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The new face of China's chequebook diplomacy in Central America

On his 1-6 December 2019 visit to China, El Salvador's President Nayib Bukele announced the latest infrastructure investment from the country's new Asian benefactor would be "gigantic" and "non-refundable". Ambiguous in his stance on China prior to his predecessor Salvador Sánchez Cerén (2014-2019) severing ties with Taiwan in August 2018, Bukele's newly unequivocal support for the 'One China Policy' won him a water treatment plant and a new sports arena. Such investment harks back to the decades-old 'stadium diplomacy' that won Beijing allies worldwide, including Costa Rica in 2007 and various Caribbean nations between the 1980s and early 2000s.

A popular strand of Chinese diplomacy in Central America and the Caribbean involves infrastructure investment in exchange for the formal endorsement of the Belt and Road Initiative (BRI), Beijing's ambitious plan to facilitate global overland and maritime trade. On 17 November 2017, Panama became the first country in Latin America and the Caribbean to ink a memorandum of understanding (MOU) under the framework of the BRI. Since then, 18 countries in the region have followed suit. Cooperation under the framework of the BRI, which China's President Xi Jinping launched in 2013 as his signature foreign policy, also required Panama to sever diplomatic ties with Taiwan. It set a precedent that El Salvador is the latest to follow, after the Dominican Republic in April 2018. Costa Rica also signed a BRI agreement on 3 September 2018.

Lending from China's state-run development banks, which are both profit-oriented and lend to support China's foreign policy objectives, totals over US$140bn since 2005, according to the Inter-American Dialogue's China-Latin America Finance Database. Though paltry in comparison to Venezuela (US$67.2bn) and Brazil (US$28.9bn), the Dominican Republic (US$600m) and Costa Rica (US$355m) both feature among the top ten loan recipients. Along with El Salvador, Costa Rica is a rarity in the region in that its trade with China does not rely on raw material exports. Chinese policymakers have pledged to invest in "industrial upgrading" in Latin America to address the regional trade imbalance, a pledge included in a 2016 Chinese foreign ministry White Paper.

The BRI's arrival in the US' historic sphere of influence is also a source of tension for the world's two superpowers. US Vice President Michael Pence and Secretary of State Michael Pompeo have warned that BRI investment entraps countries with unsustainable debt amid guarantees for China over access to their natural resources. In 2018 US Senator Cory Gardner (R-CO) proposed a legislative counteroffensive. The Taiwan Allies International Protection and Enhancement Initiative (Taipei) Act was passed by the US Senate in October 2019. The current version (it will now be considered by the US House of Representatives) proposes to "provide incentives to countries considering or taking steps to alter or downgrade official or unofficial ties with Taiwan". The bill offers food for thought for Taiwan's remaining Central American allies – Guatemala, Honduras, and Nicaragua.

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"Since the signing of a FTA in 2011, the same year the China-backed national sports stadium opened, exports from Costa Rica fell slightly from US$214m to US$198m in 2018, the bulk of which are semi-conductors and other electrical parts, according to United Nations Comtrade data. Costa Rica brought in a highly diverse basket of Chinese imports worth some US$2.27bn. In 2017, Costa Rica attained phytosanitary permits to exports its pineapples to China following years of negotiations. On 3 September 2018, Costa Rica signed an MoU on the BRI".

El Salvador

In addition to a shiny new sports stadium, Bukele's reiteration of El Salvador's support for Beijing and the BRI has opened the door for a new national library and drinking water sanitation projects associated with Lago Ilopango, a lake on the borders of San Salvador, La Paz, and Cuscatlán departments, and the proposed 'Surf City' tourism development in La Libertad department. The new deals with China build on the 13 cooperation agreements signed in 2018 by Sánchez Cerén, who Bukele had accused of allowing China to interfere in national politics through a rice donation programme. Nor was there any suggestion of Bukele's warmth towards Beijing in his 40-page election manifesto, which neglected to mention either Taiwan or the People's Republic.

The infrastructure projects may have sweetened El Salvador's new government, but the 2018 establishment of diplomatic ties with Beijing put it at odds with its sugar producers. In February 2019, El Salvador's national sugar growers' association (AAES) filed a complaint before the supreme court's constitutional chamber against the cancellation of El Salvador's free trade agreement (FTA) with Taiwan (one of the conditions of establishing relations with Beijing was the cancellation of all treaties with Taiwan). AAES argues that the decision to cancel the FTA – which was due to take effect from 15 March – was abrupt, unilateral, and did not follow due process. The Chinese embassy in San Salvador moved to quell fears in March 2019, tweeting: "Chinese businesses are motivated to buy sugar and other products from El Salvador". Sugar accounted for 95% of El Salvador's exports to China in 2018.

Panama

Before it landed in Panama, the initial scope of the BRI, known previously as One Belt, One Road, the New Silk Route, or other variations, had been to revive the ancient Silk Roads through Eastern China, Central Asia, and Eastern Europe, and maritime routes through port and canal development, mostly in the Indian Ocean. To clarify which projects qualified as 'BRI projects', in April 2019 President Xi said China's National Development and Reform Commission, the country's top economic planning body, would draw up a list.

The improvement of port infrastructure and the application of port tariffs consistent with those applied to international vessels, has formed the backbone of China-Panama cooperation. The addition of a fourth berth to the Colón Container Terminal, executed by China Harbour Engineering Corporation (CHEC), the Chinese company with by far the largest portfolio of projects in Latin America, is one of four Panama Canal-related developments. Perhaps the most significant is the award (also to a consortium including CHEC) of the 4km-long fourth bridge over the Canal that will connect the centre of Panama City with the cities of Arraiján and La Chorrera in Panamá Oeste province. Yet since the election in May 2019 of President Laurentino Cortizo, who is more sceptical of China than his predecessor, Juan Carlos Varela (2014-2019), Chinese companies appear to have lost ground. China Railway Engineering Corporation failed in a recent bid to build a new line of the Panama City metro; and the proposed US$5.5bn Panama-Chiriquí high-speed rail link, which Varela and Chinese partners agreed to explore in 2017, appears to have been shelved.

Costa Rica

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The 2015 award of the contract, again to CHEC, to upgrade national route No.32 from San José to the Caribbean city of Limón represents the single largest Chinese investment in Costa Rica. The state-run Export Import Bank of China

is financing US$395m of the project's US$465m total cost. The People's Bank of China also paid in US$50m to Costa Rica's US$450m transportation infrastructure programme, which is administered through the China Co-financing Fund for Latin America and the Caribbean.

Despite some fruitful cooperation on trade and infrastructure, China-Costa Rica relations have been tested by a long-running dispute over the US$1bn national oil refinery (Recope), which centred on a potential conflict of interests. Huanqiu Contracting & Engineering Corp, the company that conducted the project's feasibility studies, is a subsidiary of China National Petroleum Corporation International (CNPCI), the Chinese partner. On 31 October 2019, the International Chamber of Commerce's Court of Arbitration in London ordered the dissolution of joint venture the Sociedad Recontructora China-Costarricense (Soresco) and for CNPCI to transfer the company's remaining US$36bn to the Costa Rican government.

"The Chinese infrastructure project in Central America to attract most global media attention has been the proposed Nicaragua Canal. Embattled President Daniel Ortega insisted on 14 August 2019 that the project would go ahead as planned but Wang Jing, the project's figurehead and CEO of the now dissolved Hong Kong Nicaragua Development Corporation (HKND) seems to have disappeared from view. Even before the protests sparked by President Ortega's proposed 2018 social security reforms, international rights groups complained about illegal expropriation of land for the project".

Dominican Republic

In September 2018, the Dominican Republic's President Danilo Medina wrote to China Civil Engineering Construction Corporation (CCECC), listing a number of development projects that might be of interest to the state-owned infrastructure company. Among them were a railway between the Dominican Republic (DR) and neighbouring Haiti, dams in the Monseñor Nouel province and on the Boba-Baquí rivers, and the modernisation of the Arroyo Barril port.

Song Yang, director of CCECC's foreign aid division, responded with interest in pursuing feasibility studies for electricity distribution projects, opening the possibility of concessional loans offered, or in the form of aid. The exchange of favours is not limited to infrastructure cooperation. Declarations of support for the BRI have been met in kind with China's backing for the DR's non-permanent seat on the United Nations Security Council, which it eventually took on 1 January 2019. Meanwhile, DR exporters of rum, mango, avocado, and coffee are all hoping that efforts to market their products in China will yield dividends and enable the country to broaden the sale of raw materials such as nickel, aluminium, and some medical equipment and pharmaceuticals that make up the bulk of its exports.

Honduras, Guatemala, and Nicaragua

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Similarly, in Honduras, Chinese company Sinohydro's tentative steps into investing in the country's infrastructure sector as a partner in the Aguas Zarca dam project, ran up against local resistance. Sinohydro had pulled out of the project as tensions with indigenous Lenca culminated in the murder of Goldman Environmental Prize winner Bertha Cáceres in 2016. However, Sinohydro returned to the country to construct the Patuca III hydroelectric project that was inaugurated in October 2018.

US President Donald Trump's November 2019 decision to cut aid to Honduras, along with El Salvador and Guatemala as a punitive measure for failing to stem the flow of migrants towards the US southern border, has tested relations with Taiwan. Yet on an October 2019 visit to Taipei, ahead of taking office in January this year, Guatemala's President Alejandro Giammattei pledged to "stand with Taiwan". Given this, potential US incentives to resist recognition of the People's Republic, and Nicaragua's international isolation, an imminent switch from these countries seems more remote. But as Bukele's volte face has shown, Beijing's unique brand of incentive can be just as persuasive.

Struggling to address the electricity crisis

The 2019 Global Competitiveness Index, released by the World Economic Forum on 8 October 2019, ranked Venezuela 133rd out of 141 countries, making it the second worst performing economy in the region, only followed by Haiti. One of the factors that led to this outcome was the quality of its electricity supply, a category in which Venezuela ranked 123rd, meaning it provides one of the worst electrical services in the world.

In 2019, large areas of the country suffered electricity failures and five national blackouts were registered (on 7, 25, and 29 March, 9 April, and 22 July), the first of which lasted a continuous period of four days before the service was partially restored, representing the longest blackout in national history. To date, the service has been by-and-large re-established in the capital city, Caracas, but disruptions persist everywhere else.

There is a crisis in the electricity sector despite the fact that Venezuela has the natural resources and infrastructure required to generate enough electricity for its internal consumption and has even exported it in the past. In 1986 Venezuela inaugurated the hydroelectric plant with the highest installed capacity in the world at that time, the Guri Dam in Bolívar state.

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In a 2018 report entitled 'Venezuela en Apagón' ('blackout in Venezuela'), Transparencia Venezuela - the local chapter of international anti-corruption NGO Transparency International - brought together the country's top electricity experts and determined that the current crisis can be traced to a decade-long process of deterioration of the electric grid due to its politicisation, which was exacerbated by the 2007 nationalisation of the sector and the issuing of two electrical emergency decrees in 2010 and 2013 (decrees 7728 and 09).

With the arrival of former president, Hugo Chávez (1999-2013), in 1999, the approval of a new constitution and the call for elections for all public offices (the so-called 'mega elections' of 2000) enabled the new ruling Movimiento Quinta República (MVR) party to amass unprecedented leverage over the political system. During Chávez's third presidential term, this control was extended to the main industries of the country by a programme of nationalisation and expropriation, through the implementation of the Chávez government's plan, the 'first socialist plan 2007-2013'.

This included all companies related to the electricity sector, the telephone company (CANTV), the Banco de Venezuela (BDV) commercial bank, and part of the steel complex and ports in the Orinoco oil belt - where most of the country's oil reserves are located –and other sectors deemed of strategic interest. Critics maintain that ruling elites used nationalisation to gain direct control over public resources, divert funds toward partisan use, and create patronage jobs while generating negative returns and deteriorating the quality of services.

In the case of the electricity sector, nationalisation eliminated the previous model of mixed participation that ensured the separation of the activities of generation, transmission, distribution, and commercialisation of electricity. Instead, it created the Corporación Eléctrica Nacional (Corpoelec) - which combined all public and private electricity companies - and merged Corpoelec with the electric energy ministry, eliminating in one stroke competition and accountability.

The nationalisation also effectively ended the implementation of the development plan for the national electricity system (PDSEN) 2005-2024, a detailed investment plan in infrastructure, maintenance, and capacity-building. Instead, a significant amount of resources allocated to this plan have

since been invested in new ad hoc projects. This has led to a rapid deterioration of the electric industry despite large-scale investments, particularly during a period of historically high oil prices (2008-2013).

In 2010, just three years after the nationalisation, the government was compelled to declare an electrical emergency and enacted the first emergency decree. This measure accentuated the politicisation and inefficiency of the sector by explicitly allowing direct allocations - that is, by permitting the allocation of government funds without the need for public and competitive tenders. Corruption cases began to surface when the opposition gained control of the national assembly in 2016 and began auditing spending in the sector.

According to Transparencia Venezuela, between 2010-2015 as much as US$40bn in generation and transmission equipment was disbursed through direct awards following political criteria. The newly allocated resources were spent on projects not contemplated in the PDSEN and at a considerable surcharge. In 2017, the national assembly's special commission to investigate the electricity crisis denounced that the awarding of contracts was done without tenders and planned expenses were exceeded by 180% over the period between 2011-2013. The commission estimated that during this period, the cost per kilowatt climbed from US$800 to US$2,778, costing the nation US$25.38bn. National Deputy Jorge Millán, head of the special commission, revealed that the electricity emergency had been used to facilitate the process of diversion of funds.

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In parallel, the prohibition on state-owned enterprises to outsource services, issued in 2012, increased by 46% the roster of workers employed in the electricity sector between 2011 and 2012, most of whom lacked necessary technical training. Critics complained that these hires responded to political motivations - the creation of patronage jobs - in preparation for Chávez's third re-election campaign in 2013.

The second electrical emergency decree was issued in 2013. While leaving in place the same institutional framework and extending the validity of direct allocations, it effectively militarised Venezuela's electricity system by designating all related to the industry as 'security areas' and restricting access to all information. As of January 2020, there are no official figures from the electricity industry beyond 2013.

Furthermore, since 2013 the electric energy ministry (and Corpoelec, since both are headed by the same individual) have been for the most part led by members of the military: Lieutenant Jesse Chacón (2013-2015) and Major General Luis Motta Domínguez (2015-2019). This corresponds with the broader trend of militarisation that has taken place across the public sphere since President Nicolás Maduro assumed power in 2013. At the height of the crisis in April 2019, Motta Domínguez was dismissed and two civilians have held the post since: Igor José Gavidia and Freddy Brito Maestre.

Following a year of intense political conflict, in which many public protests were triggered by discontent over the suspension of electric services, according to the Observatorio Nacional para la Conflictividad Social (OVCS) – a local NGO that measures protests across the country - no significant reforms to the electric system have been introduced.

Tellingly, there have been no modifications of the electricity subsidy, which allows Venezuelans to pay US$0.31 for every kilowatt consumed, "the cheapest tariff in the world since the international average is US$0.92" according to Chacón. It is likely that there will be further disruptions in the provision of the electric supply in 2020. Notably there are signs that the population is starting to adapt to this new status quo, with an increase in the purchase of electric generators and a growing relocation to Caracas in a bid to ensure more reliable access to electricity.

Tax reform a much-needed victory for the government

On 1 January Ecuador's 'tax simplicity and progressivity law' came into effect following its final approval by the national assembly on 30 December 2019. The law is an important part of the packet of measures which the government led by President Lenín Moreno is seeking to implement in order to comply with the conditions attached to Ecuador's US$4.2bn loan from the International Monetary Fund (IMF). Although the law will raise fairly modest funds, its approval is a much-needed victory for an administration which has faced significant opposition to its tax reform plans.

The tax simplicity and progressivity law was first submitted to Ecuador's national assembly for consideration on 21 November 2019 following the legislative body's overwhelming rejection of the more comprehensive 'economic growth law' on 17 November.

The new law shares much of the same content as the failed bill with regard to tax reform but omits the more controversial measures aimed at advancing fiscal responsibility, such as a setting a limit on public spending, and reforms to increase the independence of Ecuador's central bank (BCE). As well as the objectives suggested by its name, the tax simplicity and progressivity law seeks to spur productivity and increase revenue, necessary for the reduction of the country's large fiscal deficit.

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According to the government, the law has simplified income tax legislation for microenterprises, agriculture, livestock, and specifically banana producers, as well as the income tax system for companies in general through the elimination of advance income tax payments. The latter measure also aims to stimulate growth by providing businesses with more liquidity in a year in which Ecuador's economic growth is forecasted to reach only 0.2%, according to IMF projections.

In terms of the reforms which principally aim to raise revenue for the government, for consumers the most significant measures are the imposition of a value-added tax (VAT) of 12% on imported digital services and a new tax on mobile phone plans. Large businesses whose 2018 revenues exceeded US$1m will face a temporary tax, programmed for three years from 2020 onwards, with three different tax rates established depending on their 2018 revenue. Finally, the government hopes to raise significant funds from a new withholding tax on dividends received by foreign shareholders.

According to the congressional economic commission, the tax simplicity and progressivity law is projected to raise an additional US$620m in 2020, a modest amount when contrasted with the deficit of US$3.38bn projected for 2020 by the economy & finance ministry. Nonetheless, the passing of the law has reassured the IMF and investors after a tumultuous few months for the Moreno administration's reform programme following the October 2019 protests sparked by the economic growth law.

Indeed, in a 19 December 2019 statement, the IMF cited the progress of the tax reform bill in the legislature as a justification for the release of US$500m to Ecuador as a part of the country's loan. Nevertheless, as cited by the IMF, the next steps for the Moreno government include returning to its attempts to reform the BCE and improve fiscal sustainability, which, as shown by the failure of the economic growth law, will be an uphill struggle.

Economy faces ongoing challenges in 2020

According to a report published by the World Bank on 8 January 2020, although economic growth in Bolivia slowed dramatically in late 2019 amid social unrest following the October general election and subsequent resignation of former president Evo Morales (2006-2019) in November, the outlook for 2020 is tentatively positive. Current estimates are for economic growth of 3% in Bolivia in 2020, 3.2% in 2021, and 3.4% in 2022. This rate is above the predicted average for Latin America and the Caribbean of 1.8%, as well as above the predicted global growth rate of 2.5% for 2020.

The other slightly positive sign for Bolivia and the government of interim president Jeanine Áñez is that 2019 saw the lowest registered rate of inflation in Bolivia in a decade. Having peaked at 7.18% in 2010, inflation fell to 1.47% in 2019, and in fact saw a negative score of 1.54% deflation for the month of December, driven largely, according to the national statistics institute (INE), by a decrease in the price of food and non-alcoholic drinks.

While this apparently flat rate of inflation will come as good news for those who may have feared that the political crisis could trigger similar economic issues as in Venezuela, which has seen soaring hyperinflation in recent years, there are concerns that it could mark the beginning of a deflationary spiral, which would likely be exacerbated by lower regional demand for Bolivian products, driven in turn by poor economic outcomes across Latin America.

As much as Bolivia's internal situation was cited as the contributing factor in poorer-than-expected growth figures for 2019 (down to 2.8% from a predicted 4%, according to the World Bank), the country is at the mercy of regional and global trends. Economist José Gabriel Espinoza noted in a late December 2019 interview with US-based news website, *Voz de América*, that ongoing protests in Chile had negatively impacted Bolivia's economy, given that most Bolivian exports have to pass through that country's ports for onwards shipment.

Similarly, the World Bank report notes that the economic recession in Argentina has negatively impacted both the demand for goods from Bolivia (approximately 46% of Bolivia's petroleum gas exports – which make up 32% of total exports from the country – go to Argentina), and the value of remittances from migrant seasonal workers who have crossed the border into northern Argentina.

As any Bolivian economist could confirm, neither supply chain disruption nor reliance on the caprices of the international market are new problems. It has been suggested that one reason for the economic slowdown observed in December 2019 was the road blockades that were put in place across major supply routes amidst the political chaos. These blockades, which were led by supporters of Morales, resulted in shortages of food supplies in Santa Cruz department, and of fuel and liquified petroleum gas (LPG) in La Paz department. Given that many Bolivians rely for their livelihoods on selling these products for a small mark-up, it seems entirely plausible that even a relatively short period of interrupted supply would result in decreased spending and demand.

It is this heavy reliance on the informal sector that should be an obvious target of future Bolivian leaders' efforts to modernise and stabilise the economy. One of the major criticisms levelled at Morales' 14 years in power is that he dramatically increased the country's fiscal deficit – which has been almost 7.5% of GDP since 2015 – without making any real progress in bridging the gap between the large section of the population working in

> "One of the major criticisms levelled at Morales' 14 years in power is that he dramatically increased the country's fiscal deficit – which has been almost 7.5% of GDP since 2015 – without making any real progress in bridging the gap between the large section of the population working in the informal economy and large-scale export producers the in hydrocarbon and agro-industrial sectors. Although many people saw short-term improvements in their material circumstances, many would argue that there has been no fundamental change in the structure of the economy, with Bolivia as prone to external shocks as it ever was".

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Yet another contributing factor to the economic slowdown in late 2019 is believed to be the forest fires that hit the north and east of the country, the most fertile parts of the country. The conflict surrounding the occurrence of these fires and the government's response to them is likely to spill over into the next administration, as Bolivia, like Brazil, faces the dilemma of how both to capitalise on growing global demand for crops such as soybeans and preserve the conditions that make the cultivation of these crops possible.

Given the criticisms levelled against Morales for failing to allow entrepreneurship and decentralise control of Bolivia's exports, the incoming president is likely to allow the expansion of agro-industry, particularly in Santa Cruz and Beni regions.

Indeed, candidates such as Luis Fernando Camacho, and, to a lesser extent, interim president Añez, have made such policies central to their campaigns. Such an approach may well pay off, but as with the current hydrocarbon-focused economy, it relies on demand for export crops remaining high.

In short, what seems the likely path to be taken by the Bolivian economy remains in danger of strikingly similar problems to those experienced under Morales's leadership, with expected growth undercut as much by global trends as by domestic factors. Amid a global economy still struggling to find its feet, it is unlikely that Bolivia will see any dramatic recovery from this approach, even though it may be politically popular in the east of the country.

It is also likely that an incoming government will respond to criticisms that Morales simply relied on increasing public debt as a way of financing targeted spending while cutting back on state funding for major works and looking for the private sector to pick up the slack. Bolivia is a country that has oscillated between state and private ownership of major industries, and whilst there is likely to be little appetite for another privatisation of state-owned hydrocarbon companies, it is clear that nationalisation did not bring all that was promised.

It remains to be seen whether any politician emerges who is brave enough to devise a long-term strategy allowing for a counter-cyclical fiscal policy funded by hydrocarbon export revenues – somewhat akin to the much-feted copper fund in Chile – in order to finally prise Bolivia away from the rollercoaster ride of global economic fortunes.

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For the interim government, as well as whoever takes over following the May 2020 election, a major question is likely to be whether they can continue delivering the economic growth and poverty reduction that was the main factor for many of Morales' followers to continue supporting his government, even amidst allegations of corruption.

The political cost of failing to deliver on economic promises became all too apparent in the 2016 referendum, when Morales lost the support of what had once been strongholds of support for his party, the Movimiento al Socialismo (MAS). Many of the candidates bidding for the presidency in May will be campaigning in some form around promises to bring economic prosperity to the country, either by continuing Morales' legacy in the highlands, or by focusing on the agro-industrial region in the east and ensuring it receives what many of its population feel is their due. In either case, as the October 2019 protests showed, any sign of an economic drop-off is likely to be swiftly, and harshly, punished.

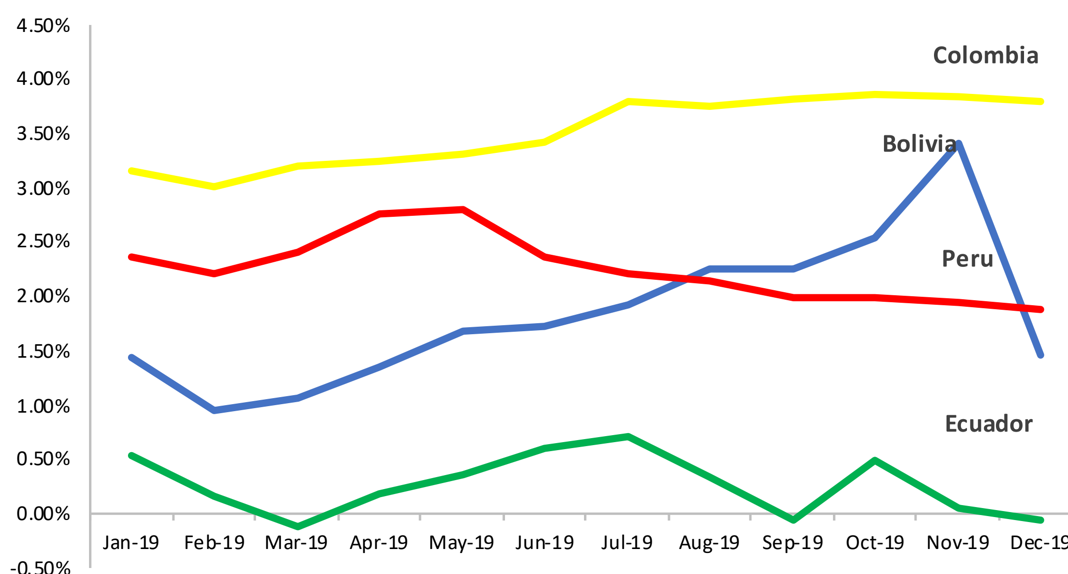
ECONOMIC HIGHLIGHTS

PERU | **Odebrecht lawsuit**. On 4 February, a subsidiary of Brazilian engineering firm, Odebrecht, filed a US$1.2bn lawsuit against the Peruvian government, before the World Bank's International Centre for the Settlement of Investment Disputes (Icsid). An Odebrecht-led consortium won a US$7bn contract in 2014 to build the 1,150km Gasoducto Sur Peruano (GSP) gas pipeline, but the massive 'Lava Jato' corruption scandal left the company unable to complete the project, and the contract was cancelled in January 2017. Odebrecht now contends that it is owed compensation for this cancellation. Peru's President Martín Vizcarra insisted on 7 February that the failure to complete the project amounted to a cancellation of the contract, and voiced confidence that the Icsid would rule in favour of the Peruvian government. Vizcarra also referred to ongoing investigations into Odebrecht corruption in Peru, including allegations of bribery surrounding the GSP bidding process in 2014, in which the only other competitor was disqualified at the last minute.

COLOMBIA | **Pension reform**. On 2 February, Colombia's President Iván Duque confirmed that pension reform will again be a legislative priority for his government once congress reconvenes in March. This issue has been a thorn in the Duque government's side since he took office in 2018, and its last attempt to introduce a pension reform programme led to the November 2019 workers' strike which escalated into widespread popular protests. The government is clearly keen to avoid repeating this fiasco. While the details of the reform have not yet been finalised, Duque has insisted that neither retirement age nor contributions will be increased, and that the goal will be to rectify the uneven subsidy system that results in overly generous 'mega-pensions' for some, and a total lack of coverage for others – it is estimated that only 24% of pensions in Colombia exceed the minimum wage. However, Duque has also promised not to touch the specialised pension schemes - reserved for the judiciary, police, and armed forces, amongst others - that make up the bulk of the country's pensions expenditure. Tackling pensions inequality without amending these schemes will be extremely difficult.

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	2.3
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	No 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						

BRAZIL | ECONOMY & TRADE

Riding the dragon

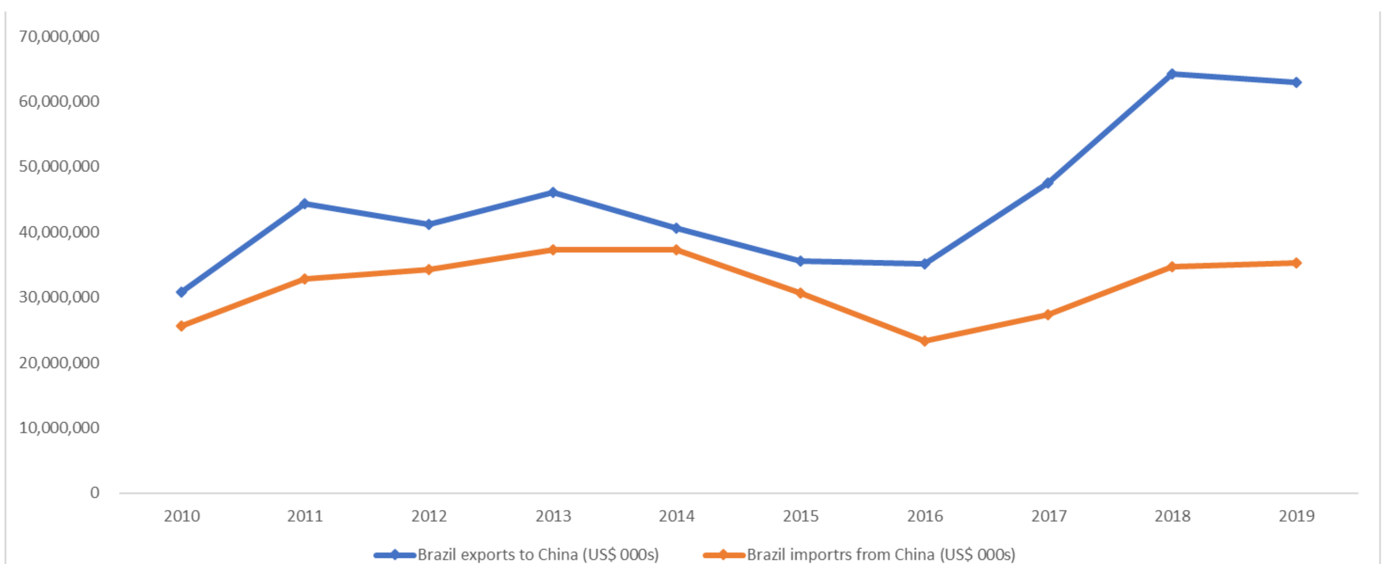
When he took office last year, it looked as if right-wing President Jair Bolsonaro might try and steer Brazil away from its close trading links with Communist China. Just over one year later, however, pragmatism appears to have prevailed, although there may be some turbulence ahead as Brazil negotiates the implications of the 'Phase One' US-China trade deal, the impact of the coronavirus epidemic, and looming battles over 5G technology.

"It is hard to over-emphasise China's economic importance for Brazil. Together the two countries represent a market of 1.6bn people and 21.1% of global GDP [...]. In recent years bilateral trade has grown to nearly US$100bn, representing about 40% of Brazil's total trade with the world".

It is hard to over-emphasise China's economic importance for Brazil. Together the two countries represent a market of 1.6bn people and 21.1% of global GDP (Brazil represents 2.5% of world GDP, while China accounts for 18.6%, both on a purchasing power parity basis). In recent years bilateral trade has grown to nearly US$100bn, representing about 40% of Brazil's total trade with the world. China buys 22% of Brazil's exports and supplies 19% of its imports. For comparison, Brazil's number two trading partner, the US, buys 11% of Brazil's exports and supplies 15% of its imports. By product, Brazil's key sales to China are soya beans (about 42% of the total by value), followed by iron ore (22%), crude petroleum (15%), wood pulp (4.5%), frozen beef (1.9%) and poultry (1.6%).

Brazil's politically and socially conservative farmers, a key part of the Bolsonaro right-wing electoral coalition, benefit from China's voracious appetite for soya and other agriculture and livestock products. This goes some way to explaining the victory of pragmatism over ideology in the new government's first year in office. Steered by Vice President Hamilton Mourão, Agriculture Minister Tereza Cristina da Costa Dias and Economy Minister Paulo Guedes, Bolsonaro dialled down his anti-China rhetoric. On an official visit to Beijing last October Bolsonaro declared China to be a "very capitalist country". The Chinese government meanwhile has carefully avoided political controversy and focused on the longer-term development of the relationship. Amid widespread international criticism of Bolsonaro's environmental policies during last year's Amazon fires, China expressed support for Brazil. Chinese oil companies were also the only international bidders last year in Brazil's otherwise disappointing offshore oil and gas licensing round [EB-19-11].

Brazil's trade with China



Source: *International Trade Centre*

There are however some continuing factors driving volatility in the two country's economic relationship. One of the most important has been the ongoing political and economic tension between Washington and Beijing. Since US President Donald Trump took office in January 2017 the world's two largest economies have been involved in an on-off tariff war. The confrontation has had both negative and positive effects for Brazil. Brazil suffers an indirect negative global effect, to the extent that the lurch towards protectionism adds costs and barriers that hinder the growth of world trade. On the other hand, there is a potentially positive and more direct trade displacement effect: China has bought less agricultural commodities from the US and has turned to Brazil to make up the difference. Indications are that the positive effects have so far exceeded the negative ones. Certainly, Brazilian exports to China surged strongly in 2016-2018, while provisional data for 2019 shows them levelling off somewhat.

In January the US and China signed a so-called 'Phase 1' trade agreement, widely seen as a truce in their tariff war. Under the terms of the agreement the US rolls back some of its tariffs on Chinese goods, and China commits to importing US$200bn of additional US products over the next two years. This has raised concern in Brazil. China says US$32bn of its increased imports from the US will be agricultural goods. That might displace Brazilian commodities. Marcos Casarin of Oxford Economics, a global economic forecasting firm, estimates that in a worst-case scenario Brazil could lose US$10bn in exports, equivalent to a 4% "negative shock" to its overall overseas sales. Pedro Dejneka of MD Commodities, a consultancy, told *The Financial Times* that the second half of 2020 could be a "major problem for Brazil". Other analysts, however, are less worried, arguing that Brazil may be able to further diversify soya sales to other countries. Larissa Wachholz, a Mandarin-speaking trade expert recently appointed as head of a new China-focused unit within Brazil's agriculture ministry (Mapa), says there is also scope to diversify sales to China beyond soya and beef, to include fruit, melons, grapes, and pecan nuts.

Anatel and 5G technology

After several delays, Brazil's telecoms regulator, Anatel, approved on 6 February a proposal for the 5G technology auction in the country. The proposal has been submitted to public consultation for 45 days and must undergo another vote before being confirmed. The auction, when it eventually takes place, will offer four frequency bands: 700 MHz; 2.3 GHz; 3.5 GHz; and 26 GHz.

Potentially more serious for Brazil is the outbreak of the coronavirus epidemic in Hubei province, and its spread across other parts of China. The outbreak is already disrupting the Chinese economy and is expected to lead to lower economic growth this year and, critically, to lower Chinese import demand. At the time of writing, it was not yet known how long it will take to bring the virus under control, or how severe the impact will be. What can be said is that the Latin American countries most reliant on trade with China, such as Chile, Peru, and Brazil, are most likely to be affected. On the other hand, there may again be at least some offsetting positive effects in Brazil. Brazilian meatpacking plants JBS and BRF say demand for their products could increase amid Chinese concerns over the safety of domestically supplied food products. "Remember that the virus supposedly started at a market in China where live animals were sold", says BRF chief executive Lorival Luz.

Brazil also needs to navigate a degree of political uncertainty over the transition to 5G technology. Moving quickly to adopt 5G is necessary to promote innovation and to develop a competitive digital economy. It may also be particularly important for the development of agri-tech programmes in Brazilian farms like using drones to monitor and increase crop and livestock yields. But the world's largest and currently most competitively priced 5G equipment manufacturer is Huawei, a Chinese company which the Trump administration deems to be a cyber-security threat. Trump is leaning heavily on his political allies, such as Bolsonaro and Prime Minister Boris Johnson in the United Kingdom, to exclude Huawei from any national 5G network building tenders. The issue presents Brazil with some difficult choices. One scenario for the coming global technological revolution is that there will be a 'decoupling' between the US and China, with each pursuing rival and mutually exclusive technical standards and security protocols. Brazil, which has key relationships with both Washington and Beijing, may find itself caught in the middle. Its moves will be closely watched.

The Bolsonaro government has moved the 5G portfolio from telecoms regulator Anatel to the presidential office. Vice President Mourão is reportedly closely involved with planning 5G adoption. The tendering process has been delayed (*see sidebar*). Science & technology Minister Marcos Pontes has said 5G will not be introduced in Brazil "before the end of 2021", something that may favour US attempts to promote competitors to Huawei.

XCMG sets up Brazilian bank

Xuzhou Construction Machinery Group (XCMG), a Chinese heavy equipment manufacturer for the construction industry that has operated in Brazil for eight years, is now developing its presence by following an unusual route: setting up a local bank. Taking advantage of a change in Brazilian law that encourages direct investment in the financial sector, Banco XCMG is expected to open its first branch in São Paulo state in the first quarter of this year. XCMG chairman, Wang Min, said the aim was to develop a "highly efficient and pragmatic corporate bank" which would offer a new financial platform serving Chinese and Brazilian companies and supporting economic development and job creation. Over 90% of Brazil's engineering machinery purchases are financed though bank loans and it appears that the new bank will focus initially on this sector, although it also plans to be involved in leasing, capital funding, investment and consumer credit.

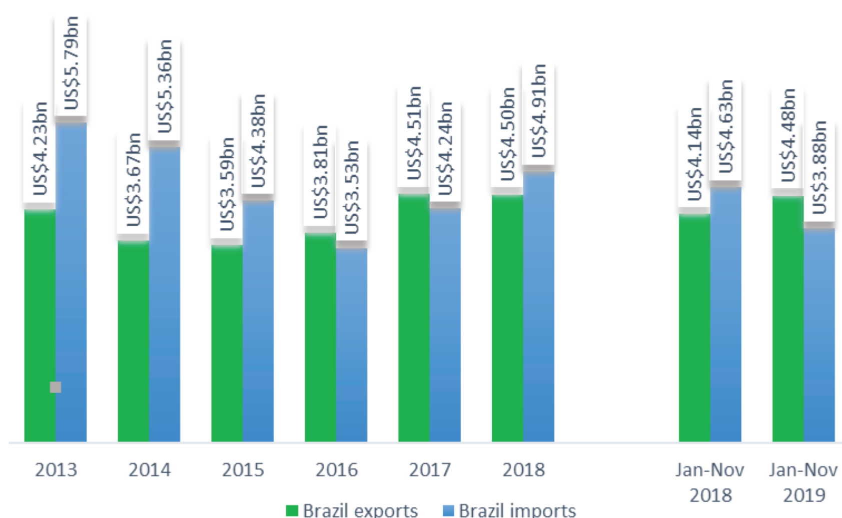
BRAZIL | TRADE

The Brazil-Mexico trade option

Brazil and Mexico are the first and second largest economies in Latin America respectively, accounting for over half of the region's GDP. Despite that, trade between the two is comparatively small. Both governments are now making positive noises about boosting trade flows in the name of Latin American integration, but it still looks as if change will take time.

The two Latin American giants don't do much business with each other. In 2017 Brazil shipped only 2.2% of its exports to Mexico, worth US$4.81bn, according to data gathered by the Massachusetts Institute of Technology-supported Observatory of Economic Complexity. Mexico in turn shipped an even smaller proportion of its exports to Brazil, 0.95% worth US$3.97bn. Brazil's top exports were cars, semi-finished iron products, delivery trucks, poultry meat, and vehicle parts. Mexico's top exports to Brazil were cars, vehicle parts, polycarbonic acids, thermostats, delivery trucks, and electrical lighting and signalling equipment.

Brazil's trade with Mexico



Source: *Brazil's ministry of economy, industry, foreign trade & services*

There are all sorts of reasons why trade is so low. The two countries have not always seen eye-to-eye in political and diplomatic terms. They currently have populist presidents of the political right (Brazil) and the political left (Mexico). In some senses they remain rivals for regional leadership. They speak different languages. They are geographically distant. Transport links are not very good. Brazil has notoriously high protective tariffs, while Mexico has a much more open economy. Each has traditionally prioritised trade pacts with their immediate neighbours: Brazil forms part of the Southern Common Market (Mercosur) along with Argentina, Paraguay and Uruguay, while Mexico is a member of the US-Mexico-Canada

"There are all sorts of reasons why trade is so low. The two countries have not always seen eye-to-eye in political and diplomatic terms. They currently have populist presidents of the political right (Brazil) and the political left (Mexico). In some senses they remain rivals for regional leadership. They speak different languages. They are geographically distant. Transport links are not very good".

Agreement (which recently replaced the North American Free Trade Agreement) with Canada and the US. Brazil focuses much of its export efforts on China and Europe, while Mexico is closely aligned with the US economy.

There is, however, a coherent case for closer relations. For years the United Nations Economic Commission for Latin America and the Caribbean (Eclac) has argued for closer regional integration. Free or freer trade within Latin America could be a logical steppingstone to competing more effectively at a global level. At different times in the last few years both Mexico and Brazil have felt the need to diversify. At various points in Mexico's recent trade negotiations with the US, when President Donald Trump has threatened punitive tariffs, officials have talked of shifting their trade patterns towards countries like Brazil. Brazil in turn, has worried about its over-reliance on commodity exports, which has locked it into a kind of relative de-industrialisation. For it too, selling more sophisticated value-added products in Latin America is attractive.

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Currently there are two partial-scope bilateral economic complementation agreements (ACE) in place. ACE 53 covers various sectors but mainly facilitates trade in chemicals. ACE 55, the more important of the two, provides for limited free trade in the automobile sector provided there is local content of at least 40%. In March 2019 it was agreed that the scope of ACE 55 would be progressively enlarged until the two countries achieve 100% free trade in the auto sector by 2029.

In September last year Marcos Troyjo, a senior trade official at Brazil's economy ministry, said the two countries had formally begun negotiations on a free trade agreement. Then on 31 January Mexico's economy minister, Graciela Márquez, picked up the theme, confirming that negotiations are underway to find areas of mutual benefit. Márquez warned, however, that "Brazil is a difficult country, it is the opposite of Mexico. Mexico is a very open economy; Brazil is very closed".

ARGENTINA| ECONOMY

Beware the ides of March

The province of Buenos Aires came to the brink of default but backed down on 4 February. The episode may help move the national-level debt restructuring talks forward. An International Monetary Fund (IMF) mission visited Buenos Aires for a week from 12 February. The government has published a timetable which envisages the bulk of negotiations with foreign creditors taking place in the second half of March. Completing talks by then looks difficult but President Alberto Fernández will be under domestic pressure to settle so as to shift focus to ending two years of economic recession.

A trick of fate and politics has meant that the current governor of Buenos Aires province is Axel Kicillof, a Peronist nationalist from the nationally ruling Partido Justicialista (PJ, Peronists) and former federal economy minister (2013-2015) known for his intransigence in debt talks. His views do not necessarily mesh with the more moderate positions of President Fernández. True to type, Kicillof took a hard line on provincial debt. Facing a US$250m bond repayment deadline, the governor proposed delaying payment until May. He needed 75% of the bondholders to agree to the delay but with US-based fund Fidelity, which holds 25% of the bond issue, refusing to budge, his options narrowed down to either paying up or triggering a formal default. Federal economy minister, Martín Guzmán, had already ruled out any rescue package for the province. So an unhappy Kicillof, professing that he had negotiated in good faith, agreed to make the payment after all, complaining of Fidelity's "enormous intransigence".

The episode could have a positive effect helping move national debt talks forward. Argentine bond prices enjoyed a small rally with spreads tightening on 7 February on the back of optimism about talks with the IMF. Gustavo Rangel, an ING economist, told *The Wall Street Journal* that the Buenos Aires province

Argentina and the IMF
An IMF mission led by Assistant Director Julie Kozack, initially due to visit Buenos Aires from 12 to 14 February, extended its stay in Argentina to a full week to allow for more substantial discussions. The mission had just arrived in the country at time of writing. To get the latest updates on President Alberto Fernández's government's discussions with the IMF and efforts to renegotiate Argentina's debt, consult our sister publications *LatinNews Daily* and *Latin American Weekly Report.*

backdown showed the province did have the funds needed to pay, and that "bravado doesn't work". Adrian Yarde of Buenos Aires fund manager Grupo SBS said, "this is a very good sign of good faith showing they want to prevent default."

While the episode may have helped President Fernández and his economy minister Guzmán, the road ahead to re-negotiate some US$100bn-plus of debt is still difficult. To build international support for a deal Fernández travelled in early February to France, Germany, Italy, and Spain. The trip included a meeting in the Vatican with Argentine-born Pope Francis and IMF managing director Kristalina Georgieva. The government also says that it has received the support of the Donald Trump administration in the US.

There has been a tactical deadlock in the approach to the talks. The Buenos Aires government takes the view – shared by many analysts – that getting the debt down to sustainable levels will involve a combination of delaying repayments on the one hand, and the creditors accepting a 'hair cut' – writing off part of the debt as unpayable – on the other. Guzmán has therefore been trying to get the creditors to indicate how much of a haircut they are actually prepared to take. The creditors reject this approach completely saying the onus should be on the government to put a credible economic plan on the table, one that will quantify the country's real ability to repay its debt. According to former central bank president, Martín Redrado (2004-2010), "It's like two trains coming towards each other. We'll see who blinks first. The good thing is that no-one wants a crash". The IMF mission to Argentina may help begin to narrow the gap (*see sidebar*). However, there is real concern that shifting the bulk of the negotiations to only two weeks in the second half of March may be overambitious.

PARAGUAY | INFRASTRUCTURE

Fly me to Asunción

Medium-term economic growth (despite a slow year in 2019) and new routes are increasing traffic at Asunción's 'Silvio Pettirossi' international airport. The authorities are moving ahead with plans for a new terminal.

Earlier attempts to modernise Paraguay's main airport ran into trouble. In 2018, plans for a US$149m new terminal were cancelled amid disputes over the public-private partnership (PPP) tendering process. At the time, the main contenders to do the work were Sacyr-Agunsa of Spain, Vinci Airports of France, and Tocsa of Paraguay. Since then there have been complaints that the airport is operating beyond its capacity of 1m passengers a year. There is also a legal dispute between the national civil aviation authority (Dinac) and commercial tenants in the main terminal offering currency exchange and bag-wrapping services, which Dinac is trying to evict.

The plan now is to build a new terminal and two new runways at a cost of around US$200m (some estimates range up to US$270m) which Dinac will finance from its own funds. The tendering process, including a feasibility study, is to be managed through the International Civil Aviation Organisation (Icao). Work is expected to start in July this year and be completed by late 2022. Expansion will take overall capacity up to 6m passengers a year. Dinac believes this will allow the airport to cope with new regional routes (daily Asunción-Bogotá and Asunción-Brasília routes opened in December 2019), as well as to become more of a hub airport within South America.

Dinac president, Edgar Melgarejo, says that there has been virtually no new investment in the airport since it came into service four decades ago. Work to improve the existing terminal is underway and will conclude in March. This has involved expanding the passenger embarkation area. Dinac is also seeking to improve security with the addition of new X-Ray scanners and the construction of a perimeter wall.

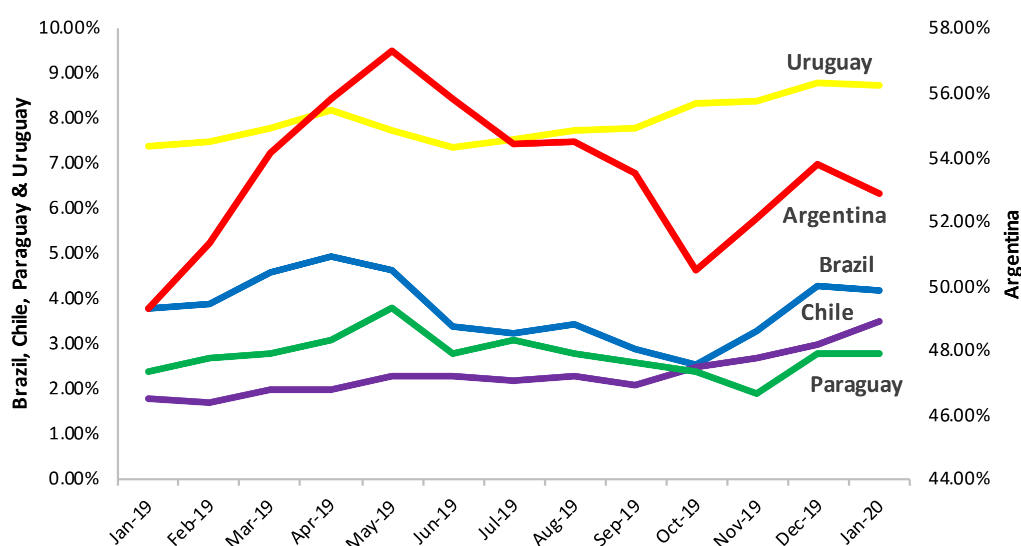
ECONOMIC HIGHLIGHTS

CHILE | **Growing economic pessimism despite some positive indicators**. A public opinion survey published by local pollster Cadem on 10 February shows that a majority of Chileans have a pessimistic outlook on the country's economy. Of those surveyed, 43% believe the economic situation will worsen in the first half of 2020, up from 20% in August 2019. Just 13% believe it will improve, while 43% predict no change. The crisis of social discontent and inequalities are cited as the country's principal economic problem by 43% of respondents, while 57% believe that unemployment will increase. This pessimistic outlook comes despite some better than expected economic indicators for the end of 2019. The latest monthly economic activity index (Imacec), published by the central bank (BCCh) on 3 February, shows that economic activity expanded 1.1% year-on-year in December 2019 and 3.5% compared with November 2019, following year-on-year contractions of 3.4% and 3.5% in the October and November 2019 Imacec, respectively. Unemployment figures, released by the national statistics institute (INE) on 31 January, show only a slight year-on-year increase in the rolling quarter to December 2019. The unemployment rate totalled 7% in October-December 2018, up from 6.7% over the same period in 2018.

URUGUAY | **Tourism surprises in January**. On 13 February, Uruguay's tourism ministry (Mintur) released figures for tourist arrivals for January 2020. Despite cautious expectations for the tourism industry, tourist arrivals increased 3% year-on-year to a total 444,509 visitors in January (including non-resident Uruguayans). Within this, the number of Brazilian visitors increased 6.8% to 60,421, while the number of Argentine visitors increased 0.7% to 288,605. The economic crisis in Argentina and the introduction of a 30% tax on foreign currency transactions there was expected to negatively impact Uruguay's tourism industry which depends heavily on Argentine visitors (they made up 65% of total tourist numbers in January). Although the number of tourists visiting Uruguay in January increased, total tourist spending decreased 7.5% to a total US$327.6m. Deputy Tourism Minister Benjamín Liberoff recognised that the January results were not entirely satisfactory, but were nonetheless a "success" in light of the situation in Argentina. In 2019, Uruguay received over 3.22m visitors, bringing in US$1.75bn.

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						

IMF urges Caricom to renew integration efforts

At its 40th heads of government conference, held in July 2019, the leaders of the Caribbean Community (Caricom) expressed their frustrations over the lack of progress on the Caribbean Single Market and Economy (CSME). Now, with a Working Paper issued in January 2020, the International Monetary Fund (IMF) has added its weight to the calls for more urgency in Caribbean economic integration.

In the final communiqué of the July 2019 summit, the Caricom heads of government "expressed concern at the slow pace and low level of implementation of the…CSME…and at the lack of urgency exhibited by some member states in enacting the necessary legislation and putting in place the administrative measures for implementation". And the communiqué "urged member states participating in the CSME as a matter of priority to undertake the necessary action at the national level as agreed in the implementation plan".

"Caricom was created in 1973, and the decision to create the CSME was taken in 1989, with implementation beginning in 2002 after the signing of the Revised Treaty of Chaguramas (Caricom's founding document) in 2001. The single market is intended, among other things, to create the free movement of people and goods throughout member states. This has not happened. At the 2017 summit, the-then host, Grenada's Prime Minister Keith Mitchell, complained that progress was being held up by "knee jerk nationalism".

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The July 2019 communiqué attributed some of the poor performance to capacity constraints rather than to a lack of will, particularly with regard to drafting legislation, and the leaders agreed that there was a need "to provide greater support to the CSME focal points through the strengthening or establishment of CSME units within ministries with a focus on implementation in accordance with the agreed timelines".

The IMF report has two central themes. The first is that further integration is an unqualified good; the second is that progress is slow and insufficient. With regards to economic gains that might result from further integration, the report states that according to the IMF modelling: "All Caricom countries achieve welfare gains from the trade liberalisation, with a US$6.2bn gain for the region as a whole…equivalent to 7.6% of the region's GDP in 2018".

With regard to progress, the report notes: "Implementing the CSME provisions has been a gradual and incomplete process, with around 57% of the actions required to establish the CSME completed since the Revised Treaty". The report adds that most progress has been in the area of free trade, "with intra-Caricom goods trade essentially free of tariffs". However, there has been less progress on the customs union and common market, "with significant nontariff barriers (NTBs) to trade".

For the IMF, the key impediments are "the lack of a regional body with powers and accountability to effect decision making" and the lack of the tools to "transform community decisions to binding laws". In conclusion, the IMF asserts that the region needs to focus "its utmost attention" on addressing these impediments. And, as a first step, it recommends increasing co-operation in areas where Caricom members face "significant common challenges", such as safeguarding regional financial stability, building resilience to climate-related risks, fighting violent crime, and preventing "a race to the bottom in granting incentives to foreign investors". It refers to these as the "low-hanging fruit" in the integration challenge.

Guyana's oil surge distorts regional outlook

The Caribbean Development Bank (CDB) held its annual news conference on 11 February at which it predicted healthy economic growth for the region of 4.1% in 2020, but the projection is dramatically skewed by the oil-fuelled surge in growth in Guyana, which the International Monetary Fund (IMF) projects at 85.6% for 2020.

The CDB has 19 borrowing member countries (BMCs), namely Anguilla, Antigua & Barbuda, Barbados, Belize, British Virgin Islands, Cayman Islands, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Kitts & Nevis, St Lucia, St Vincent & the Grenadines, Suriname, The Bahamas, Trinidad & Tobago, and the Turks & Caicos Islands. For 2019, the bank reported: "Our BMCs recorded another year of low growth, averaging just about 1.0% in 2019, compared with 1.6% in 2018".

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The bank attributed the poor 2019 performance to "relatively sluggish global growth of 2.9%, prolonged drought in Belize, Haiti, and Jamaica, and social unrest in Haiti (where the economy contracted by 0.3%). On the other hand, hurricane reconstruction effort boosted growth in Anguilla (10.9%) and Dominica (5.7%) while the effects of Hurricane Dorian on The Bahamas were limited by coming in September after a record tourism season with the highest-ever number of visitor arrivals prior to the hurricane.

But if growth was subdued, the news on debt was encouraging. Barbados, which recorded a primary surplus of 6% of GDP in 2019 (compared with 3.5% in 2018), saw its debt-to-GDP ratio fall from 127% in 2018 to below 120%. In total, the debt-to-GDP ratio fell in ten BMCs, with the steepest declines in Barbados, Grenada (to below 60%), Jamaica (from 101% to 94.4%), and St Kitts & Nevis (also to below 60%). In The Bahamas, debt was also falling until Hurricane Dorian hit, taking the debt ratio back to 63.3%.

The Guyana factor

Looking ahead to 2020, the CDB makes it clear that the overwhelmingly dominating influence will be Guyana. Although Guyana is, by a factor of nearly 10 times, the largest of the 12 independent countries of the English-speaking Caribbean, on a per capita basis it has until now been the poorest, with a GDP per capita of US$4,578 against a regional average of US$12,600 (on 2017 figures). Even in absolute terms, Guyana's GDP ranks it 5th out of 12 countries, ahead only of Belize and the tiny island states of St Lucia, Antigua & Barbuda, Grenada, St Kitts & Nevis, St Vincent & the Grenadines, and Dominica. But from this year onwards, all this will change.

In total, ExxonMobil has announced 16 oil discoveries in the Stabroek Block, and the gross recoverable resource from the offshore block is now estimated to be more than 8bn oil equivalent barrels. Output from the first discovery in the Liza field is expected to reach full capacity of 120,000 gross barrels of oil per day (bpd) in early 2020, and the total output from the Stabroek Block is expected to reach more than 750,000bpd by 2025. It is this that will fuel the 85%-plus domestic economic growth rate in 2020, lifting the region's average to 4.1%.

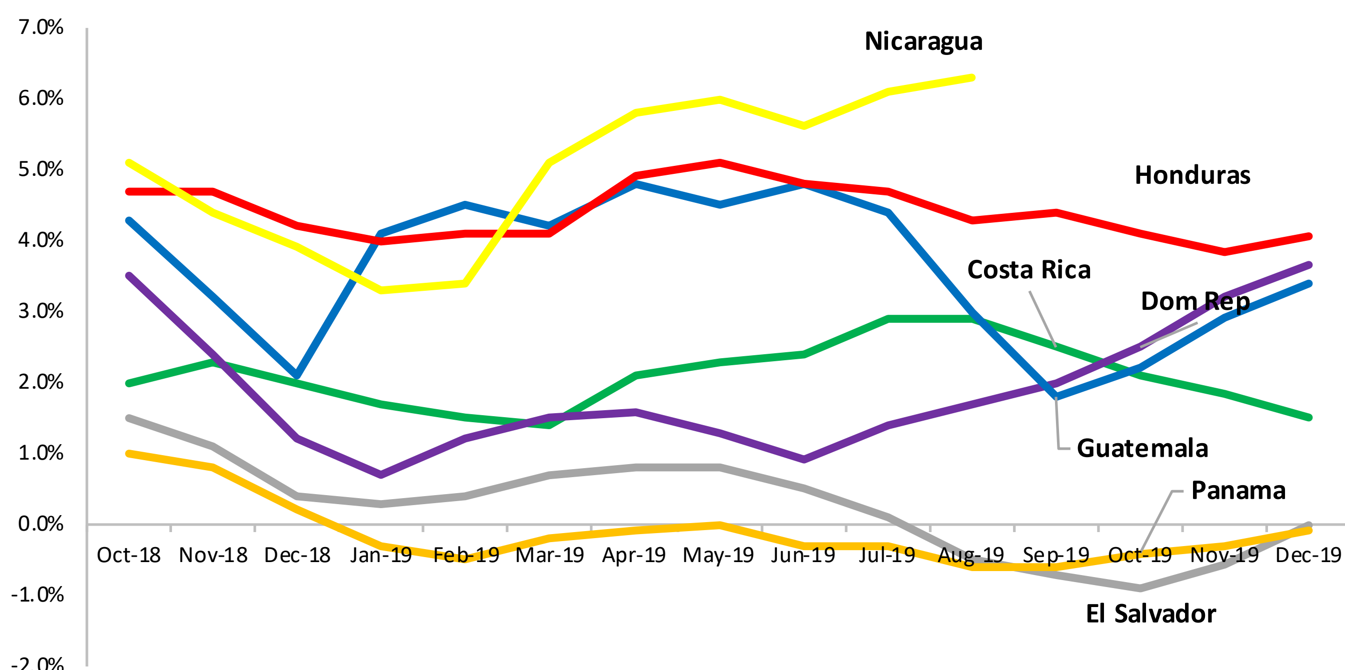
But, away from Guyana, the CDB says that economic growth "will remain lopsided and below the sustainable rates needed for long-term resilience". Of the 13 other independent BMCs, the IMF growth predictions for 2020 are: Antigua & Barbuda (3.3%), Barbados (0.6%), Belize (2.1%), Dominica (4.9%), Grenada (2.7%), Haiti (1.2%), Jamaica (1.0%), St Kitts & Nevis (3.5%), St Lucia (3.2%), St Vincent & the Grenadines (2.3%), Suriname (2.5%), The Bahamas (-0.6%), and Trinidad & Tobago (1.5%).

ECONOMIC HIGHLIGHTS

PANAMA | **Panama Canal water shortages**. On 13 January the Panama Canal Authority (ACP) issued a statement highlighting new efforts to conserve water flowing through the Panama Canal after 2019 marked the fifth driest year seven decades. The new measures, which were due to take effect on 15 February, include a freshwater surcharge on vessels over 125 feet, adjustments to the booking system for all shipments, and a vessel handling fee. According to the ACP statement, these measures were necessary "to sustain an operational level of water and provide reliability to customers while it implements a long-term solution to water". A 6 January ACP press release noted that rainfall in 2019 was 20% less than the country's historic average, while water evaporation levels increased by 10% due to a 0.5- to 1.5-degree Celsius rise in temperature. As a result, Gatún Lake, the main source of water for the Canal and local communities, has lower water levels than average for this time of year. Low precipitation levels generate the risk that the lake will not have enough water to sustain canal operations during Panama's dry season. The new measures join a series of ongoing water conservation initiatives that ACP officials have been implementing to address water sustainability. These include suspension of energy generation at the Gatún hydroelectric plant, elimination of hydraulic assistance at the Panamax Locks, which use high levels of water to ease vessel passage, use of water-saving basins at the Neopanamax Locks, and use of tandem lockages, which allow two vessels to pass the canal at the same time.

Brazil & Southern Cone: 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	4.8
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*						

GDP data confirms economic recession in 2019

Despite Mexico's President Andres Manuel Lopez Obrador's still high public opinion ratings, the promised economic acceleration has not yet materialised. What is more, economic performance has actually worsened, with preliminary data released by the national statistics institute (Inegi) confirming that Mexico's economy fell into recession last year for the first time in a decade.

The recession was mild, with real GDP slipping just 0.1% year-on-year in 2019, but the fact that President Lopez Obrador pledged much firmer growth (a heady 4%) means that the result comes as a particular disappointment to the government. To date, only the headline figure has been published, although Inegi did give more details about performance in the fourth quarter of the year. Both primary activities (mainly agriculture) and secondary activities (dominated by manufacturing and oil) contracted compared to the third quarter, while service-sector output registered positive (albeit marginal) growth.

The causes are homegrown

One of the most interesting aspects of the GDP results is that Mexico's recession has not been caused by an economic slowdown in the US economy, to which Mexico's economy is closely linked thanks to trade and investment ties. What is usually the case is that a slowing US economy translates into weaker demand for consumer goods imports, which feeds through to lower orders at Mexico's manufacturing hubs. However, in 2019 Mexican export growth was firm; data is unavailable for the fourth quarter (and thus full-year), but export volumes averaged growth of 2.7% year-on-year from January-September, making it one of the strongest areas of the Mexican economy.

Instead, the causes of the recession were homegrown. López Obrador has been described as a "populist who does not like to spend"; regardless of the accuracy of such a label, it is clear that fiscal austerity has fed through to the national accounts, resulting in a sharp contraction in both government spending and public fixed investment. Reflecting reasonable levels of consumer confidence, private consumption registered positive growth, but at under 1% it failed to compensate for the contractions registered elsewhere.

Shrugging it off

To date, López Obrador does not appear unduly concerned, stating that the 2019 result is only weak because the government is not spending in order to prop up growth. He said that the GDP result was unimportant to him and that he had "other data" that points to greater socioeconomic development in the country. He appears to remain confident that economic growth will pick up in 2020.

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Still-high approval ratings (which remained above 70% in January) indicate that the majority of Mexicans share his optimism. Around half of respondents back the government's handling of the economy – a figure that actually rose by two percentage points in January, despite the weak underlying economy. However, it remains unclear how long people will remain loyal if the economy remains weak for a prolonged period. It is feasible that in the context of the president's campaign pledges of strong GDP growth, people may have been willing to turn a blind eye to one weak year. But López Obrador is likely to have to begin delivering concrete results if he wants to maintain his current levels of public support.

This year will therefore be a crucial year for the government. With its honeymoon period well and truly behind it, the authorities will be focused on stimulating economic growth. Despite López Obrador's dismissive comments about the utility of GDP as an accurate indicator of economic progress, it is an important headline figure and one that the government will want to boost.

There are few leading monthly indicators for January yet, so it is difficult to assess the momentum at the start of the year, but several developments suggest that underlying conditions remain weak. This is particularly true for the external backdrop (which serves as a barometer for Mexican exports), as the US economy is showing signs of slowing as the impact of the trade war between the US and China feeds through to the US domestic economy.

This is hampering US consumer demand, which is now showing signs of impacting Mexican manufacturing. Mexico's producer confidence index fell in January, as did sentiment in the manufacturing sector. The latter slipped from above the 50 mark (implying optimism) in December 2019 to below 50 in January (implying pessimism). These early indications imply that external demand – which was one of the few relatively strong areas of the economy in 2019 – is likely to be weaker this year. This places the onus on the government to stimulate domestic demand if it is to lift overall GDP growth. With the emphasis still on fiscal austerity, it is difficult to see how it will achieve this.

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Labour market deteriorates

Data on job creation in the formal sector was particularly bad in December 2019, as the Mexican government's huge increases in the minimum wage earlier in 2019 appears to have hampered the labour market. In the context of a weakening external economic backdrop and the government's consequent need to bolster domestic demand, negative news on the labour market front is particularly unwelcome. A total of 382,210 formal jobs were shed in December alone; although it is not unusual for employment levels to fall in that month, as firms fire workers in order to avoid having to pay a holiday bonus, the result brings the net number of formal jobs created in 2019 to 342,000, which is only around half the level of 2018. It is likely that several large rises in the minimum wage since President Andrés Manuel López Obrador took office in December 2018 has made it financially more difficult for firms to create new jobs. The president increased the minimum wage by 16% in December 2019 and by another 20% a year later. These increases were likely intended to improve living conditions and bolster spending power, but weak private consumption indicates that this has not fed through to domestic demand. And with firms now appearing more reluctant to create formal jobs, it is possible that labour market indicators may deteriorate over the coming months.

Continued tourism growth

On 10 February Mexico's national statistics institute (Inegi) released its latest report on international entries to the country, which shows that foreign tourism increased in 2019 for the seventh consecutive year, despite concerns about the negative impact of factors such as the sargassum micro-algae invasion on Caribbean beaches and the bad press surrounding the country's public security situation. The number of international tourists to Mexico increased 9% year-on-year in 2019, to over 45m, and they spent 9.7% more in the country than in 2018, with total spending amounting to US$22.34bn. On average, each international tourist spent US$496 last year (a figure which increases to US$1,000 when only considering tourists arriving via air). In December 2019, the number of international tourists totalled 4.71m, up 11.2% on December 2018, bringing in US$2.28bn. Including day visitors, Mexico received a total 97.4m international visitors in 2019, bringing in a total US$24.56bn. Meanwhile the head of Mexico's tourism ministry (Sectur), Miguel Torruco Marqués, has estimated that tourism will generate US$26.7bn in revenue this year, up 8.7% on 2019. Torruco said that based on current projections, Sectur estimates that the country can expect 46.2m tourists this year, a 2.7% increase of foreign tourists. Such trade, he added, will also create 95,000 jobs, bringing the total jobs in tourism to 4.5m, up 2.1% on 2019. In total tourism accounts for 8.7% of Mexico's GDP, according to government figures.

Interest rates fall to three year low

With preliminary GDP data or 2019 just confirming a slight economic recession, it came as little surprise that Mexico's central bank (Banxico) opted to cut the policy interest rate by 25 basis points at its most recent monetary policy meeting on 13 February. Although annual inflation is rising, it is well within the bank's 2%-4% target range, giving Banxico plenty of scope for manoeuvre.

The latest cut in interest rates marks the fifth such reduction in seven months. In its accompanying press release explaining its policy decision, Banxico referred specifically to the weak domestic economic backdrop, stating that it would be downgrading its 2020 GDP growth forecast in its next quarterly publication, from a rate of between 0.8% to 1.8% year-on-year. Banxico emphasised downside risks to both the domestic economic outlook, as well as the external scenario. Banxico noted that annual inflation was rising, from 2.97% in November 2019 to 3.24% in January 2020, but emphasised that this was not a sufficiently strong factor to prevent a further cut in interest rates, since inflation remains well within its target range.

"Banxico did not specifically mention movements in US interest rates, but one of the most interesting aspects of the Mexican authorities' decision is that it marks a continued move towards the decoupling of rates. In recent years, Banxico has been influenced by policy movements by the US Federal Reserve (Fed), often moving Mexico's policy rate roughly in line with changes in the US. This reflects the fact that both economies are closely linked, so a downturn in the US often feeds through to weaker conditions in Mexico (therefore a monetary easing bias emerges in both countries), as well as concerns about currency volatility in Mexico".

Greater decoupling from the US

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This reflects the fact that both economies are closely linked, so a downturn in the US often feeds through to weaker conditions in Mexico (therefore a monetary easing bias emerges in both countries), as well as concerns about currency volatility in Mexico. If the Mexican authorities choose to cut interest rates at a time when the Fed keeps rates on hold, as is currently the case, then investors are more likely to sell pesos to buy US dollars, as returns will be lower.

So far, the impact of narrowing spreads between Mexican and US interest rates on the peso has been limited, as the Mexican currency barely moved following the announcement of a fresh cut in rates. Given that the news that Mexico's domestic economy went into recession last year had already been unveiled, it is likely that Banxico's rate cut had already been priced in by markets. The peso was trading at M$18.5/US$1 in mid-February after the announcement, marginally stronger than M$19/US$1 at the start of the year and a weak point of over M$20/US$1 in late August 2019.

Banxico has given little indication about the direction of future monetary policy decisions in the coming months. However, the fact that the most recent decision was voted for unanimously by the Banxico monetary policy committee members, in contrast to some recent announcements, suggests a greater consensus about the need for monetary easing, thus increasing the likelihood of future rate cuts. With the policy rate standing much higher (7%) than many countries in Latin America, real (inflation-adjusted) interest rates remain comfortably in positive territory. This will give Banxico scope for continued rate cuts, if that is the desired course of action, in response to weak underlying economic growth.

Public deficit shrinks

The latest report on public finances by Mexico's finance ministry (SHCP) shows that the public accounts closed the year with a deficit of M$398.356bn (US$21.108bn), equivalent to 1.6% of GDP and below the M$503.8bn projected deficit. This is down from the M$494.982bn public sector deficit registered in 2018 (equivalent to 2.1% of GDP). The government posted a primary fiscal surplus of M$275.748bn last year, equivalent to 1.1% of GDP.

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Gov't raises over US$2bn in bond sale

The Mexican government tapped international capital markets in mid-January, in a two-part bond sale. A 10-year bond was four-times oversubscribed and accounted for the majority of the funds raised, while the government also sold a smaller amount in 30-year notes. The fact that the issues were heavily oversubscribed and that the coupons were comparatively low indicate that the sales were a broad success. Investors have appeared to sweep aside underlying concerns about the weakness of the domestic economy and the economic policy line of the current government, which potentially is a reflection of the renewed monetary easing seen in many other economies, which reduces investment options and makes emerging market bond issues more attractive to investors. Mexico's finance ministry (SHCP) has stated that proceeds from the bond sales will cover 100% of public external debt repayments in 2020, as well as around 50% of total external financing needs. Meanwhile, the authorities have also continued to work to improve the profile of peso-denominated debt. A restructuring operation in late January involved the repurchase of debt falling due between 2020 and 2022 and the issuance of fresh notes that mature between 2023 and 2050.

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Energy policy in the spotlight

There have been mixed messages from the Mexican authorities regarding energy policy in recent weeks. On the one hand, comments made at an international energy conference – Energy Mexico 2020 – implied that the government is considering opening up greater opportunities for foreign investment in the national oil sector. But on the other hand, a spat between the state-owned oil firm, Pemex, and a consortium led by a private US firm, Talos Energy, has underlined the difficulties experienced by foreign oil firms hoping to get a foothold in the Mexican market.

At the conference held in late January, government representatives hinted that dozens of projects may be launched in the coming weeks, which are likely to be open to private sector participation. However, there have been mixed messages about what these opportunities might consist of: in some areas, it has been heavily implied that the government is considering 'farm-out' contracts, in which private oil firms will be able to provide particular services to Pemex in the areas of exploration and production.

However, other officials have been more sceptical. The energy minister, Rocío Nahle García, has recently been clear that she does not believe that the plans of the government led by President Andrés Manel López Obrador will include either farm-outs or fresh auction rounds (these were placed on hold when López Obrador assumed office just over a year ago). This begs the question of what projects might be open to the private sector, with supporting infrastructure for the energy sector the most likely candidate.

But the likely level of interest from private firms is unclear, since the government will place significant pressure on private sector firms to suppress costs. The experience of the Dos Bocas refinery construction project, which the authorities initially opened to public tender, only to reject all the bids submitted by private firms on the basis that their cost estimates (which were regarded as in line with international norms for the construction of a new refinery) were too high, will deter many potential private firms.

Ambitious oil production target

Aside from potential government efforts to boost private investment in the energy sector, the authorities remain confident about their ability to

increase overall oil production this year. In late January, Pemex's CEO, Octavio Romero Oropeza, announced an ambitious target of increasing oil output by nearly 15% between the end of 2019 (when production stood at 1.66m barrels per day [bpd]) and the end of 2020. This implies a production target of 1.9m bpd.

There are significant doubts about Pemex's ability to reach this goal. Pemex issued US$5bn in bonds on 21 January, with the proceeds used to repurchase debt falling due this year as well as refinance other expensive near-term liabilities, but the company remains heavily indebted. This will complicate its ability to channel sufficient funds into existing and new projects to engineer such a sharp upturn in oil production.

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Against this backdrop, a deepening spat between Pemex and a US-led consortium is threatening to delay new oil wells coming on stream. The 'Zama 1' oil well had been viewed as something of a success story; after the previous Enrique Peña Nieto administration (2012-218) opened the sector to foreign participation, the Zama 1 well was one of the first to be drilled by a private firm consortium (including the US firm Talos Energy, the United Kingdom's Premier Oil and Mexican firm Sierra Oil & Gas).

Large-scale discoveries were confirmed in 2017, reportedly in the region of 1bn-1.5bn barrels. But progress has slowed dramatically in recent months. The problem is that part of the extensive oil reserves discovered extend into a neighbouring block owned by Pemex. Both sides claim that a majority of the oil is located in their blocks and that they therefore have exploration rights.

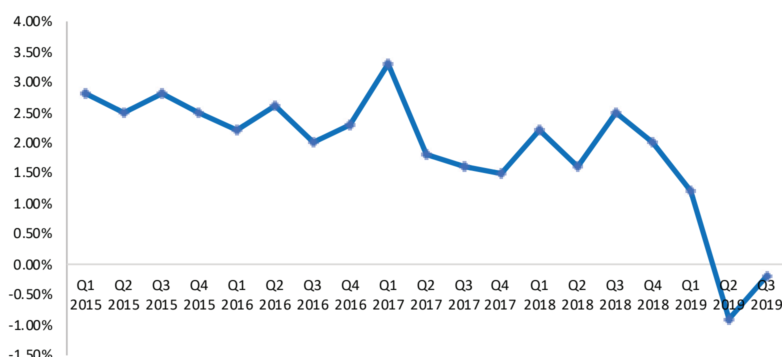
Although developments will not impact on oil production trends in 2020, since the Zama 1 well was not expected to come on stream this year anyway, the case has broader implications for foreign investment in Mexico's oil sector as a whole. Other firms that won concessions in the various auctions that were held under the Peña Nieto administration may well be more reticent to power ahead with investment, particularly given that international oil prices have fallen.

Pemex reduces its debt

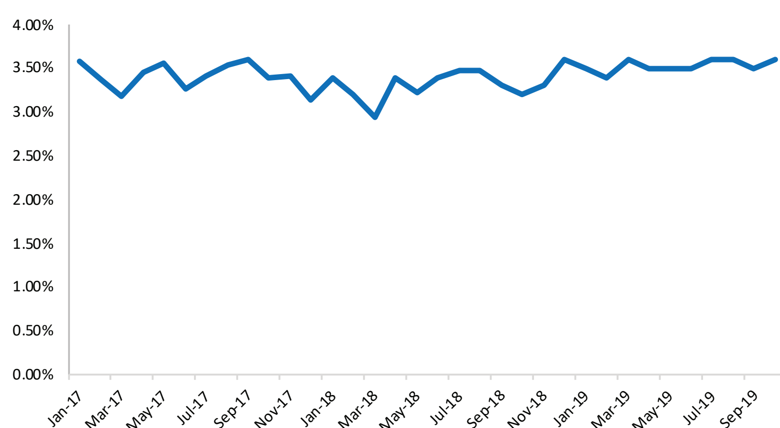
On 29 January the general director of Mexico's state-owned oil company Pemex, Octavio Romero, reported that the firm's debt stood at M$1.95trn (US$103.2bn) at the close of 2019. The figure is lower than the M$2.08trn reported by Pemex in 2018. Romero said that the M$127bn reduction in the debt was the result of the M$107bn financial rescue package that the government led by President Andrés Manuel López Obrador has implemented since it assumed office in December 2018 to shore up Pemex's finances. This involved the restructuring of the company to cut costs; the reduction of its tax burden; and the refinancing of its debts. Romero celebrated "We have managed to reduce the debt… Pemex's debt has fallen in real terms last year". Despite the improvement Pemex remains one of the world's most indebted oil firms.

ECONOMIC HIGHLIGHTS

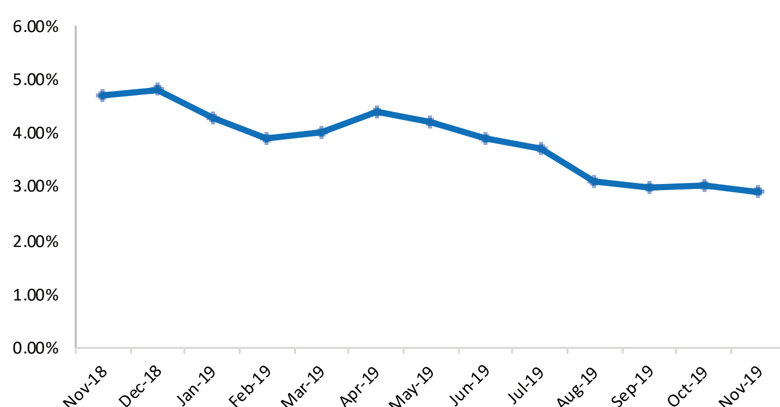
Mexico: GDP Growth
Percentage variation (year-on-year)



Mexico: Unemployment Rate
Economically active population



Mexico: Inflation Rate
Economically active population



Source (all graphs): *National Statistics Institute (Inegi)*

Agricultural exports to China: On 23 January Mexico's agriculture minister Víctor Villalobos said that the Mexican government hopes to increase Mexico's agricultural exports to China after signing new export protocols and successfully completing the first exports of plantains to the Asian country. Villalobos said that a first shipment of 39 tonnes of plantains left the Mexican port of Manzanillo bound for China this week following the signing of a bilateral export protocol back in May 2019. Villalobos added that Mexico and China signed a protocol for the export of balckberries in December 2019 and there are plans to sign another for the export of sorghum in February. Meanwhile Villalobos said that he has also held discussions with Chinese officials regarding the possibility of exporting beef, pork, and chicken meat. Mexico's agricultural exports to China reached US$34.6bn in the first 11 months of 2019, an 8.61% year-on-year increase. Villalobos said that the export of plantains alone would increase agricultural exports by US$280m a year.

Trade surplus: On 28 January Mexico's national statistics institute (Inegi) released new figures which show the country registered a trade surplus of US$5.8bn in 2019. This compares with the US$13.6bn deficit reported in 2018. This change stemmed from a higher surplus of the non-oil trade balance which totalled US$27bn in 2019, up from US$9.54bn in 2018, as well as a reduction in the deficit of the oil trade balance which totalled US$21bn in 2019, up from a US$23bn deficit in 2018. Mexico's exports in 2019 totalled US$461bn, up 2.3% on 2018 while imports totalled US$455bn, down 1.9% on the previous year.

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