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First steps by the Alfonso Prat-Gay team

Argentina's new government took office on 10 December and as this issue went to press (the week beginning 14 December) the team led by the new finance minister, Alfonso Prat-Gay, was expected to announce a package of measures. Some were clearly signalled in advance, but others, particularly those concerned with the exchange rate and the availability of US dollars, were subject to intense last-minute negotiations.

Both President Mauricio Macri and finance minister Alfonso Prat-Gay had already outlined the general direction of the new administration's economic policies, and anticipated some of its first steps. Export taxes on some of the main agricultural crops are to be eliminated or reduced. The government will seek to negotiate a settlement with hold-out creditors and to bring Argentina out of the technical default it has been in since mid-2014. It also aims to restore the country's access to international capital markets and is negotiating an initial loan package with a group of international banks. The aim is to eliminate the multiple exchange rate systems and to move towards a single floating exchange rate – although Prat-Gay has said the speed at which that is done will depend on the results of an audit to establish the real level of freely disposable foreign currency reserves. As for domestic economic matters a degree of gradualism can also be expected. A new director of INDEC, the national statistics institute has been appointed in an attempt to restore reliable data on inflation. The income tax threshold on salaries is due to be raised. The existing price controls system (known as precios cuidados) will be maintained for the moment (although in the long term the government favours phasing it out).

The exchange rate is perhaps the most urgent issue, and here the new team faces two problems, one long-standing, the other newer and unexpected. The unexpected issue is that the outgoing president of the central bank (Banco Central de la República Argentina, BCRA) Alejandro Vanoli is reported to have left a nasty surprise for his successor, Federico Sturzenegger. In the last months of the outgoing government, faced with acute foreign currency shortages, the BCRA is said to have propped up the value of the peso by selling dollar futures at below market prices. Bank sources said March dollar contracts had been sold by the BCRA at a currency rate of 10.60 to 10.85 pesos, when they were trading in New York at around 15 pesos. Sturzenegger initially took the view that these loss-making deals were fraudulent contracts (indeed, Vanoli faces legal action over them). In a

series of meetings with bank representatives Sturzenegger suggested a kind of retrospective renegotiation of the prices of the currency contracts issued after 25 October, so as to reduce the losses suffered by the BCRA and pass back some of the burden to the banks.

This idea was strongly rejected by the banks, with one representative quoted as saying "they have been sounding us out to see how much we might give way, but these are signed contracts and we are going to ensure commitments are respected". The idea of a renegotiation in any case appeared to be fading as it became clear that the process could incur multiple legal challenges (the banks pointed out that many of the contracts were bought not just for their own positions but also for clients) and as the new government realised it would not be helpful to start out its four year term in office by alienating the financial community, on whose help it will be relying.

The second and more familiar problem is the long-standing dispute with a small group of hold-out creditors who did not accept the terms of Argentina's debt restructurings in 2005 and 2010. Since 2014 there has been an outstanding US court ruling that Argentina should pay some of the holdouts the full face value of their defaulted bonds. At the time of the ruling that was US$1.33bn. Given additional past due interest and the potential claims of other "me too" creditors, under some calculations the cost of settling could be as high as US$7bn. So the question for the new government is how it can negotiate to keep the cost of settlement as low as possible.

"Given additional past due interest and the potential claims of other "me too" creditors, under some calculations the cost of settling could be as high as US$7bn."

In effect, the new economic team is taking a step-by-step approach. Step one is to conduct an audit of existing foreign currency reserves. Step two is to try and agree a financing package with international banks. Discussions are report to have begun on a package worth around US$7bn-8bn. This involves reassuring the banks that both the issues over the BCRA dollar futures contracts and the holdout creditors dispute can be resolved. Step three will then involve lifting the system of multiple exchange rates and controls. It is still not clear the exact sequence and speed in which these steps will take place.

SPECIAL FOCUS

ARGENTINA

The economic reform race: what the start of the track looks like

President Mauricio Macri has named his six-man economic cabinet (*Latin American Weekly Report, WR-15-47*). Economic reform priorities announced so far include the removal of all foreign currency controls; an elimination of restrictions on agricultural exports; an improvement in standards for compilation of official statistics (especially inflation); and a new governor at the Banco Central de la República Argentina (BCRA – the central bank) (LN Daily 24 November 2015). What does the economy look like at the beginning of the reform process?

The administrations of Presidents Néstor Kirchner and Cristina Fernández de Kirchner (2003-2015) did not adhere to orthodox economic, financial, or

monetary policies. In part because of the government's lack of access to global capital markets following its default in late 2001 and subsequent (and as yet still unresolved) negotiations with hold-out creditors, the Kirchner administrations chose to follow a particular economic model.

How the race used to be run

The central feature of the model was the role of government as promoter of economic growth and allocator of resources. The government would consistently run a budget deficit, which was monetised. The resulting inflation was high, difficult to verify in the absence of reliable data, but tolerable. Although the rate of inflation, which consistently exceeded 20% annually, was excessive by current global standards, it was far less than what Argentina had experienced in previous episodes in its economic history. Regular and substantial pay increases preserved the real incomes of workers and households. Regulations caused the real prices of some goods and services to fall. The government extended its control over the financial system through the politically popular renationalisation of major non-financial corporations such as Yacimientos Petróleos Fiscales (YPF – the integrated energy company) in 2012 and the private pensions system in 2008. Some state-owned enterprises – such as national airline Aerolíneas Argentinas – were supported financially over several years. Unable to borrow from global markets in an orthodox fashion, the government would secure funding through other sources – such as state-owned enterprises with US dollar revenues, bilateral loans from other governments (eg Venezuela's), and the Corporación Andina de Fomento (CAF – a regional development bank).

"Although the performance of the economy during Néstor Kirchner's administration was influenced by his coming to power at a time the economy was in a very deep recession, there was strong growth in incomes and a reduction in inequality."

Prior to the global financial crisis of 2008-09 and again in 2010-13, the operation of the model was helped by improvements in Argentina's terms of trade thanks to rising prices for export commodities. Although the performance of the economy during Néstor Kirchner's administration was influenced by his coming to power at a time the economy was in a very deep recession, there was strong growth in incomes and a reduction in inequality. In his mid-October 2015 statement to the International Monetary & Finance Committee of the IMF, former Finance Minister Axel Kicillof noted that, through 2003-14, real GDP and per capita GDP increased by 5.75% and 4.60% annually on average. At the end of the period, Argentina's per capita income in PPP terms was among the highest in Latin America and its Gini coefficient was one of the lowest.

The main losers under the model were varied and included Argentina's globally competitive agricultural sector, which was a crucial source of tax revenue for the government; households which could not protect themselves from the inflation (eg by investing in real assets); and households and businesses that needed ready access to foreign exchange.

In part because of periodic deterioration in the terms of trade, and in part because of volatility in global financial markets from time to time, and because of persistent hostility to the government's policies from orthodox-minded observers, the government had to maintain a tight control of the currency market. The Argentine peso (AR$) was allowed to depreciate against the US dollar at a steady rate – in order to maintain the general competitiveness of exports in a country with one of the world's highest inflation rates. The government tolerated a parallel market in which households

and small businesses could buy foreign exchange at the 'blue dollar' rate. From time to time, the 'blue dollar' rate would spike (implying a sharp fall in the value of the peso) as a result of political developments. In general, though the premium of the 'blue dollar' rate to the official rate reflected the costs and risks to market operators (such as having to hold large quantities of US dollar banknotes in the streets of central Buenos Aires) and the value placed by households on ready access to foreign currency.

Mediocre, perhaps, but not disastrous

In spite of the rhetoric from some observers, the situation of Argentina's economy at the end of Cristina Fernández de Kirchner's administration is far from disastrous. The latest data published by the BCRA [1] indicates that, in

Chart 1: Argentina's economy: key metrics		
Nominal GDP (AR$mn)	2Q15	5,441,470
Nominal GDP (US$mn)	2Q15	588,267
Nominal GDP (US$mn) per capita	2Q15	14,487
Year-on-year real GDP growth	2Q15	2.3%
Monthly Economic Indicator	Aug-15	2.6%
Year-on-year real consumption growth	2Q15	2.0%
Year-on-year real investment growth	2Q15	4.6%
Year-on-year growth in real net exports	2Q15	30.9%
Year-on-year growth in industrial production	Sep-15	0.2%
Capacity utilisation	Sep-15	73.6% and rising
Consumer confidence index	Sep-15	56.0 and rising
Year-on-year growth in construction	Sep-15	5.8% and slowing
Year-on-year growth in public services	Sep-15	2.4% and broadly stable
Unemployment rate	2Q15	6.6% and falling
Official consumer price inflation	Oct-15	14.3% and falling
Wage inflation	Sep-15	29.8% and falling
Construction cost inflation	Oct-15	24.3% and falling
Current account deficit (US$mn)*	2Q15	2,083
Current account deficit (last four quarters)	2Q15	1.5% of GDP
Foreign reserves (US$mn)	Oct-15	26,970 and falling
Total external debt (as % GDP)	2Q15	26.2%
Government revenues over rolling 12 months	Oct-15	up 28.5%
Government spending over rolling 12 months	Oct-15	up 32.9%
Primary budget deficit over rolling 12 months	2Q15	1.8% of GDP
Overall budget deficit over rolling 12 months	2Q15	3.6% of GDP
Public sector debt	End 2014	42.8% of GDP
Base money	2Q15	9.0% of GDP
Base money growth year-on-year	Oct-15	35.7%
M3	2Q15	24.9% of GDP
M3 growth year-on-year	Oct-15	35.7%
EMBI+ Argentina bond spread	Oct-15	586 basis vs 745 average for 2014
*NB The trade account is roughly in balance with merchandise exports and imports of about US$5-6bn each, monthly.		
Source: *BCRA - RADAR Macroeconómico*		

real terms, the economy has expanded by more than 2% over the last year or so. This is in spite of the economic problems in Brazil, the deceleration in China, the generally anaemic growth in much of the developed world, and the fall in commodity prices. Growth has been driven by investment, although consumption spending has also been increasing. The rise in consumption has been supported by increased real household incomes – thanks in part to the slippage in the unemployment rate and mainly due to the nearly 30% increase in wages.

The economy has also been primed by government spending. Over the year to the end of October, government expenditure and revenues rose by 33% and 29% respectively – which implies that the overall deficit is likely to rise from the mid-2015 level of 3.6% of GDP. On 30 November, Fernández de Kirchner decreed an AR$133bn (US$13.7bn) increase in the budget for 2015 (*Latin American Weekly Report, WR-15-48*), for spending on public sector wages and energy subsidies (which Macri wishes to phase out). This is in the context of overall cash receipts in the first 10 months of the year of AR$1,405bn, primary (pre-interest) spending of AR$1,407bn and overall spending of AR$1,563bn. In essence, the increase in the budget is equal to less than one month's average expenditure so far in 2015.

The true reason for the high inflation

On a cash basis, the primary deficit in the first ten months of 2015 amounted to AR$70bn, while the overall deficit was AR$157bn. Assuming the money in Fernández de Kirchner's budget increase is actually spent by the end of December, and assuming that the trends in the deficit remain in place for the remainder of the year, the total deficit for 2015 should be in the order of AR$320bn or about 5% of GDP.

> "What makes this spending so inflationary is not the size of the deficit per se, *but the size of the deficit relative to the remarkably small money supply*..."

What makes this spending so inflationary is not the size of the deficit per se, *but the size of the deficit relative to the remarkably small money supply*. As of the middle of the year, M3 – the broadest aggregate for which data is available – was equivalent to about 25% of GDP. Because of the problems of the banking sector during the 2001-02 crisis, it remains underdeveloped by many metrics. Argentina's economy is very under-monetised. A comparison with Australia, another medium-sized G20 country that is a major commodity exporter, is instructive. In Australia, M3 is equivalent to about 112% of GDP, according to IMF data.

Nevertheless, the financial system is efficient at recycling deposits as loans [2, *overleaf*]. Local currency deposits (from both the non-financial private sector and the non-financial public sector) at the end of September amounted to around AR$1,200bn. Local currency loans at the same time amounted to around AR$1,500bn. In spite of the government's inability to issue foreign currency bonds in global markets, the financial system has captured nearly AR$160bn in foreign currency deposits and has advanced AR$660bn in foreign currency credits.

Low debt

One of the achievements of the Fernández de Kirchner administration was that the real value of outstanding government debt grew more slowly than real GDP. According to McKinsey Global Institute (MGI), Argentina had the lowest debt-to-GDP ratio of 47 developed and emerging economies that it

Chart 2: Argentina's monetary panorama - key metrics (AR$mn)			
	Sep-14	**Sep-15**	**Change**
Credit to the non-financial public sector	1,005,558	1,467,068	45.9%
of which: in AR$	608,397	807,096	32.7%
in foreign currency	397,161	659,972	66.2%
Credit to the non-financial private sector	589,411	766,396	30.0%
of which: in AR$	552,232	726,791	31.6%
in foreign currency	37,179	39,605	6.5%
TOTAL CREDIT	**1,594,969**	**2,233,464**	**40.0%**
Deposits from the non-financial public sector	282,809	428,071	51.4%
of which: in AR$	271,205	356,559	31.5%
in foreign currency	11,604	71,512	516.3%
Deposits from the non-financial private sector	658,762	917,393	39.3%
of which: in AR$	599,697	840,465	40.1%
in foreign currency	59,065	76,928	30.2%
TOTAL DEPOSITS	**941,571**	**1,345,464**	**42.9%**
Monetary base	382,315	530,134	38.7%
Notes and coin in circulation	271,812	375,715	38.2%
Source: *BCRA*			

surveyed[1]. MGI calculated the debt-to-GDP ratio of 33%. Elsewhere in the region, the equivalent figure varied between 62% (for Peru) to 136% (for Chile). For most developed countries in North America and Europe the debt-to-GDP ratio varied between 200% and 330%. Argentina was one of very few countries whose debt-to-GDP fell over the seven years to the end of 2014, declining by 11 percentage points overall. This was entirely due to the government. The increase in borrowing by households and businesses would have boosted the overall debt-to-GDP ratio by three percentage points.

According to the BCRA, total public sector debt at the end of 2014 was equivalent to 43% of GDP (having risen from about 35% of GDP over the preceding two years). Assuming that the overall deficit for 2015 is about 5% of GDP, then the ratio should increase to about 46% of GDP by the end of this year. Outstanding debt should then be around AR$2,750bn. As of September 2015, the BCRA's local currency claims against the government amounted to AR$327bn or so. The BCRA also held foreign currency claims against the public sector amounting to AR$638bn. The commercial banks held around AR$331bn in government bonds [3]. Of the AR$563bn in total assets under management of the Fondo de Garantía de Sustentabilidad (FGS – the buffer fund supporting the Agencia Nacional de Seguridad Social or ANSES), some AR$373bn was held in bonds.

Limited downside for the currency

Over the last year or so, the official exchange rate has slipped from US$1:AR$8.60 to US$1:AR$9.77, a fall of about 14%. As noted, the true rate of inflation has been a lot higher than this, which means that the real effective

[1]McKinsey Global Institute, Debt and (not much) deleveraging, February 2015.

Chart 3: Key metrics of Argentina's banking system (AR$mn)			
	30-Sep-14	**30-Sep-15**	**Change**
Cash & deposits with BCRA	173,211	229,620	32.6%
Claims on the public sector:	366,701	525,366	43.3%
of which, AR$ bonds	239,674	330,606	37.9%
Foreign currency bonds	22,669	35,266	55.6%
Claims on the private sector:	572,232	747,512	30.6%
of which, in local currency	535,195	708,007	32.3%
in foreign currency	37,037	39,504	6.7%
Other assets	224,301	131,293	-41.5%
TOTAL ASSETS	**1,336,445**	**1,633,791**	**22.2%**
Total public sector deposits	281,329	342,096	21.6%
of which: in local currency	270,917	327,671	20.9%
in foreign currency	10,412	14,425	38.5%
Total private sector deposits	655,164	913,889	39.5%
of which: in local currency	596,606	836,993	40.3%
in foreign currency	58,558	76,896	31.3%
Owing to the BCRA	4,508	3,368	-25.3%
Other liabilities	246,698	176,843	-28.3%
Capital accounts	153,254	200,963	31.1%
TOTAL CAPITAL AND LIABILITIES	**1,336,445**	**1,633,791**	**22.2%**
Memo Items			
Term deposits:	270,153	398,242	47.4%
Source: *BCRA*			

exchange rate (REER) has appreciated. Nevertheless, the current account deficit over the year to the end of June 2015 was equivalent to 1.5% of GDP, and the trade account was broadly in balance.

The implication of this is that the removal of controls on the market for foreign exchange (and the eventual likely elimination of the parallel market which sets the 'blue dollar' rate) will probably be accompanied by a further devaluation of the peso, but not a dramatic one. Given that the government's expenses are overwhelmingly in pesos, but its revenues from agricultural sector are linked to the US dollar, a devaluation should help reduce the fiscal deficit as well. As we explain elsewhere in this issue, the speed of changes to the currency market will depend on the results of an audit to identify the true level of readily available foreign exchange reserves.

The investors are relaxed

Even while the results of the election were still in doubt, investors took a fairly positive view of the prospects for the economy. The 'blue dollar' rate has moved over the last year from US$1:AR$12.85 to US$1:AR$14.70, a devaluation of about 14%. In other words, the 'blue dollar' rate has essentially moved in line with the official rate. Data from the BCRA showed that the velocity of money through current accounts (ie debits in a month divided by the average balance) was 3.6 times in September 2015. This was slightly faster than during most other months in 2015, but lower than in mid-2014. Velocity in January 2014 was also 3.6 times. This indicates that investors are not looking for Argentina to descend into hyperinflation. As at the end of

October, the yield spread over Treasuries on Argentine government bonds stood at 586 basis points, according to JP Morgan. The spread has therefore been falling consistently for years, from 1,036 basis points at the end of 2012 to 804 at the end of 2013 to 745 at the end of 2014. Perceptions of risk had been improving well before the end of the Fernández de Kirchner administration.

What next?

Arguably the most pressing priority for the Macri administration is a reduction in the budget deficit, which has undoubtedly been exacerbated by Fernández de Kirchner's decree of the end of November. This should help moderate the inflationary pressures and may serve to alter inflationary expectations. The behaviour of the various actors in Argentina's economy is unlikely to change while everyone continues to expect that inflation will remain at 20% or more.

The new currency regime will likely be one that incorporates flexibility in the exchange rate. This is partly for political reasons. Given the limitations of the so-called Convertibility regime, which differed in important respects from a true currency peg – even though it was seen as one, immediately prior to the 2001-02 crisis – it would be difficult to generate popular support for a fixed exchange rate regime. There are also economic reasons for a flexible exchange rate regime. It will take some time for the government to reduce actual and expected inflation to levels that are similar to those in the rest of the world. The peso will have to fall further over time if exporters are to remain competitive. In addition, the foreign reserves are slim, having fallen to around US$22bn in October.

"The new currency regime will likely be one that incorporates flexibility in the exchange rate."

Negotiations with the hold-out creditors in relation to foreign bonds with a face value of US$1.3bn represent something of a positive wildcard. As we note elsewhere in this issue, the costs of settling could be much higher. Nevertheless, if Macri's administration can reach an agreement with the creditors, the government will once again be able to access global capital markets, which will make the task of reforming the economy a lot easier.

It remains to be seen what are the details of the policies of the new administration's economics team and how those policies are actually executed. Whether Macri's administration reduces the deficit through cutting subsidies and other spending, or through increasing taxes, the impact will be contractionary – and at a time that the global economy is weak. However, most other changes that may take place – such as a reduction in inflation and the likely devaluation of the currency – are stimulatory.

It is possible that progress in dealing with the deficit – and inflation – will produce a change in investors' perceptions, with a result that interest rates fall sharply and the entire financial system doubles or trebles in size over a period of, say, five years. In this outcome, Argentina's economy could, once again, sustain superior growth rates for a decade or longer.

However, it is too early to predict this outcome with confidence. The race to economic reform will likely run quite differently to the way the race was run under the previous two administrations. It may yet include significant unorthodox elements.

VENEZUELA

Where now for economic policy?

Local and international reporting on Venezuela over the last month seems to have verified two incontrovertible facts. One, that the Venezuelan economy is a mess – "the world's worst economy this year" suggested CNN. And two, that in the 6 December congressional elections the opposition won a landslide victory, gaining a two-thirds majority. The temptation is to put one and two together and conclude with a point three, that the economic recovery is now about to begin. Here we explain why we think that still looks improbable.

The government of President Nicolás Maduro has published hardly any economic statistics during 2015, so it is hard to get an accurate picture of what is happening to the Venezuelan economy. But almost all the news is bad, even allowing for the fact that opponents of the regime may want to exaggerate the severity of the crisis. The story, in a nutshell, is that an economy almost entirely dependent on oil exports has been very hard hit by the global oil price slump, with gross domestic economic mismanagement making matters much worse. The IMF estimates Venezuelan GDP will have plunged by 10% this year, and is set to fall a further 6% in 2016. It also estimates inflation was just under 160% this year, and will rise to 204% in 2016.

"While according to official data poverty levels were halved in 2003-2011 during the oil boom years, there have been no subsequent surveys and it is believed the crisis is now pushing families back down below the poverty line."

Shortages are endemic. According to polling company Datanalisis, Venezuelans spend an average of five hours a week buying groceries and have to visit at least four different stores to find what they need. The Venezuelan Pharmaceutical Federation says up to 70% of key medicines are in short supply. There are three official exchange rates, a complex set of currency controls, and an illegal black market rate, meaning a dollar can cost anything from VEN6.3 (the lowest official rate) up to VEN930 (the black market rate). The system is widely abused and creates massive opportunities for corruption.

While according to official data poverty levels were halved in 2003-2011 during the oil boom years, there have been no subsequent surveys and it is believed the crisis is now pushing families back down below the poverty line. A survey by Venezuelan universities (rejected as inaccurate by the government) suggests the poverty rate has rocketed back up from 27% in 2013 to 73% in 2015. According to Víctor Álvarez, a former industry minister, the fiscal deficit is running at somewhere between 18% and 20% of GDP. Speaking before the 6 December elections, Álvarez issued a stark warning that "the country will be engulfed by flames if the government does not reconsider its policies". To add to the dark picture, there are doubts over the real level of foreign currency reserves, and over Venezuela's ability to pay for imports over the next few months. There has been intermittent speculation of a debt default.

While the landslide opposition victory on 6 December has been hailed by many as a turning point – leading among other things to a rally in

Venezuelan bond prices – it is hard to predict a rapid and positive change in the Venezuelan economy. There are two fundamental reasons for this. The first is that the opposition has not won executive power, and rather than having a single economic policy-making authority, Venezuela looks set to be entering a difficult period of 'cohabitation' and implicit power-sharing between hostile camps. The second is that at this stage the opposition parties themselves have no coherent economic plan. In fact very little was said during the election campaign about alternative approaches to the management of the economy.

Economic policy will continue in the hands of the government, controlled by the ruling Partido Socialista Unido de Venezuela (PSUV). With their two-thirds majority in Congress the parties of the Mesa de Unidad Democrática (MUD) opposition coalition will have major but largely reactive countervailing powers – they will be able for example to reject government budget proposals, to recall ministers (indeed the Congress may seek a recall referendum to force President Nicolas Maduro to step down early), and to modify the constitution (a power which, could for example be used to try and restore greater autonomy for the Central Bank). But being able to veto some aspects of a failed economic policy is not the same thing as introducing a new one.

"The deep political differences between the executive and the legislature create less than ideal conditions for coherent management of the economy."

The deep political differences between the executive and the legislature create less than ideal conditions for coherent management of the economy. To that must be added the fact that there are many shades of opinion within the MUD and that in the aftermath of its electoral defeat, the PSUV may well find itself dominated by factional struggles. Matters are made more complex by the government's political narrative over the last year, which has held that the economic crisis has been caused not by its own mistakes, but by an "economic war" fought against it by the forces of reaction (considered to be Venezuela's old ruling elite, the United States, and the IMF). This has led some critics to comment that the hapless Maduro administration has fought a battle against its own creation – an imaginary enemy – and lost.

For argument's sake, it is possible to suggest that against the odds some kind of non-adversarial collaboration over economic policy could emerge during 2016 between some sectors of the PSUV and some sectors of the MUD. Given Venezuela's recent history, this would be an unusual and perhaps unlikely strengthening of the political centre. For that to happen, however, elements of the PSUV would have to ditch the "economic war" rhetoric, and elements of the MUD would have to accept political responsibility for some unpopular economic measures that are now necessary. This is because, barring a miraculous (and unlikely) recovery in oil prices, most measures to correct the Venezuelan economy's deep imbalances will carry a heavy political cost. They include steps like unifying the exchange rate, eliminating excessive energy subsidies, or easing price controls to try and get the private sector producing again. The balance of probabilities therefore suggests that it will take some time before economic policy begins to change in Venezuela, and economic recovery is unlikely in 2016. A more optimistic reading would simply state that current economic policies have failed, and that the December elections mark the early stages of a search for alternatives.

Bye, bye, investment grade?

Overshadowed by the political crisis triggered by the attempt to impeach President Dilma Rousseff, Brazil's economy has continued to deteriorate. The latest setback was the announcement on 9 December that Moody's Investors Services was placing Brazilian debt on review for a possible downgrade to junk status.

Standard & Poor's (S&P), one of the other global ratings agencies, has already reduced Brazil to sub-investment grade (it did so in September 2015). A Moody's review usually takes 90 days, so there could be a decision in February or March 2016. Separately, there have been reports that a third ratings agency, Fitch, may change its Brazil rating as early as January. The significance of this is that it is highly likely that either Moody's or Fitch will over the next couple of months join S&P in downgrading Brazilian debt. Many global investment funds have internal rules that require them to pull their money out of a country if two or more ratings agencies withdraw investment grade status. Analysts suggest that if this happens to Brazil – something that is looking increasingly likely – there could be immediate consequential capital flight at some point early next year of US$2bn-US$5bn.

"The latest data is not encouraging. The economy is stagflating, caught between a tight monetary stance and a loose fiscal one (the equivalent of stepping on the brakes and the accelerator at the same time)."

More important than the short-term financial impact of a debt downgrade will be the negative signal it sends about the general state of confidence in the Brazilian economy. There could be a further blow as rumours that finance minister Joaquim Levy may resign have once again reappeared. Levy is seen as a market-friendly figure committed to reducing Brazil's large fiscal deficit, which in the eyes of many investors is one of the root causes of the country's economic difficulties.

The latest data is not encouraging. The economy is stagflating, caught between a tight monetary stance and a loose fiscal one (the equivalent of stepping on the brakes and the accelerator at the same time). Inflation was above target at 10.3% in mid-November. The Selic interest rate, currently at 14.25%, is one of the world's highest, and the signs are that it may go even higher, as to combat inflation the Central Bank is considering another 25bps hike. That would deepen the recession. The overall public sector deficit meanwhile was 9.5% of GDP in the 12 months to September. GDP has fallen for three consecutive quarters. The contraction in the third quarter was 4.5% relative to year-earlier levels, leading some to claim Brazil is now experiencing the worst recession since the 1930s. Industrial production slumped alarmingly by 11.2% in the 12 months to October.

The IMF is forecasting a 3% GDP contraction in 2015, followed by a further 1% fall in 2016. Other analysts expect this year's GDP fall to be sharper, at around 3.5%. Alejandro Werner, director of the IMF's Western Hemisphere department, summed up the situation in December by saying "In Brazil, the political crises and corruption scandals have generated an 'impasse' in which the issues of economic policy could not be processed and have delayed the expectations of recovery".

It is hard to see an easy way out of the stagflationary trap in which the economy finds itself. Levy has argued that a reduction in the fiscal deficit is key, as it will stabilise debt levels, rebuild confidence, and thereby eventually pave the way for recovery. But he faces daunting political and procedural obstacles, not least the fact that there is a major political crisis over the attempt to impeach the president. The minister tried – and ultimately failed – to secure a small primary fiscal surplus (before debt interest payments) in 2015. The latest figures suggest 2015 will close with a primary deficit equivalent to at least 0.7% of GDP. In early December, Levy was reported to be insisting on achieving a 0.7% primary surplus in the 2016 budget plan, and to be threatening to resign if this was not agreed. But achieving it looked unlikely, and Levy subsequently denied issuing any ultimatums.

The draft Lei do Orçamento (LDO) approved by Congressional committee in December formally set a 0.7% target for 2016, but the necessary measures to achieve it were simply not in place. The LDO numbers assumed that a financial transactions tax, known as the CPMF, would be re-introduced, but Congress is unlikely to support such a move. The draft also assumes BRL27.5bn (US$7.1bn) in revenue from privatisations that are unlikely to happen in the current political climate. According to deputy Ricardo Barros (of the Partido do Movimento Democrático Brasileiro, PMDB) even with these assumptions in place there is a BRL10bn (US$2.63bn) primary shortfall for 2016, not a surplus. Other items may widen the deficit. Struggling to fend off the impeachment threat, in late December the government tried to gain support by promising greater funding next year to state governors, another commitment not yet included in the budget numbers. PMDB Senator Rose de Freitas told the *Wall Street Journal* she expects the final version of the LDO to target a primary budget balance of zero, instead of the 0.7% surplus.

> "It is hard to see an easy way out of the stagflationary trap in which the economy finds itself. Levy has argued that a reduction in the fiscal deficit is key, as it will stabilise debt levels, rebuild confidence, and thereby eventually pave the way for recovery."

In addition, attempts to reduce the proportion of mandatory spending within the budget and lower the financial burden of pension payments (for example by increasing the age of retirement for public servants) are unlikely to prosper. Planning minister Nelson Barbosa has been attempting to modify the existing mechanism for upwards adjustments in the minimum wage (inflation + the last two year's GDP growth rate) to something less costly, but was overruled by the president.

MEXICO

Light and shade in IMF Article IV consultation

One of the regular Article IV consultations between Mexico's economic team and the IMF concluded on 17 November with a generally positive, but also quite mixed conclusion. On the plus side the Fund praised the government for advancing its programme of structural economic reforms, described the economy as "resilient", and highlighted the benefits of low inflation and the maintenance of low, pro-growth interest rates by the Bank of Mexico (Banxico). Yet the Fund also reduced its growth forecasts for the country and described the rate of Banxico foreign currency intervention to support the peso as "not sustainable over the medium term".

One of the key messages about Mexico from the IMF seems to be that the economy is holding up relatively well in difficult times. The summary view

coming out of the Article IV consultation was that "Mexico's economy continues to grow at a moderate pace, despite an array of external challenges, including a collapse in oil prices and heightened volatility in international financial markets". Despite the oil price shock a combination of rising exports to the US and firm domestic demand was seen as keeping the economy on a positive growth path, and allowing a fall in the unemployment rate to 4.5% in the second half of 2015. But the IMF still trimmed back its forecasts for the country's growth. In its World Economic Outlook published in October the Fund had said it expected Mexican GDP growth of 2.3% in 2015 and 2.8% in 2016. But following the November Article IV consultations that projection was trimmed back to 2.25% in 2015 and 2.5% in 2016. It also warned that those numbers could again be revised downwards if capital flow volatility spikes, domestic oil production drops further, or growth falters in the US. As for the longer term, the IMF now expects Mexico's structural reforms to support a GDP trend growth rate of 3.0%-3.5%, lower than the 4.0%-5.0% projected by the government as the average running up to 2020.

The Fund notes that as an open economy with significant participation by foreign investors, Mexico is exposed to external shocks. But the fact that it has a fiscal policy designed to ensure sustainable debt levels and a monetary policy "guided by a credible inflation-targeting regime", along with a flexible exchange rate and relatively deep financial markets which allow the hedging of exchange rate risks, meant that "reserve buffers are strong". These defences were also being further strengthened by the government's policy of gradually reducing the fiscal deficit from 4.1% of GDP in 2015 to 2.5% by 2018.

Mexico: Selected economic and financial indicators

	2011	2012	2013	2014	2015f	2016f
Real GDP (%)	4	4	1.4	2.1	2.2	2.5
Inflation (period average, %)	3.4	4.1	3.8	4	2.8	3.1
Gross domestic investment (% of GDP)	22.3	23.1	21.7	21.8	22.7	23.1
Gross domestic savings)% of GDP)	21.1	21.7	19.3	19.9	20.4	21
Exports fob (% change)	17.1	6.1	2.5	4.5	-3.2	7.6
Imports fob (% change)	16.4	5.7	2.8	4.9	-2	6.9
Current account balance (% of GDP)	-1.1	-1.4	-2.4	-1.9	-2.3	-2.1
Change in net international reserves (US$bn, eop)	28.6	17.8	13.2	15.5	-17.2	0.6
Outstanding external debt (% of GDP)	24	28.9	31	32.8	37.8	37.8
Government revenue (% of GDP)	22.9	23.9	24.3	23.5	22.7	22.2
Government expenditure (% of GDP)	26.3	27.7	28	28.1	26.8	25.7
Nonfinancial public sector balance (% of GDP)	-3.4	-3.8	-3.7	-4.6	-4.1	-3.5

Source: *IMF*

Where the IMF sounded a more critical note was over Banxico's interventions in the currency markets. The slump in oil prices and expectations of tightening interest rates in the US have led the Mexican peso, along with most other Latin American currencies, to depreciate against the dollar. While a weaker peso ultimately helps exports become more competitive, it also brings some negatives, such as a pass-through effect to domestic inflation or a rise in volatility which can create economic uncertainty. So Banxico's policy throughout 2015 has been to conduct daily dollar auctions to support the value of the peso and to smooth out any abrupt oscillations.

The Fund noted that supporting the peso had been expensive: reserves fell from US$195.7bn in December 2014 to US$182bn in September 2015. For 2015 as a whole it estimated reserves will have fallen by 17.5% because of the policy of supporting the peso. It recommended ending the daily auctions because "the current pace of intervention is not sustainable over the medium term". It also suggested that reserves should be conserved and only used at times of genuine need. Banxico took the hint. Only days after the IMF's findings were published it announced that from late November the daily US$200m currency auctions were being partially suspended. Under the new system US$200m auctions will still be held, but only on days when the peso weakens by 1% or more against the US dollar. In the year to mid-November, the peso had weakened by about 18% against the dollar.

DOMINICAN REPUBLIC

The economy: glass half full/empty

By a number of metrics, the Dominican Republic is one of the strongest economies in Latin America and the Caribbean. In the meantime, the business environment remains challenging and, relative to other countries, may be deteriorating.

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On 30 November, the Banco Central de la República Dominicana (BCRD – the central bank) announced that it would maintain its key policy interest rate at 5.00%. The BCRD highlighted that the economy is growing strongly, with real GDP expected to rise by 6.5%-7.0% this year and with local currency credit to the private sector rising at an annual rate of about 11% as of November. In October, headline and core year-on-year inflation were running at 1.23% and 1.91% respectively; the BCRD thinks that inflation will rise to around 3% (ie the lower end of its target band of 4% ± 1%) over the coming months.

The good...

The BCRD noted: "The current account balance should close the year with the lowest deficit in the last ten years, around 2.0% of GDP, due to lower oil prices and a favourable performance of tourism revenues, remittances, and exports from the industrial free zones. With regard to fiscal policy, a primary surplus is projected for the current year, while for 2016 it is [expected that there will be] a primary surplus of around 0.7% of GDP. These positive results in the external and fiscal accounts should facilitate the accumulation of reserves and the relative stability of the exchange market."

The latest data from the IMF [1], and comments from the IMF's Aliona Cebotari on 23 November, following the regular Article IV consultations with the government of the Dominican Republic, also indicate that there are no serious imbalances in the economy. Thanks to the benefits of lower fuel costs and higher export revenues, household disposable incomes have been rising, boosting domestic demand. The unemployment rate is expected to fall from 6.4% in 2014 to 5.7% this year and to 5.4% in 2016. The net debt of the central government should remain steady at about 35% of GDP. However, Cebotari noted that the consolidated public sector deficit (including the electricity sector and the BCRD) has been running at around 5% of GDP. In the absence of a further tightening of fiscal policy, the IMF believes that total public sector debt will trend upwards from the current level of about 50% of GDP to 54% in

2020. Cebotari added that the real exchange rate is broadly in line with the Dominican Republic's economic fundamentals[2].

Chart 1: The economy of the Dominican Republic - as the IMF sees it

	2014	2015	2016
GDP (US$bn)	64.1	66.6	69.9
Real GDP Growth (%)	7.3	5.5	4.5
GDP per capita (US$)	6,481	6,664	6,923
Total investment (% GDP)	21.5	20.2	20.3
Total savings (% GDP)	18.4	17.9	17.8
Current account deficit (% GDP)	2.0	1.6	1.8
Inflation (end of year cons. Prices)	1.6	2.0	3.5
Growth in imports of goods, services (%)	4.9	10.4	6.1
Growth in exports of goods, services (%)	9.0	4.3	5.2
Unemployment rate (%)	6.4	5.7	5.4
Government revenue (% GDP)	15.1	17.7	14.6
Government spending (% GDP)	18.0	18.3	18.5
Government net debt (% GDP)	35.0	33.3	34.6

Source: *IMF World Economic Outlook database, October 2015*

...and the not so good

That the Dominican Republic's economy is performing so well is in spite of the fact that the country is not an easy one in which to do business. According to the World Economic Forum (WEF) in its latest (2015-16) *Global Competitiveness Report*, the Dominican Republic's ranking for Global Competitiveness has risen from 105/144 in 2012-13 to 105/148 in 2013-14, to 101/144 in 2014-15 to 98/140 currently. Unsurprisingly, the country is reasonably highly rated (at 57/140) for its macroeconomic environment. However, its competitive position is held by institutional factors such as diversion of public funds (134/140), favouritism in decisions by government officials (126/140), the ethical behaviour of firms (130/140), and the reliability of police services (130/140). No one factor really stands out as something that is a problem for businesses operating in the country. Tax rates, corruption, and an inadequately trained workforce are seen as problems of similar importance.

Like the WEF, the World Bank – in its *Doing Business* report for 2015-16 – found that there had been a small improvement in the business environment over the previous year. However, the World Bank's research suggested that other countries had made greater progress. This year, the Dominican Republic was ranked 93/189 – a middling position that represented slippage of three places relative to 2014-15. The country's ranking for trading across borders (already an area of relative strength) improved, while its ranking for protection of minority investors was unchanged. However, the rankings for all other aspects considered by the World Bank worsened.

Within Latin America and the Caribbean, the only countries that are assessed by the WEF as being less competitive than the Dominican Republic are either

[2]The BCRD runs a sliding peg regime, allowing the currency to devalue by an amount that reflects the differential between inflation in the Dominican Republic and its main trading partners. As of mid-December 2015, the exchange rate is US$1: DOP45.6.

a lot poorer in terms of per capita income or have well publicised economic imbalances. This group included Argentina (ranked at 106/140), Bolivia (117), Paraguay (118), Guyana (121), Venezuela (132), and Haiti (134). The Dominican Republic's strong macro-economic situation gives policymakers good scope to undertake structural reforms over the coming years. The IMF's Cebotari noted that the government has been improving social safety nets, reforming the education sector, and promoting financial inclusion.

Chart 2: The Dominican Republic as a place for doing business

	2014-15	2015-16	Change
Overall Ease of Doing Business Score	60.77	61.16	0.39
Overall Ease of Doing Business Rank/189	90	93	-3
Ranking for:			
Starting a business	106	110	-4
Dealing with construction permits	43	44	-1
Getting electricity	148	149	-1
Registering property	79	82	-3
Getting credit	90	97	-7
Protection of minority investors	81	81	0
Paying of taxes	75	77	-2
Trading across borders	63	57	6
Enforcing contracts	114	115	-1
Resolving insolvency	158	159	-1

Source: *World Bank - Doing Business research*

Chart 3: The most problematic factors for doing business

	Weighted Score
Tax rates	16.0
Corruption	13.5
Inadequately trained workforce	12.4
Inefficient government bureaucracy	9.2
Access to financing	8.4
Crime and theft	7.3

Source: *World Economic Forum, Global Competitiveness Report, 2015-16*

JAMAICA

Reaping the benefits of reform (and lower fuel prices)

In mid-November 2015, Jamaican Prime Minister Portia Simpson Miller ended speculation that she might call an election in December – a year earlier than is required in the constitution (LN Caribbean & Central America December 2015). The latest economic developments suggest that she is right to wait.

At the end of November, the Statistical Institute of Jamaica (SIJ) noted that the country's merchandise trade deficit for the first eight months of the year was US$2,523m, or 11.5% less than in the previous corresponding period.

Exports slipped by US$107m, or by 10.7%, however this was dwarfed by the fall in imports of 11.3% or US$434m. The main reason for the slump in imports was the US$530m (or 39%) fall in purchases of fuel and oil to US$839m. Jamaica is a major beneficiary of the drop in oil prices. Import volumes were lower as well.

This was the latest piece of good news about an economy that is moving in the right direction. On 13 November, Uma Ramakrishnan, chief of the latest IMF Mission to visit Jamaica, noted that economic growth should accelerate from around 1.5% in the 2015/16 fiscal year to 2.5% in 2016/17. Thanks to growth in tourism and business outsourcing, the unemployment rate has fallen to 13.1% in July. In part because of lower fuel prices and in part because of the receding impact of drought, annual inflation dropped to a historic low of 1.8%.

Ramakrishnan highlighted how the IMF is impressed with the progress that the government of Jamaica has made with the IMF-prescribed program. "With macroeconomic stability now well entrenched, and the debt dynamics improving, the authorities and mission agreed that a loosening of fiscal policy and a realignment of monetary policies were both warranted to support the real economy. To this end, a staff level agreement was reached to lower the target for the primary surplus to 7.25% of GDP for this fiscal year and to 7% of GDP for 2016/17. This additional fiscal space will provide an opportunity to increase public spending on capital outlays that boost growth and job creation as well as to continue to protect social spending. Further, a more expansionary monetary stance will help complement the fiscal expansion by supporting credit expansion and private sector activity."

"Other reforms of which the IMF approves include the new Banking Services Act, the granting to the Bank of Jamaica (the central bank) of a broad mandate for financial stability, and changes to the operation of money markets."

Other reforms of which the IMF approves include the new Banking Services Act, the granting to the Bank of Jamaica (the central bank) of a broad mandate for financial stability, and changes to the operation of money markets. In the World Bank's recently published *Doing Business* ratings for 2016, Jamaica was one of the ten most improved economies globally.

Collectively, these details indicate that Jamaica's economy is at an early stage in a virtuous circle of stronger growth, lower inflation, and reducing financial risk. Increased economic activity and lower inflation should boost household incomes. The government has greater fiscal leeway to spend. The benefits will be felt widely by voters. Simpson Miller has good reason to wait before she calls the next general election.

REGIONAL BUSINESS REVIEW

NICARAGUA

Grand Canal faces delay

Latin America's largest, most ambitious civil engineering project faces at least a year's delay. Bill Wild, head of the project to build a US$50bn inter-oceanic canal running across Nicaragua, admitted at the end of November that it was running some 11 months behind schedule because approval of the environmental and social impact assessment had only been secured that month, rather than in December 2014. According to the official version presented by the Nicaraguan government and operating company Hong

Kong Nicaragua Development (HKND), the delay is no more than a technical hitch, something to be expected on an enterprise of this scale. According to the unofficial version presented by environmental activists and other groups, it highlights major operational and financial difficulties. They believe the project may never be completed.

Nicaragua's Grand Canal project has been surrounded by controversy since June 2013 when the government of President Daniel Ortega granted HKND a 50-year concession, renewable for another 50 years, to build and operate it. The project requires excavation of a 172-mile canal running through the fresh-water Lake Nicaragua and linking the Pacific and Atlantic oceans. It will be three times longer than the existing Panama Canal, with which it will compete. Controversy has ranged over the potential environmental damage the project may cause, and over the background and financial credentials of HKND chief executive Wang Jin, who has insisted that his company can and will raise the necessary funding.

According to the official version, the delay is a relatively small issue for a project that is otherwise progressing to plan. Wild said the delay "will not hinder us, because many suggestions were made during this period and we had to take the necessary time to correctly do this study". So far the focus has been on survey and planning work. Excavation work, initially promised for 2015, will not now begin until 2016. The project is expected to take five years. Under the terms of the concession HKND must complete it by 2020. The company has said that "the construction of locks and the big excavations will start towards the end of 2016".

"The project requires excavation of a 172-mile canal running through the fresh-water Lake Nicaragua and linking the Pacific and Atlantic oceans. It will be three times longer than the existing Panama Canal, with which it will compete."

According to the unofficial version there is, however, a gigantic spanner in the works: the money is not there. Various sources say that Wang's personal fortune has shrunk by as much as 84% as a result of the Chinese stock exchange crash in September. According to Bloomberg, Wang was listed as having a net worth of US$10.2bn in June this year, but that fell to US$1.1bn in October. The news agency dubbed him "the world's worst performing billionaire in 2015". For the critics, that raises a big question mark over HKND's ability to raise the US$50bn. Some in any case suggest that the latest revisions of the canal route, along with cost overruns, could take the final bill as high as US$70bn. Jorge Quijano, chief executive of the Panama Canal Authority, has said that the Nicaraguan project is simply "not feasible from a private investment standpoint". Bearing in mind that it would be competing for business with the Panama Canal, he held that returns to investors would be scant unless the project was being subsidised by "another country", a reference to the widespread view that the Chinese government is ultimately behind the project. The authorities in Beijing have denied that this is the case.

Telémaco Talavera, a spokesman for the Nicaraguan Canal Commission, has insisted that the delays do not reflect a lack of funds, and that sufficient private investors are lined up to back the project. Wild said that the approval of the environmental and social impact assessment (ESIA) was key to unlocking funds. He told the London-based *Financial Times* "Now we have the ESIA approved, such organisations as the World Bank and the International Financial Corporation (IFC) are now in a position to support the project. Without an ESIA that conforms to their standards they would not do so. In that regard we have moved ahead."

There is also controversy over the ESIA itself, prepared by the UK-based consultancy Environmental Resources Management (ERM), and said to be a 14-volume, 11,000 page report. Not all sections of the report have been made public, so it is hard to accurately summarise its conclusions, and both sides have invoked it as supporting their positions. Salvador Montenegro, a former head of the aquatic research centre at Universidad Nacional Autónoma de Nicaragua and an opponent of the project, credits the report with calling for further studies of the impact on Lake Nicaragua (also known as Lago Cocibolca). Others have mentioned the need for seismic studies to assess earthquake risk.

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Mónica López, an environmental activist, says the report says neither HKND nor the Nicaraguan government have the necessary experience in environmental protection, and that the report recommends they bring in expert help from organisations such as the World Bank and the Interamerican Development Bank (IDB). Much hinges on the reported recommendation that the project should adhere to "best international practice". In a letter to the *Financial Times* the Academy of Sciences of Nicaragua said that a panel of experts it convened concluded that such standards were not being met and "the canal could result in devastating and irreversible losses of biodiversity through damage to marine, freshwater, and terrestrial ecosystems, and disruption of the Mesoamerican Biological Corridor along the Caribbean coast". Some of the main concerns include the effects of dredging on fish life in Lago Cocibolca and the necessary resettlement of farming and indigenous communities in the area.

Part of HKND's strategy has been to try and convince the international investment community that the project is credible, and conforms to international standards. So it received something of a setback in November when it was reported that US consultancy McKinsey & Co, initially hired to conduct a feasibility study, was no longer involved. McKinsey would not comment directly, but HKND confirmed that the US company had not worked on the project since 2014. According to a "confidential source who claimed to have insider knowledge of McKinsey's work with HKND" quoted by JOC.com, the US consultancy had to make repeated requests for payment for its services, and after finally being paid "informed HKND in writing that it would discontinue working on the project". The feasibility report remains confidential, giving further ammunition to opponents of the project who say it lacks transparency.

BRAZIL

Vale and BHP accused over Samarco disaster

Brazil suffered a major environmental disaster on 5 November when the Fundao tailings dam collapsed at the Samarco Mineração iron ore mine, releasing about 60m cubic metres of water and slurry that destroyed the local town of Bento Rodrigues and pushed its way down the Rio Doce river towards the Atlantic coast some 500km downstream. At least 15 people died, with some still listed as missing.

The dam break covered the Rio Doce flood plain in mud for 80kms and polluted the river. Drinking water supplies for around 250,000 people had to be cut off. Large quantities of fish died in the river. Government officials have been describing what happened as Brazil's worst environmental disaster, and in a first response they suspended the company's mining licence. The accident happened just before COP21, the global climate change summit conference in Paris in December. Speaking at the summit Brazil's President Dilma Rousseff said the disaster had been caused by "the irresponsible actions of one company" and that there would be "severe punishment".

Samarco is a 50-50 joint venture between Brazil's Vale – the country's largest mining company – and Australia-based global mining group BHP Billiton. The disaster triggered a steep fall in both companies' shares. In the month after the incident, Vale ADRs slumped 32.5% on the NYSE, while BHP securities fell by over 25% on the Australian exchange. Both companies face a range of legal actions and investigations. Environmental agency Ibama fined Samarco an initial BRL250m (US$90.3m). Environment minister Izabella Teixera said that federal and state governments would sue Samarco for a total of BRL20bn (US$5.3bn). A class action lawsuit on behalf of investors has been filed by lawyers in the US against Vale, accusing it of making false statements and failing to disclose "material adverse facts" about the Samarco project. A Brazilian tax lawyer has also filed a BRL10bn (US$3.6bn) class action suit in Minas Gerais state against Samarco.

"Both BHP and Vale have said they are creating a US$200m fund to help clean up the Rio Doce and its tributaries."

Both BHP and Vale have said they are creating a US$200m fund to help clean up the Rio Doce and its tributaries. In December, US credit ratings agency Moody's Investor Services said it had downgraded Samarco Mineração from Ba1 to Caa1 reflecting "continued uncertainties" about its ability to resume operations, and the impact of fines, penalties, and claims from the accident. Standard & Poor's had also downgraded the company in November, from BB+ to BB- citing cash-flow difficulties and uncertainty over when it might resume operations. Vale's chief financial officer Luciano Siani Pires has said "the best way to settle all the claims would be to have Samarco back into operations". A research paper by Citigroup said BHP might have to cut its dividends to shareholders to meet the cost of claims.

One of the issues in what looks like being a prolonged legal fight concerns whether the mud was – or became – toxic, how and when that happened, and the precise responsibilities involved. Based on riverbed analysis, the United Nations has claimed that the mud contained high levels of toxic metals including arsenic and cadmium. BHP argues that the water and mud was not toxic when it left the dam. It has argued that the material that washed down the river course "will behave in the environment like normal soils" and is chemically stable. Léo Helier, UN special rapporteur on the human right to safe drinking water and sanitation, has called on the government to monitor raw and treated water quality in the area. According to him, "there is growing discontent due to the poor management of this water crisis, which has already generated some violent incidents and could lead to further unrest".

Samarco Mineração is also under pressure over its lack of adequate emergency plans to deal with further accidents, with a local judge threatening to fine the company BRL1m (US$262,000 a day) until it produces them. There is concern over the nearby Germano and Santarém tailings dams, which were partly damaged when Fundão collapsed. According to some sources, as the reservoirs behind the dams built up, the company built up higher dikes on top of tailings – a method that is low-cost but also more prone to failure. The

disaster has triggered a wider debate about the handling of mine tailings – waste materials held in slurry form behind dams. According to the United Nations there are around 3,500 such impoundments in different mines around the world. Given growing concerns over safety risks, some argue in favour of an alternative, although more expensive, method of residue storage know as "dry-stacking" where a filtering process is used to extract water from the slurry, creating dry waste material which can be controlled more easily.

The disaster is also having a series of political repercussions. There have been calls for a much tighter mining code, particularly since the revelation that mining companies made campaign contributions to many of the federal deputies who were involved in drafting the current code. According to newspaper *O Estado de S Paulo*, 28 out of 36 federal deputies who sat on three separate Congressional committees to discuss mining legislation received campaign contributions from the mining companies.

PUERTO RICO

One deadline after another

On 1 December 2015, the Government Development Bank (GDB) of Puerto Rico paid US$354m owing in principal and interest to its creditors. However, this involved the legal diversion of funds from five other government-backed entities. On 1 January 2016, it will be necessary for payment to be made on around US$900m of the government's General Obligation (GO) bonds and bonds of other entities. Meanwhile the government is asking the US Congress to allow it to restructure its debts in an orderly fashion with bankruptcy protection.

> "Another, even more challenging, deadline is looming. At the beginning of January 2016, the government and several of the entities that it backs are due to make payment of around US$900m."

At the beginning of December, the GDB made payment on US$354m that it owed. However, this was only possible by the diversion of money from the sinking funds of the Puerto Rico Infrastructure Finance Authority (PRIFA), the Puerto Rico Highways and Transportation Authority (PRHTA), the Metropolitan Bus Authority (MBA), the Integrated Transportation Authority (ITA), and the Convention District Authority (CDA). The appropriation of funds from these authorities was made legal on 1 December by the signature of Executive Order No OE 2015-46 by Puerto Rico's Governor Alejandro García Padilla.

Another, even more challenging, deadline is looming. At the beginning of January 2016, the government and several of the entities that it backs are due to make payment of around US$900m. Six entities – PRIFA, PRHTA and CDA, as well as the Puerto Rico Electric Power Authority (PREPA), the Public Buildings Authority (PBA), and the Puerto Rico Aqueduct and Sewer Authority (PRASA) – account for a little over US$500m of this. These amounts are in the context of total outstanding debt of around US$73bn.

As of mid-December, García Padilla has led a delegation of Puerto Rican legislators and officials to Washington DC, in order to push influential members of the US Senate and House of Representatives to pass new laws that would provide the government of Puerto Rico with the protection of the US Bankruptcy Code while it negotiates with its creditors on behalf of itself and the other entities. Because Puerto Rico is an unincorporated territory of the US, the government cannot seek protection under Chapter 9 of the Bankruptcy Code in the way that cities and municipalities are able to do.

The early indications from Washington DC are positive. Orrin Hatch (R-Utah), the Chairman of the Senate Finance Committee, has introduced a bill in the US Senate that would provide for an orderly restructuring of the debts of the government of Puerto Rico and the various entities that it backs. Hatch's bill provides for up to US$3bn in cash relief, a reduction in employee payroll taxes for five years and the establishment of an independent authority that can borrow on behalf of Puerto Rico's government. Hatch has also written to US Treasury Jack Lew asking for details on how the US government is planning to respond to Puerto Rico's fiscal problems. Hatch agrees with the administration of President Barack Obama that there should not be a bailout of the government of Puerto Rico (and the other entities) and that an orderly resolution of the debts is much better than the alternative.

In the meantime, the government of Puerto Rico has been meeting with hedge funds and investment companies whose municipal-bond funds hold Puerto Rican bonds. The objective, as described in a 19 November 2015 press release from the GDB, is "a comprehensive single transaction to be accomplished by a voluntary exchange offer". Such an offer would include GOs and bonds issued by COFINA, the sales tax financing corporation. The bondholders consider that they should receive a better deal through direct negotiations with the government of Puerto Rico than they would if the government is able to find protection from its creditors through Chapter 9 of the US bankruptcy code.

> "Meanwhile, Puerto Rico's fundamental problems – of economic stagnation and temporary lack of access to bond markets – persist..."

Meanwhile, Puerto Rico's fundamental problems – of economic stagnation and temporary lack of access to bond markets – persist. The GDB's latest economic activity indicator (EAI) for October 2015 was 1.0% higher than it had been one year previously. Relative to October 2014, non-farm payroll employment in Puerto Rico was 910,200 or 0.5% higher. Domestic power generation was 1.4% lower, while gasoline consumption and cement sales were, respectively, 0.4% higher and 14.4% lower. On 11 December 2015, Fitch Ratings confirmed that it was retaining its Negative ratings watch on the CC rating for the GOs, as well as the PREPA, PRASA, COFINA, and PBA securities that it rates. Fitch "believes that the political environment and liquidity pressures leave all of [Puerto Rico's] debt vulnerable to default until restructuring plans become clearer".

It remains to be seen how the government of Puerto Rico deals with the 1 January 2016 deadline. However, all parties agree that an orderly resolution of the debt crisis is better than the alternative. In the coming weeks, it is reasonable to expect the enactment of new law in the US Congress which extends the protection of the Bankruptcy Code to Puerto Rico and/or a substantive agreement between the government and the hedge funds and investment funds.

REGION

ECLAC highlights femicide issue

The Economic Commission for Latin America and the Caribbean (ECLAC) has highlighted the issue of 'femicide' – the murder of women purely because of their gender – by pointing out that there were at least 1,678 such deaths in 2014.

Femicide is clearly a major social and political issue in the region, but also an economic one. According to ECLAC, there were 1,678 such deaths across 14 Latin American and three Caribbean countries last year. The real number is almost certainly higher because some countries were not covered and because many deaths are not reported nor specifically classified as cases of gender violence. ECLAC executive secretary Alicia Bárcena said 20 countries in the region currently have laws defining femicide as a crime, but only eight of them allocate specific public funding to combat it.

Speaking on the international day for the elimination of violence against women (25 November), Bárcena called on countries in the region to improve data collection on femicides and to launch adequately funded prevention and reparation programmes. She said gender violence "must be faced comprehensively by States, taking into account the factors of economic, social, and cultural inequality that play out in society and in the power relations between men and women".

> "The lack of data means it is difficult to assess the true extent of the problem. However, according to a 2012 report by an independent Geneva-based research project called the Small Arms Survey, more than half of the 25 countries with the world's highest femicide rates were in Latin America."

The lack of data means it is difficult to assess the true extent of the problem. However, according to a 2012 report by an independent Geneva-based research project called the Small Arms Survey, more than half of the 25 countries with the world's highest femicide rates were in Latin America. The report estimated that 66,000 women had been victims of femicide in 2004-2009. A separate report by the Latin American Social Sciences Institute (FLACSO) said that murder rates of women (due to all causes, not just femicide) were in 2013 highest in Brazil, and that black women there suffered a higher murder rate than lighter-skinned women. That report said that after Brazil the female homicide rate was highest in El Salvador (8.9 murders for every 100,000 women), Colombia (6.3), and Guatemala (6.2).

It is clear that gender violence has an economic cost, whether it be in the extreme cases of murder or across a range of other behaviours including non-lethal violence or sexual harassment on the street. ECLAC describes harassment on the streets or on public transport as "one of the most minimised and naturalised forms of violence against women". It notes that Peru approved a law against street harassment in March, while Chile, Argentina, and Uruguay are also considering legislation. A small number of countries have launched specific laws against gender violence. Bolivia did so in 2012. In Colombia a law against gender violence came into force in July, which also made femicide a crime carrying jail sentences of 20 to 41 years.

In Argentina there were major demonstrations last June following the murder of a pregnant 14-year old girl, part of a campaign known as #NiUnaMenos ('not one less'). At the other end of Latin America, in July the governor of Estado de Mexico declared 11 municipalities there to be on "gender alert", an administrative move that allows issues of gender-based violence to be given higher priority. Eruviel Ávila, the governor, said "the alert will allow us to strengthen public policy in favour of women and obtain additional resources". Mexican government statistics suggest that the female murder rate rose sharply between 2007 and 2013, reaching 4.4 per hundred thousand women – double the global average.

Corporate Radar

New management at Aerolíneas Argentinas: A radical change is underway at the top of state airline Aerolíneas Argentinas. Out goes president and general manager Mariano Recalde and a group of senior managers closely identified with La Cámpora, the youth wing of the Frente Para la Victoria (FPV) faction of the Peronist party, which was voted out of office in November. His critics accused Recalde of running the loss-making airline as a political fiefdom. In comes Isela Costantini, appointed by newly elected President Mauricio Macri to bring in some private sector management expertise. Costantini was previously CEO of GM Argentina and president of ADEFA, the association of Argentine automobile manufacturers. Aerolíneas has had a troubled history, being controversially privatised in 1990 and equally controversially re-nationalised in 2008. During the election campaign, President Macri denied claims he would launch a new privatisation attempt; instead, he said, the company would remain in public ownership and efforts would be made to run it more efficiently. This job now falls to Costantini, who takes over in January. Significantly, the Brazilian born Argentina executive, listed by Forbes in 2013 as one of the world's top 50 business women, has a reputation as a tough negotiator. She will have to establish good relations with Aerolíneas multiple and often militant trade unions.

Odebrecht leaves Odebrecht: After six months in prison facing corruption charges linked to the "car wash" scandal centred on state oil company Petrobras, Marcelo Odebrecht has formally stepped down from his role as president and chief executive of Grupo Odebrecht, one of Brazil – and Latin America's – largest civil engineering and construction companies. Marcelo, from the third generation of the family that founded and still controls the enterprise, also stepped down from a number of other companies in the group, including Braskem (petrochemicals) and other subsidiaries in oil and gas and real estate. The company has said it is confident that when the case comes to trial it will be cleared of any wrongdoing. But in November the federal police said it was widening its investigations to include the possible payment of bribes in construction contracts related to the 2016 Olympic Games in Rio de Janeiro. Odebrecht is reputed to be involved in half the Olympic Games construction contracts, measured by value.

"After six months in prison facing corruption charges linked to the "car wash" scandal centred on state oil company Petrobras, Marcelo Odebrecht has formally stepped down from his role as president and chief executive of Grupo Odebrecht, one of Brazil – and Latin America's – largest civil engineering and construction companies."

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