a senior manager at oil industry company Baker Hughes, says that with enough investment Vaca Muerta’s production could increase five-fold over the next five years, taking exports from near-zero in 2019 to US$20bn by 2024, the last year of the current government’s term in office.

To get there the Fernández administration will have to overcome some big challenges. They relate to pricing, investment, labour, infrastructure, and politics. The shale hydrocarbon business requires very significant levels of investment. Typically, shale wells see a 70% decline in production after two years, so the business requires sustained drilling activity to keep production rising. For that to happen international oil companies need to make profits and have confidence that investment and pricing rules will be favourable and relatively constant. Under a succession of Peronist nationalist governments, Argentina has a long history of capping domestic energy prices in a way that has squeezed oil company margins. Even the centre-right pro-market government of Mauricio Macri (2015-2019) froze petrol prices last year amidst the country’s inflation and currency crisis. The new government has introduced a six-month price freeze and its future pricing policy is not yet clear.

The sheer size of the investment needed is daunting. One estimate is that for Vaca Muerta to reach its full potential, US$10bn-US$15bn a year needs to be spent on 'fracking', US$2bn is needed for pipelines, and US$5bn to build a liquefaction export terminal for natural gas/LNG. Companies already active in Vaca Muerta, such as Chevron, Exxon, Shell, Tecpetrol, and Total Austral, may require further reassurances over future hydrocarbons policy before green-lighting new projects. Labour costs and industrial relations are also an issue. Production costs have been falling, to an estimated US$56 a barrel in 2018 (a calculation which includes allowance for a 10% return on investment), but this is still higher than the break-even point of US$45 a barrel for US shale.

The industry has powerful unions. Lay-offs and efforts to cut labour costs are politically sensitive. Geopolitics also looms large. Mapuche indigenous communities say their rights to ancestral lands in Patagonia have been ignored. Bloomberg news agency says US officials, angry at Argentina's decision to grant asylum to Bolivia's former president, Evo Morales (2006-2019), have threatened to withdraw the Donald Trump administration's cooperation for Vaca Muerta's development. Argentine environmental campaigners have opposed a big increase in fracking. A sign of potential domestic political volatility came in December 2019 when mass protests against the use of cyanide and sulphuric acid in mining operations broke out in the province of Mendoza.

URUGUAY | ECONOMY

IMF sends message to Lacalle Pou team

The International Monetary Fund (IMF) has delivered a slightly mixed endorsement of the Uruguayan economy. It has praised the country for its "enviable characteristics" which include political stability, social cohesion, and over a decade and a half of "robust" economic growth. However, it has also suggested that the incoming economic team of President-elect Luis Alberto Lacalle Pou needs to undertake a "credible adjustment", starting this year, to get overall public debt levels on a downward pathway.

Talks with the IMF took place in December 2019 in the context of the regular Article IV consultations. The IMF mission met current government officials as well as the transition team led by Azucena Arbeleche, Lacalle Pou's designated economy minister. This led to an IMF press statement which emphasised the need for the new government, which takes office in March, to make some changes.

"The IMF noted that under the outgoing left-wing Frente Amplio (FA) administration, after a long growth cycle, Uruguay's GDP growth rate began to slow, the fiscal deficit widened, and total public debt increased by around ten percentage points of GDP relative to where it stood in 2012-2014."

The IMF noted that under the outgoing left-wing Frente Amplio (FA) administration, after a long growth cycle, Uruguay's GDP growth rate began to slow, the fiscal deficit widened, and total public debt increased by around ten percentage points of GDP relative to where it stood in 2012-2014. Failure to act to counter this negative trend could undermine debt sustainability and investor confidence, it warns. The IMF therefore calls on Uruguay to anchor the fiscal deficit (estimated to have reached 4.8% of GDP in 2019), to push inflation down to the mid-point of the current 3%-7% target range, to reduce value-added tax (VAT) and other tax exemptions, and to introduce reforms to contain rising pension costs, while seeking to improve labour productivity. The aim, it is suggested, should be to get the debt-to-GDP ratio back down to where it was six-to-eight years ago.

The IMF is cautious in its GDP growth predictions for Uruguay, partly because of slower regional growth and the ongoing economic crisis in Argentina. Back in October 2019, when the IMF issued the latest edition of its twice-yearly World Economic Outlook (WEO) report, it was expecting GDP growth of 0.4% in 2019 and 2.3% in 2020 (this was down from 1.9% and 3% in the April WEO). In its 17 December mission statement, the IMF predicts 2.1% growth for Uruguay in 2020.

A survey of independent economic analysts carried out by local weekly magazine, *Búsqueda*, suggests that they expect the economy will begin to pick up pace very modestly this year because of major investment – the first phase of the UPM 2 pulp plant and the construction of an associated freight railway linking it to Montevideo. The consensus forecast is gloomier than the IMF, however: 1.6% GDP growth, still-high inflation at 8.2%, a small increase in unemployment (up to 8.8% from 8.6%) and a very modest narrowing of the fiscal deficit (to around 4.2% of GDP, down from 4.8%). They expect the gross debt-to-GDP ratio to continue moving in the wrong direction, rising to around 68%.

The team under Lacalle Pou remains upbeat, arguing that it will be able to introduce more market-friendly policies that will build business confidence and investment. On 2 January Lacalle Pou said Uruguay was unlikely to lose its investment grade credit rating this year, given that his government would be responsible and austere in its management of public spending. The president-elect takes office on 1 March and says that the following day his administration will present an omnibus bill with a whole raft of economic emergency measures. Its content is still subject to discussions within the new multi-party coalition that supported his presidential bid, headed by Lacalle Pou's centre-right Partido Nacional (PN, Blancos).

CHILE | BUSINESS

Broken retail faces adjustments

“Before the protests, Chilean retailers already had a few challenges to deal with. The economic crisis in neighbouring Argentina had led to a drop in inward tourism and shopping. Physical outlets were also having to respond to the rapid growth of online retailing. The protests made things much worse”.

Chile is facing something of a retail industry melt-down as the upheaval caused by social and political protests enters its fourth month. According to themds.com, a global online fashion business journal, protests and demonstrations have tipped retail sales into a downward spiral with falls of 27% (Hong Kong and Paris, also in the throes of widespread and sometimes violent political demonstrations, are suffering a similar trend).

Before the protests, Chilean retailers already had a few challenges to deal with. The economic crisis in neighbouring Argentina had led to a drop in inward tourism and shopping. Physical outlets were also having to respond to the rapid growth of online retailing. The protests made things much worse. Many retail premises were damaged or burnt down. Shoppers stayed away. The estimate of a 27% fall in sales comes from the Santiago chamber of commerce (CCS). Visits to shopping malls plummeted by 28% from 15.7m a year to 11.3m a year. A pre-Christmas survey carried out by consultancy Deloitte found that 61% of respondents – up from 43% before the protests began – expected to reduce their spending in the holiday period.

International pharmacy chain, Walgreens Boots Alliance, reported a 2.7% global fall in fourth quarter 2019 retail sales, partly attributed to Chile where its Farmacias Ahumada retail subsidiary is considering more closures and staff reductions. Chilean chain AD Retail has sought bankruptcy protection. US supermarket giant Walmart said over 130 of its Chilean stores were burnt.

However, some see opportunity amid the crisis: Colombian low-cost supermarket chain, Justo y Bueno, says it plans to begin operating in Chile this year. The Deloitte research suggests Chilean consumers may now be relying more on neighbourhood stores and less so on the big malls. Universidad de Chile retail expert, Marcel Goic, says companies will have to adjust to operating in a society that has become less disposed to make concessions and, in some ways, less consensual. He suggests that one defensive response will be for retailers to try and build better relationships with their local communities. In 2020 they will have to rebuild and reposition their shops; he sees the market outlook as remaining uncertain.

ECONOMIC HIGHLIGHTS

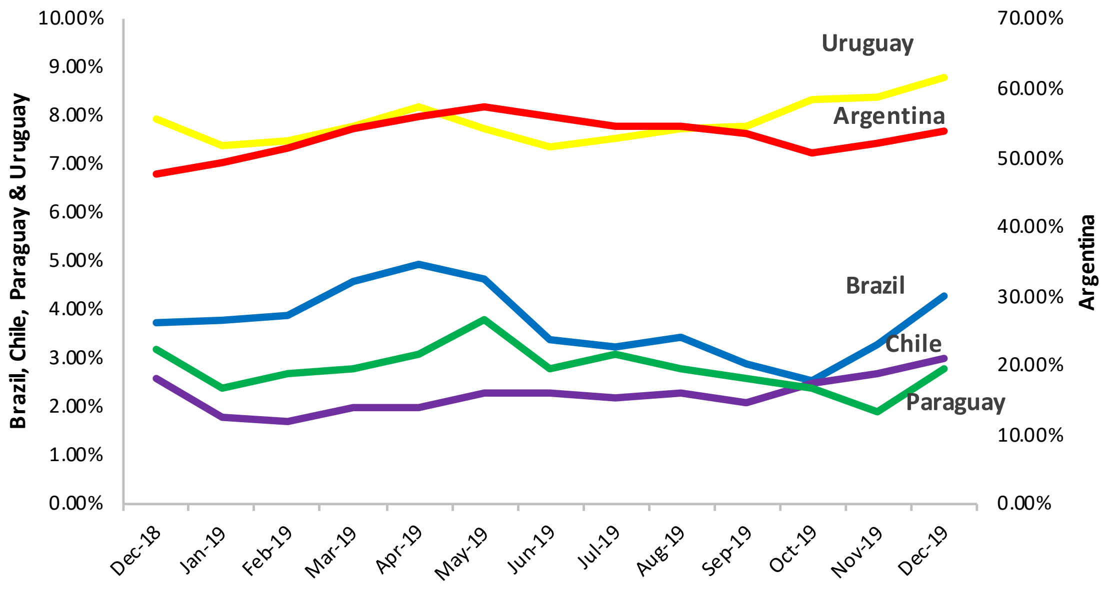
PARAGUAY | **Fiscal deficit larger than anticipated.** On 19 December 2019, Paraguay's deputy economy minister, Humberto Colmán, had warned that the country may exceed its 2.5% fiscal deficit target in 2019. In November 2019, Paraguay's congress had approved a bill which lifted the fiscal deficit cap of 1.5% of GDP, as set out in the 2013 fiscal responsibility law (LRF), to 3%. In its December 2019 report on the central government's financial situation, the economy sub-secretariat reported that the year closed with a G$6.756trn (US$1.087bn) deficit, equivalent to 2.8% of GDP. The government has stressed that this is due to record levels of public investment, which totalled 2.9% of GDP.

BRAZIL | **Exports suffer from global difficulties.** On 2 January, the foreign trade secretariat at Brazil's economy ministry (Secint/ME) released the figures for the country's 2019 trade flows, which show that Brazil recorded its lowest trade surplus since 2015. Trade flows totalled US$401.363bn in 2019, with the country registering a US$46.674bn trade surplus (a 20.5% decrease on the 2018 surplus). Brazilian exports fell by 7.5% compared with 2018, driven by a 35.6% reduction in exports to Argentina, due to the economic crisis there. Sales to the Southern Common Market (Mercosur) trade bloc as a whole fell by 30.6%. An outbreak of swine flue in China affected Brazil's soya exports there, while low demand in Argentina hit the manufacturing industry (notably automobile parts).

BRAZIL | **Natura &Co becomes world's fourth-largest beauty company.** On 3 January, Brazilian cosmetics group Natura &Co announced that it had closed the acquisition of US competitor Avon Products Inc, a deal announced last May and through which Natura becomes the fourth largest beauty company in the world, with an annual turnover of US$10bn and a global presence in over 100 countries. The Brazilian company already owns The Body Shop and Aesop. In a statement, Natura noted that from 6 January, its shares, which have already begun trading on the B3 São Paulo stock exchange, would be listed through American Depositary Receipts (ADRs) on the New York Stock Exchange (NYSE).

Brazil & Southern Cone: Inflation Rate

Percentage variation (year-on-year)



Brazil & Southern Cone: GDP growth (%)						
Quarterly figures are year-on-year growth						
Country	**End 2019 forecast***	**2020 forecast ***	**Q4 2018**	**Q1 2019**	**Q2 2019**	**Q3 2019**
Argentina	-3.0	-1.3	-6.1	-5.8	0.6	Not available yet
Brazil	0.8	1.7	1.2	0.6	1.1	1.2
Chile	1.8	2.3	3.6	1.5	1.9	3.3
Paraguay	0.2	3.0	1.2	-2.0	-3.0	2.8
Uruguay	0.3	1.5	0.6	-0.2	0.1	0.9
**Figures from the United Nations Economic Commission for Latin America & Caribbean Dec 2019*						
Quarterly growth based on figures from the local central banks						

Ambitious plans for Central American integration

Plans for regional integration in Central America have been progressing, and representatives discussed further initiatives at a forum in El Salvador.

Following the summit, which took place from 4-5 December 2019, the Central American integration system (Sica) announced a new plan which aims to improve regional connectivity through infrastructure projects such as railways and motorways; integrate security systems and air travel regulations; and guarantee free movement of citizens. Entitled 'Development Plan for Central America & the Dominican Republic', the plan will be developed by Sica members Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Belize, and the Dominican Republic in 2020.

The region currently suffers a major infrastructure deficit which makes trade more difficult and expensive. Improvements would make Central American economies more competitive, according to Melvin Redondo, secretary general of the secretariat for Central American economic integration (Sieca) reducing logistical costs and attracting investment (*see sidebar*).

Vinicio Cerezo, Sica general secretary and former president of Guatemala (1996-2001), emphasised that the regional market is the second most important for Central American economies after the US, and integration is key to driving economic growth in the region. One of the main aims for regional leaders is to boost intra-regional trade and given that average tariffs have traditionally been low (around 2% according to the United Nations Economic Commission for Latin America and the Caribbean [Eclac]), reducing non-tariff barriers, such as administrative issues and a lack of infrastructure, is the focus.

So far there has been some success, but issues have also arisen that call into question the viability of further integration. In June 2017, Guatemala and Honduras matched tariff rates, coming together in one unique customs territory. This reduced customs formalities for 80% of bi-national trade from around 10 hours to less than 15 minutes, according to Sieca. In 2018, El Salvador agreed to join the customs union, deepening integration. Further south, Panama and Costa Rica also reached an agreement for integrated binational control systems between the two nations, with US$75m in funding approved by the Inter-American Development Bank (IADB) in April 2018.

However, Nicaragua, where since April 2018 the government led by President Daniel Ortega has been carrying a crackdown on its opponents, presents a significant barrier to further integration. Ortega has more pressing issues at hand than regional integration, and his country straddles the width of the isthmus. Efforts may also be hampered by the impact of a raft of migration deals signed by Honduras, Guatemala, and El Salvador with the US last year which will see migrants detained at the US southern border sent back to these countries to seek asylum there first. This could have a destabilising effect on the region that pushes integration down the political agenda. However, further integration is supported by Eclac, the European Union as well as the Central American bank for economic integration (BCIE). The latter approved a US$1.5m donation to strengthen the 'Northern Triangle' customs union in March 2016 and US$550m in financing for a light railway system in Costa Rica, among other projects.

Much more investment will be needed in order to realise the dream of Central American integration, and a lot depends on the stability of national politics. In terms of global trends, the tide may be turning against integrationist projects, such as the European Union, at a time when economic and political nationalism appears to be on the rise.

Opening up air travel

One idea floated by Roberto Kriete, president of airline Avianca, which is headquartered in Colombia, is to develop regional aviation laws and a Central American aviation regulator in order to open up air travel and enable better business and tourism connections. Kriete pointed out that a regulatory framework already exists in the shape of the 'CA4' agreement, signed in June 2006, which allows citizens of Guatemala, El Salvador, Honduras, and Nicaragua to travel between those nations using an ID card rather than a passport.

Giammattei faces a raft of issues as Guatemala's new president

Alejandro Giammattei took over as Guatemala's new president on 14 January. While little is known about his plans for the nation, there are various significant issues that he needs to address.

Giammattei and his Vamos government are set to inherit a raft of problems from his predecessor Jimmy Morales (Frente de Convergencia Nacional, 2016-2020), who has made little headway in dealing with poverty, corruption, and security concerns. Much like Morales, Giammattei, a former head of the prison service under the Óscar Berger administration (2004-2008), is a right-wing conservative with links to the military and far-right civilian elements. In fact, such are the links between the two camps that the new president has already been dubbed 'Jimmyttei' by Guatemalans concerned that they will end up with more of the same from their new leader.

Corruption - a common thread

Public corruption remains a major public concern and has made headlines in recent years. After former president Otto Pérez Molina (Partido Patriota, 2012-2015) was forced out of office amid a huge graft scandal, hope surged that the country had turned a corner on official corruption, with the help of the United Nations-backed International Commission against Impunity in Guatemala (Cicig). However, Morales refused to renew Cicig's mandate, and it ceased operations in September 2019.

Giammattei was no fan of Cicig either, having been subject to an investigation in relation to allegations of extrajudicial killings that occurred during his time as head of the prison service, for which he was imprisoned but ultimately acquitted, so the timing of its exit saved him a potentially unpopular political decision. Yet corruption is nonetheless a huge problem for the new president. He will find himself walking a tightrope between an electorate that is more conscious than ever of graft and its nefarious effects, and allies in the traditional elites whose interests could be affected by a crackdown on corruption. In fact, Giammattei's promise to end the corrupt practices of the past with the aid of a new national anti-corruption commission was met with scepticism by many observers.

Corruption also affects efforts to deal with Guatemala's many pressing issues, such as rampant child malnutrition and stubbornly high poverty rates. Almost half of children under five are chronically malnourished, part of a wider issue in a country where 59% of the population lives below the poverty line on the latest (2014) World Bank figures. This is despite fairly strong economic growth in recent years, with GDP growth rates of 3.1% in 2016, 2.8% in 2017 and 3.1% in 2018. Giammattei also needs to work on increasing Guatemala's tax revenue of just 10.3% of GDP in 2018 according to the United Nations Economic Commission for Latin America & the Caribbean (Eclac) which is the lowest percentage of any Latin American country. This is a longstanding problem which looks set to have worsened under Morales, whose removal in January 2018 of Juan Francisco Solórzano Foppa, the head of the tax authority (SAT), attracted concerns given he was well respected and received Cicig's backing.

The low tax take is just one facet of wider issues with an economic system that feeds inequality, relies heavily on the informal labour market, and fails to provide adequate education. As a result, equitable growth remains out of reach. Giammattei needs to kickstart the state sector and pull in more public money to fund social programmes that would benefit the millions of Guatemalans that are struggling to survive, particularly in areas such as the so-called 'Dry Corridor' (a tropical dry forest region on the Pacific side of Central America) that are suffering the effects of climate change and give them a reason to stay at home rather than migrate to the US.

Key elections

Elections for a new set of judges for the supreme court (CSJ) and appeals court also need to be held. This was due to take place last year but a constitutional court (CC) ruling suspended the process after admitting appeals which claim procedural irregularities. This meant that the term of the sitting judges has continued beyond constitutional limits which was meant to end on 13 October 2019. Continued uncertainty in this area will impact trust in the judicial system and could make it harder for the Giammattei government to attract foreign investment.

Relations with the US could have deep ramifications

The question of migration leads us to perhaps the most unpredictable issue for Giammattei: relations with the US and President Donald Trump. In July 2019 the Morales government signed a migration deal with the US which allows US authorities to deport asylum seekers to Guatemala if they passed through that country during their journey to the US. This has the potential to create huge problems in an impoverished nation, placing huge strain on public services that cannot support the local population as things stand and perhaps stoking a wave of xenophobia, as seen in various South American countries that have received Venezuelan migrants. Worryingly, Giammattei has said that the Morales government has not shared details of the deal, but it seems unlikely that Giammattei would be able to renegotiate with a Trump administration that so far had no qualms about threatening to suspend crucial aid payments in pursuit of migration deals. Trump has also threatened to tax remittances, which represent 12% of Guatemala's GDP, underlining the reality that Giammattei will have to appease the US throughout his term.

The new president will also have to deal with security issues. Guatemala retains one of the highest homicide rates in Central America, third to El Salvador and Honduras with 22.48 homicides per 100,000 in 2018. Giammattei is pledging to combat this with a 'mano dura' (repressive) approach to crime. He has made headlines with pledges to fight violence and organised crime "with testosterone"; enact a law against terrorism that criminalises gang membership; restore the death penalty; and deploy the military to fight crime, a policy which has been used by his predecessors. While a December 2019 report in Spanish daily El País featured an interview with a high-ranking member of the Mara Salvatrucha street gang, who offered to work with Giammattei in "pacifying" the streets in return for rehabilitation programmes, such policies are a hard sell to voters who have been affected by gangs. The new realities of Giammettei's role as president mean he will likely fall back on tough policies which traditionally go down well with voters.

It doesn't appear that Giammattei has much to worry about in terms of popular protests. Since the mass mobilisations of 2015 that contributed to the downfall of Pérez Molina there has been little appetite for protest, and social movements have been criminalised. There remains a stark divide between indigenous peasant farmer movements, that are concentrated in rural areas and tend to focus on opposing extractive projects, and the urban population that appears so far unaffected by the protest wave in Latin America.

The situation is more restive in the legislative and judicial branches of government (*see sidebar*). First of all, congress did not approve a new budget for 2020, which means Giammattei will have to work with the same amount of resources allocated in the 2019 budget (Q87.715bn [US$11.37bn]) plus an extra Q750m authorised in that budget last year. At the end of November 2019 local daily, Prensa Libre, reported that government officials are working to reallocate funds where they are needed most, but the Giammattei government will likely need to request more money from congress in early 2020.

Giammattei will also face a congress in which the opposition Unidad Nacional de la Esperanza (UNE), of his second-round opponent, former First Lady Sandra Torres (2008-2012), will be the largest party. UNE has 54 seats in the newly expanded 160-member unicameral legislature, compared with 16 for Vamos with 17 other parties making up the remainder. The legitimacy of the legislature has also been badly affected by the Morales years, in which legislators appeared more concerned about shielding themselves from corruption investigations than running the country.

Homicides

While in recent years, Guatemala's homicide rate has declined, think-tanks such as International Crisis Group (ICG) attribute this to the United Nations-backed International Commission against Impunity in Guatemala (Cicig). ICG research suggests Cicig's work helped contribute to a 5% average annual decrease in murder rates. Cicig's departure has raised some question marks as to whether this trend will continue.

Suriname finds oil at last

Back in August 2019, the CEO of Suriname's state-owned oil company Staatsolie, Rudolf Elias, said that the company would make its first oil discovery within three weeks. He was wrong as the 'Kankantrie' well proved dry. Now, five months on, Suriname has at last made its first major oil discovery, raising hopes that it can emulate Guyana from where the good news (and now 'first oil') keeps flowing.

Despite the setback in August, Elias said: "The chance of success for Suriname and Staatsolie has never been greater. Partly because of the oil discoveries in Guyana. We are in the same basin with the same parent rock where the oil was made. The chance that we or one of our partners will find oil is simply very high".

In the end it was, indeed, one of their partners that hit the first oil. On 7 January, Apache Corporation and Total announced a "material discovery" at this 'Maka Central-1' exploration well in Surname's offshore Block 58, which is adjacent to Guyana's Stabroek block.

"On 7 January, Apache Corporation and Total announced a "material discovery" at this 'Maka Central-1' exploration well in Surname's offshore Block 58, which is adjacent to Guyana's Stabroek block."

John J Christmann, Apache's CEO and president, said: "We are very pleased with results from Maka Central-1. The well proves a working hydrocarbon system in the first two play types within Block 58 and confirms our geologic model with oil and condensate in shallower zones and oil in deeper zones. Preliminary formation evaluation data indicates the potential for prolific oil wells".

Apache's CEO added: "Additionally, the size of the stratigraphic feature, as defined by 3-D seismic imaging, suggests a substantial resource. Block 58 comprises 1.4m acres and offers significant potential beyond the discovery at Maka Central. We have identified at least seven distinct play types and more than 50 prospects within the thermally mature play fairway".

A timely boost for Bouterse amid IMF concerns

This is all very encouraging for Suriname, and for its beleaguered president, Desi Bouterse, who was recently convicted of the murder of 15 opponents in 1982 during his military dictatorship. If Bouterse can win re-election on 25 May, then the new oil largesse should reinforce the already significant advantages of incumbency.

As it happens, the Bouterse government has already been spending freely in deprived areas ahead of the election despite the country's poor fiscal position. The International Monetary Fund (IMF) completed the most recent Article IV Consultation in mid-December 2019. It was reasonably positive about the outlook for growth, but it added: "The balance of risks to this outlook is negative, mainly due to fiscal imbalances". The IMF added that the overall fiscal deficit was expected to reach 8.6% of GDP in 2019, with public debt remaining high at around 72% of GDP.

The IMF was also concerned that, in early-2019, the government revoked a memorandum of understanding with the central bank that prohibited monetary financing of the budget. Since then, the IMF reports, the central bank "has provided new credit (which was also subsequently rolled over) to the government up to the limit of 10% of government revenues specified in legislation".

On debt, the IMF said that, in the short term, looser global financial conditions "could make debt service less burdensome on public finances, and the confidence provided by a higher level of international reserves could reduce pressures on the exchange rate". It also noted the potential upsides from new oil or gold discoveries.

However, it added, "failing to introduce the fiscal measures assumed in staff's baseline would add to the upward path for public debt... There is a risk that the combination of high public debt—including a high foreign-currency share—and shortfalls in external financing could move to the forefront, increasing pressures on the currency, raising inflation, adversely affecting growth, and feeding back to increase the debt-GDP ratio. If this were combined with an increase in monetary financing of the fiscal deficit, inflation could accelerate, and international reserves could be depleted".

The IMF noted that this pessimism was not shared by the Suriname authorities. It reported: "Their medium-term fiscal forecast…shows a continued consolidation through the medium term. This consolidation involves higher revenues, mostly through the introduction of the [value-added tax] VAT in 2021, modernisation of customs, and the expiration of the accelerated depreciation of past mining investments, and much lower expenditures than [IMF] staff's baseline, primarily on subsidies and interest expenditures, but also in wages and salaries. In addition to consolidation, the authorities' scenario assumes some non-debt creating financing, which they believed has already put debt on a downward path beginning in 2019".

The IMF was unpersuaded by this more optimistic assessment, and it called for "a significant, front-loaded reduction in the fiscal deficit", saying this was necessary to ensure fiscal sustainability. It added that measures amounting to about 8.5% of GDP over the medium term were required. The measures recommended by the IMF to restore order to the public finances included:

- Increase the sales tax from 8%-10% to 22% by 2020. In 2022, the sales tax would be replaced with a VAT of 15%.
- Increase electricity tariffs by 15% per year during 2020-2022 and by 20% per year during 2023-2024 to bring average tariffs in line with regional averages by 2024. However, the IMF added, "the government should…exempt low-income households from these tariff increases".
- Raise social safety net spending by 0.2% of GDP in 2020-2021 and by 0.4% of GDP thereafter "by expanding targeted cash transfer programmes".
- Implement improvements to tax and customs administration, public financial management, and the allocation and procurement of public investment.

Positive on growth

On the economic growth front, there has been a recovery since the contraction of -5.6% in 2016, with GDP growth of 1.8% in 2017, 2.6% in 2018, and an estimated 2.3% in 2019. The IMF reported that "activity growth has been broad based with expansions in wholesale and retail trade, construction, hotels, restaurants, and manufacturing, while mining has remained stable".

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Unemployment is around 7% and on a declining trend, from 9.7% in 2016 towards a forecast 4.7% in 2024.

Looking forward, but without accounting for any boost from oil discoveries, the IMF said: "Real GDP is expected to expand annually by 2.25% to 2.5% during 2019-2024, while inflation is expected to remain low".

It also noted that, contrary to the IMF's view, "the authorities see the risks to the outlook as limited, while there are large possible upsides from the discovery of offshore oil and three new gold mines that they mentioned are currently being developed".

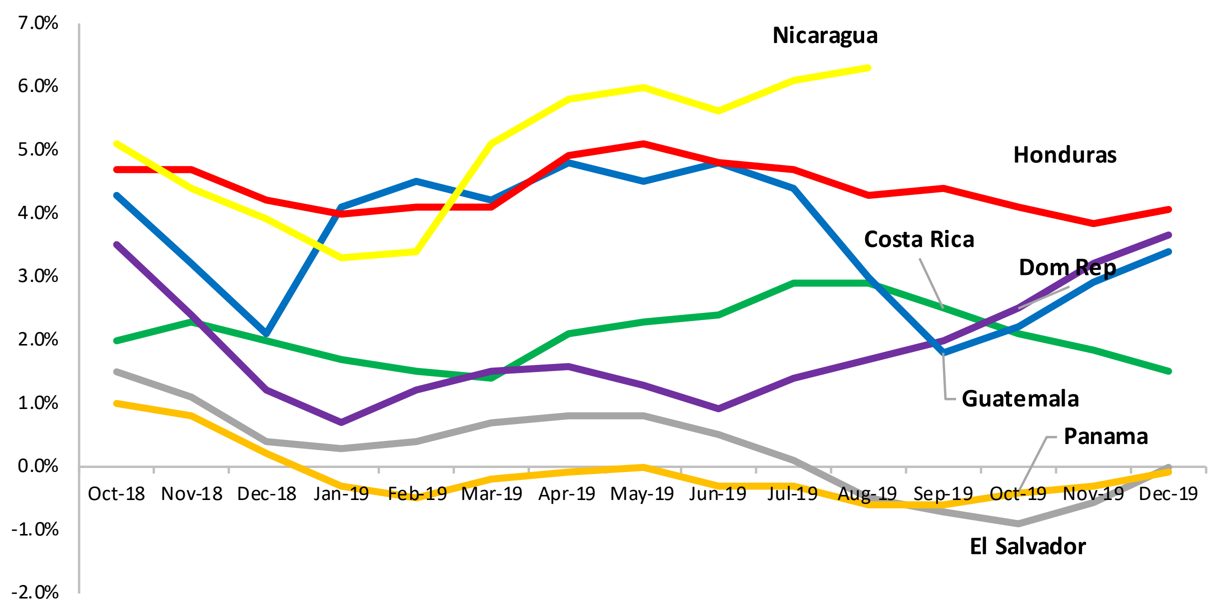
ECONOMIC HIGHLIGHTS

HONDURAS | **IMF completes reviews.** Last month the International Monetary Fund (IMF) announced that it had completed the first reviews of Honduras's performance under the economic programme supported by a two-year Stand-By Arrangement (SBA) and a two-year arrangement under the Standby Credit Facility (SCF). This programme was approved on 15 July 2019 for US$309.2m, the equivalent of 90% of Honduras's quota at the IMF. The completion of the reviews enables the authorities to access resources in the total amount of about US$144.7m. According to the IMF, the Honduran authorities remain "fully committed to the economic programme supported by the IMF". They have maintained "prudent macroeconomic policies—the fiscal position is in line with the fiscal responsibility law, inflation is within the central bank's target band, and the current account deficit has narrowed despite adverse terms of trade—and have taken initial steps on structural reforms to promote sustained, inclusive growth".

HAITI | **UN warns of food insecurity.** Last month the United Nations Office for the Coordination of Humanitarian Affairs (OCHA) warned that deteriorating economic conditions in 2019 - including low economic growth rate, (the United Nations Economic Commission for Latin America & the Caribbean forecast just 0.5% growth in 2019), high inflation (in excess of 20% at the end of September) and an increase in the cost of basic food items, have had a negative impact on the humanitarian situation in Haiti. It warns that the number of Haitians facing food insecurity rose to 3.7m this year, up from 2.6m in 2018. OCHA expects the figure will reach 4.2m by March, with some 1.2m Haitians likely to experience "emergency levels" of food insecurity.

Central America & Caribbean: Inflation Rate

Percentage variation (year-on-year)



Central America & Caribbean, selected countries: GDP growth (%)						
Quarterly figures are year-on-year growth						
GDP	**end 2019***	**2020 forecast***	**Q4 2018**	**Q1 2019**	**Q2 2019**	**Q3 2019**
Costa Rica	1.8	1.9	1.9	1.8	1.4	1.9
Dominican Republic	4.8	4.7	6.6	5.7	3.7	Not yet available
El Salvador	2.2	2.3	2.1	1.8	2.0	2.7
Guatemala	3.3	3.2	3.5	3.0	3.5	4.0
Honduras	2.9	2.9	4.8	3.5	1.9	2.4
Nicaragua	-5.3	-1.4	-7.7	Not yet available	Not yet available	Not yet available
Panama	3.5	3.8	4.0	3.1	2.9	2.7
**Figures from the United Nations Economic Commission for Latin America & Caribbean Dec 2019*						
Quarterly growth based on figures from the local central banks						

US Congress ratifies USMCA

After months of delay, both the US House of Representatives and the US Senate have approved an updated version of the US-Mexico-Canada Agreement (USMCA) regional trade accord in the past month. This brings the full ratification of the agreement that is to replace the North American Free Trade Agreement (Nafta) one major step closer. Securing the USMCA is a key objective for the Mexican government led by President Andrés Manuel López Obrador, which hopes that the accord will help to reduce uncertainty over Mexico's trade relations with its North American neighbours and help boost investor confidence in Mexico. The uncertainty and low of investor confidence have been blamed for Mexico's weak economic performance in 2019 and the Mexican government hopes that by addressing these two issues economic growth will strongly recover in 2020.

The ratification of the agreement by the US comes as a relief to those who had feared that the USMCA might not be ratified before campaigning for the US presidential election later this year kicks off in earnest. This could have made its ratification considerably more difficult amid the deepening political divisions in the US. Given that the agreement was signed by the three countries in late 2018, there had been significant foot-dragging over the course of 2019. Mexico's legislature was the first to ratify the agreement in June 2019, but there were doubts about when the US government would do so.

Diplomatic spats between the US and both the Canadian and Mexican governments delayed the ratification process last year. These related to trade and labour market issues included in the new agreement, as well as periodic disagreements over the construction of a wall along the US-Mexican border and, on the Canadian side, disparaging comments made by Prime Minister Justin Trudeau about US President Donald Trump that were inadvertently caught on camera by the media.

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Just the Canadians to go

Although President Trump had pressed the US Congress to ratify the deal quickly, there was more resistance from US legislators. The Speaker of the US House of Representatives Nancy Pelosi (D-CA) demanded better enforcement of some of the USMCA labour provisions, in Mexico in particular, raising questions about whether the House would back the agreement. There were also concerns about provisions relating to pharmaceuticals and environmental issues. In the end, minor adjustments to the text of the USMCA on these issues introduced in mid-December 2019 helped secure backing from US labour unions and, as a result, Democratic legislators.

The tweaks include the establishment of an independent three-person panel of experts who will visit sites in the event of concerns about a violation of labour regulations. The House of Representatives ratified the agreement on 19 December 2019 in a rare example of bipartisan consensus, with 385 votes in favour and just 41 against. The bill then passed to the Senate, where it was also ratified on 16 January by a wide margin (89 votes in favour; 10 against). To complete the US ratification process, the bill just needs to be signed into law by President Trump, which is expected in the coming days.

Canada has not yet ratified the USMCA, with Prime Minister Trudeau's loss of a parliamentary majority in the October 2019 federal election complicating matters somewhat and contributing to a delay on the Canadian side. However, given the impact that the loss of trading preferences would have if Canada does not ratify the USMCA, there is broad consensus that the agreement will be approved by the Canadian Parliament. The Trudeau administration has indicated that it will push for the ratification of the agreement with a vote on it due to be held once Canada's Parliament returns from its winter recess at the end of January.

Celebrations

Mexico will also need to return the tweaked agreement back to its legislature to rubber-stamp the changes agreed in mid-December, but this is unlikely to prove problematic. This makes it likely that the USMCA will come into force later in 2020, most likely before the US presidential election in the fourth quarter. This is a good prospect for Mexico and so the ratification of the USMCA by the US was celebrated by the López Obrador administration and Mexico's business sector. President López Obrador said that it was good news as the full ratification of the USMCA would "mean more confidence in Mexico and the arrival of more investment, the setting up of businesses, jobs with better salaries". The president then went on to urge the Canadian Parliament to also ratify the agreement. This was echoed by various Mexican government officials all of whom highlighted other positive aspects that ratification of the agreement would bring.

Economy Minister Graciela Márquez said that this was also good news for the whole of North America and Mexico's trading partners as it would offer certainty over the continued economic integration of North American markets. According to Márquez, this should help to attract investment and boost Mexico's productive and exporting potential. Agricultural & Rural Development Minister Víctor Villalobos said that the USMCA was a 'win-win-win' that provides certainty for North American agricultural trade worth over US$90bn a year. Villalobos added that the USMCA would also help to increase this trade by noting that it updates Nafta and introduces clearer and "science-based" rules of trade for the agricultural sector. Meanwhile Labour Minister María Alcalde Luján noted that the USMCA will also offer benefits for Mexican workers such as the introduction of collective salary negotiations and increased union democracy.

The ratification of the agreement by the Mexican business organisations. The American Chamber of Commerce of Mexico (AmCham), which groups US firms that operate in Mexico and Mexican firms with operations in the US, said the USMCA provides "a great opportunity to shield the flow of investments in North America with clear rules", which should help promote the region's future economic development. AmCham president, Jorge Torres, said that the ratification of the agreement by the US showed that North America is "moving in the right direction to take advantage of its economic advantages". This optimism was widely share by the business sector and this was clearly reflected in Mexico's stock exchange (BMV), which jumped by 1.9% on 16 January following the USMCA's ratification by the US Senate.

However, Torres warned that the USMCA is not a panacea that will resolve all the factors that have undermined investor confidence in Mexico, underlining that the López Obrador government will also have to do its part to improve investor confidence. Torres said that the López Obrador administration could boost investor confidence by showing that it is committed to respecting existing state contracts and clearly outlining its economic policy objectives. In particular, he advocated for the government to allow the private sector to help it develop the energy infrastructure projects it wants to see erected; and for the adoption of measures aimed at strengthening trade within North America, such as expediting border controls. But more generally, Torres called for the López Obrador administration to do more to strengthen the rule of law in Mexico and to combat insecurity, pointing out that these are two key factors that can discourage investments in Mexico.

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Market sentiment calms as tensions ease

“Lower public-sector spending would not be so economically damaging if the private sector was showing signs of confidence and expansion, as investment from this source could help offset fiscal austerity. However, the signs are not particularly promising in this respect. The latest business confidence survey from the national statistics institute (Inegi) show that private-sector firms are pessimistic about prospects for 2020”.

Mexico’s risk premium has continued to fall steadily, with the spread on five-year credit default swaps (CDS) – an indication of the level of credit risk that markets attach to economies – standing at just 73 basis points (bps) on 6 January. This compared to levels of over 120 bps last August and was the lowest since September 2014. Mexico’s EMBI+ spread, which is another measure of country risk, also fell by 69 bps over the course of 2019, from 241 bps at the end of 2018 to 172 bps at the end of last year.

The US’s ratification of the US-Mexico-Canada Agreement (USMCA) was one of the factors that has helped reduce CDS spread in recent weeks. Given how reliant the Mexican economy is on the US in terms of trade and investment, greater optimism that the USMCA will come into operation in the coming months has helped buoy investor sentiment. However, there are other factors at play that have impacted on market movements. Fiscal dynamics feature prominently, since the CDS market is essentially a measure of default risk (CDSs themselves are instruments that provide investors with insurance against debt default default). In this respect, the Mexican government appears to have made particular progress in recent months.

Smaller fiscal deficit boosts markets

Data for the full 2019 calendar year are not yet available from Mexico’s finance ministry (SHCP), but data from January-November reveal a much smaller fiscal deficit than programmed in the national budget. The deficit fell to M$167.2bn (US$8.9bn) during that period, compared with M$394.2bn pencilled in in the budget and the M$316.1bn registered during the first eleven months of 2018. The improvement mainly stems from the expenditure side, with the government keeping a tight rein on spending. Net expenditure came in 2.9% below budget estimates for January-November 2019 and in real (inflation-adjusted) terms, was 1.8% below year-earlier figures. Spending cutbacks were fairly evenly distributed between current and capital expenditure. On the current spending side, transfers, subsidies and pensions payments rose, but this was offset by sharp cutbacks in operational expenditure, including public-salary wages, which fell by over 5% in real terms.

There were also some improvements, albeit more minor, on the revenue front. Total fiscal income rose by 0.3% in real terms compared with January-November 2018 and was 0.6% higher than the government had projected in the 2019 budget for the first eleven months. Revenue growth would have been stronger had it not been for a sharp drop in oil income (which accounts for around 20% of total fiscal revenue). This fell by 9.2% in real terms from January-November 2018 and was sharply below budgeted figures, reflecting a drop in oil production volumes. Non-oil fiscal revenue rose by 2.5% in real terms from the year-earlier period and was also firmly above budget projections thanks to higher tax earnings (mainly rising excise taxes).

Public debt edges down marginally

These developments have been accompanied by some mild improvements in terms of public debt levels. The primary fiscal surplus rose from M$148bn in January-November 2018 to M$303bn in January-November 2019, which helped contain growth in the total public debt stock. Total public debt rose but only marginally, from M$10.7trn in November 2018 to just under M$11trn in November 2019. As a share of GDP, this is likely to have prompted a slight fall in public debt, from just over 46% at the end of 2018 to just under 46% a year later.

These results are likely to have buoyed market optimism about the likelihood of further fiscal austerity in 2020. This year’s budget keeps a tight rein on spending, aiming to generate a primary fiscal surplus of 0.7% of GDP and either keep the public debt to GDP ratio stable or generate another small decline. The overall

“There remain concerns on the revenue front, however. Calculations about likely tax revenue this year are based upon the expectation that the economy will grow by 2%, but this is significantly above the International Monetary Fund’s forecast of 1%. The economy stagnated during 2019 and it is difficult to see how GDP growth might reach the government’s projected level given growth in the US – Mexico’s main trade and investment partner – is likely to weaken as the impact of the trade war with China filter through to suppress the economy”.

emphasis remains on more targeted spending that either helps boost social conditions, improves public security or has a perceptible impact on economic performance. M$86bn is ring-fenced for the state-owned oil firm, Pemex, as part of efforts to boost funding for the company, allowing it to increase investment and ultimately lift flagging oil production.

Government may be forced to cut spending more aggressively in 2020

There remain concerns on the revenue front, however. Calculations about likely tax revenue this year are based upon the expectation that the economy will grow by 2%, but this is significantly above the International Monetary Fund’s forecast of 1%. The economy stagnated during 2019 and it is difficult to see how GDP growth might reach the government’s projected level given growth in the US – Mexico’s main trade and investment partner – is likely to weaken as the impact of the trade war with China filter through to suppress the economy. Unrealistic macroeconomic assumptions will have a significant bearing on the government’s revenue assumptions. The authorities are projecting nominal growth in government revenue of just over 4% in 2020, driven by a 6.4% anticipated increase in non-oil income, which in turn is largely driven by an increased tax take.

However, the 2020 budget does not include any major tax increases; instead, the government expects higher projected tax revenues through the adoption of measures to reduce tax evasion and fraud. This, in turn, is doubtful as public-sector cutbacks will affect the authorities’ capacity to clamp down on tax evasion. As such, if GDP growth comes in weaker than the government expects, the authorities look likely to cut spending in order to keep the deficit under control. If done sensibly, this might not be a bad thing, but there is a risk that the quality of spending cuts might be poor, with capital spending reduced (as it was in 2019). This would hurt long-term growth prospects since investment in physical infrastructure projects that would boost the economy’s potential would fall.

Businesses remain pessimistic about economic prospects

Lower public-sector spending would not be so economically damaging if the private sector was showing signs of confidence and expansion, as investment from this source could help offset fiscal austerity. However, the signs are not particularly promising in this respect. The latest business confidence survey from the national statistics institute (Inegi) show that private-sector firms are pessimistic about prospects for 2020. Confidence levels among the key manufacturing sector stood at 49.5 in December; in this index, 50 marks the dividing point between optimism and pessimism (a score of over 50 indicates that most businesses are optimistic about prospects, while a score of below 50 indicates pessimism). The index stood at below 50 for four out of the last six months of last year, while both the November 2019 and December 2019 results showed deterioration from the previous months.

The overall business confidence index is comprised of five separate areas of assessment: perceptions of present economic conditions, future economic conditions, present company conditions, future company conditions, and investment intentions. This latter sub-category remains by far the weakest component of the business confidence index, with a score of just 42.2 in December 2019, indicating that companies are highly unlikely to increase investment in 2020. Perceptions of the state of the economy were weaker than perceptions about individual company performance, with respondents showing greater confidence about future prospects than the current situation.

Minimum wage rises sharply

In late December 2019, the Mexican government announced a 20% increase to the minimum wage, effective from the start of 2020. This is designed to fulfil President Andrés Manuel Lopez Obrador's campaign pledge to boost living standards and reduce poverty.

Given that the minimum wage was increased by 16% a year ago, shortly after President Lopez Obrador took office, this latest annual increase comes as little surprise. However, the size of the increase is notable, marking the largest single hike in 44 years. The minimum wage now stands at M$123.2 (US$6.58) per day, compared with M$102.7 previously. There is a separate minimum wage for areas located within 25kms of the US border; this saw a more moderate increase of 5%, to M$185.6.

The large increase serves a variety of purposes. President López Obrador specifically targeted wages as a key area during his 2018 election campaign, promising to address the fact that real wages have stagnated for years. Back in December Mexico's national statistics institute (Inegi) released the results of its 2019 economic census which revealed that wages in the country have been falling across all sectors over the last five years, even while the proportion of paid workers has been increasing.

In 2019, 59.6% of workers were paid for their labour, up from 56.5% in 2014. And yet average wages have fallen between 2013 and 2018, by as much as 21.6% in 'other activities' (not included in the services, retail or manufacturing sectors). On average, wages in the manufacturing and services sector (which employ 18.8% and 48.7% of workers, respectively) fell by 0.6% each year between 2013 and 2018; wages in retail (which employs 23.1% of workers) fell by 0.2% annually during this period; and wages in 'other activities' (9.4% of the working population) fell by an annual 4.8%.

López Obrador hopes that a higher minimum wage will help improve living standards and boost domestic consumption (and, in turn, GDP growth). The increase also sits well in the broader context of the ratification of the US-Mexico-Canada Agreement (USMCA). Although the US government has now ratified the new regional trade agreement, labour conditions in Mexico remain a concern in quarters in the US that are unsure about the USMCA. So, a sharp rise in the minimum wage might help alleviate US worries about cheap Mexican labour.

The Mexican government has not given any information about how the minimum wage increase will be funded, but the fiscal data from January-November 2019 will help ease concerns about the impact on public spending. Even though the government increased the minimum wage by 16% in 2019, the public-sector wage bill still fell sharply. If the government manages to do the same in 2020, this will help prevent a sharp rise in spending on wages.

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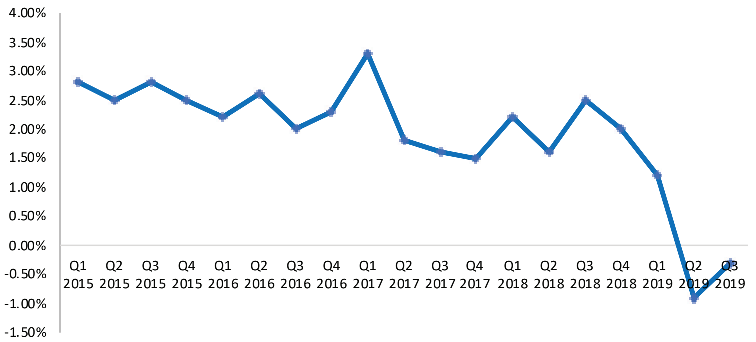
However, Mexican private sector think-tank, Centro de Estudios Económicos del Sector Privado (CEESP), has warned that while the minimum wage increase is positive and it has been welcomed by all sectors of the economy, future wage increases it should be "congruent with productivity". In a report circulated in the local press, CEESP said the latest increase is "just" but recalled a World Bank report which warned of inflationary risks if salary increases are above "productivity gains".

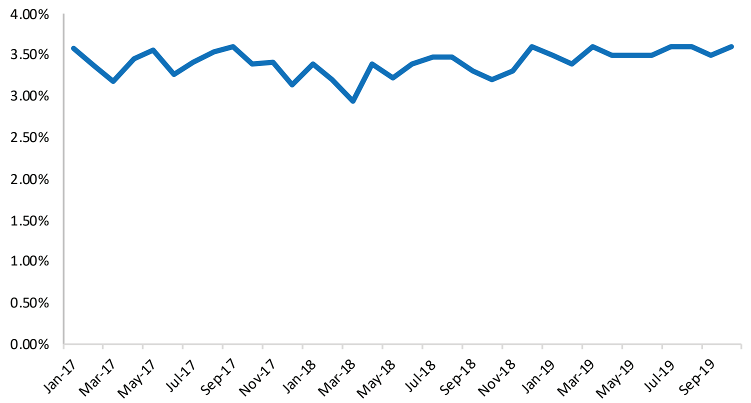
ECONOMIC HIGHLIGHTS

Interest rate cut: On 19 December 2019 Mexico's central bank (Banxico) cut its benchmark interest rate by 25 basis points to 7.25%, the fourth cut in interest rates in 2019. The decision was not unanimous; one member of Banxico's monetoary policy board wanted it cut to 7.0%. As well as the domestic economic slowdown, Banxico's report cited reduced headline inflation which closed at 2.97% in November 2019, just below Banxico's target of 3% as one of the factors that led to the slashing of the interest rate. The report also highlighted concerns that the recent increase in the minimum wage could drive up inflation.

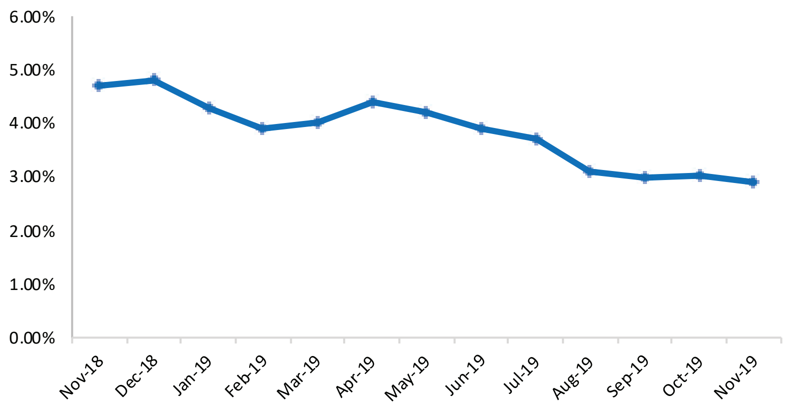
Mexico: GDP Growth
Percentage variation (year-on-year)



Mexico: Unemployment Rate
Economically active population



Mexico: Inflation
Percentage variation (year-on-year)



International bond issue: On 7 January Mexico's finance ministry (SHCP) reported that it had placed US$2.3bn worth of bonds in the international markets. This is Mexico's first international bond issue of the year, which the SHCP said had been 6.4 times oversubscribed as 350 institutional investors took part in the operation. An SHCP statement said it managed to place US$1.5bn in bonds maturing in April 2030 offering an annual return of 3.25% and US$800m in bonds maturing in January 2050 offering a yield of 4%. The statement notes that the interest rate for the 2030 bond is the lowest ever offered by Mexico for US-dollar denominated bonds. It adds that thanks to the operation and the swap offered to holders of bonds maturing in 2022 and 2028 for the new 10-year bonds Mexico has now achieved its objective of refinancing its debt and securing 58% of the external funding needs projected for the year.

FDI: On 19 November 2019 Mexico's economy ministry (SE) reported that inward foreign direct investment (FDI) increased 7.8% in the first nine months of 2019, compared with the same period in 2018. The SE figures show that between January and September Mexico received around US$26.1bn in FDI, compared to the US$24.2bn received for the same months in 2018. The FDI for the first three quarters of 2019 came from 3,759 companies with foreign capital participation, 2,814 trust contracts, and 19 foreign legal entities. However, in contrast to the increase in FDI, Mexico's national statistics institute (Inegi) reported on 9 December 2019 that gross fixed investment in the country was down 4.8% in the first nine months of 2019 compared with the same period in 2018. The figures also show that for the month of September 2019 fixed gross investment was down 6.8% compared with the same month the previous year.

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