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Cigars and mojitos - opening up US-Cuba trade

It almost certainly won't all go smoothly, but for now, things are moving fast. On 17 December US President Barrack Obama lifted his country's 53-year old freeze on full diplomatic relations with Cuba. On 15 January Cuba honoured an undertaking to release 53 detainees considered political prisoners by the US. On the same day, United Airlines said that it would look to begin direct US-Cuba flights, subject to expected changes in US federal legislation. On 16 January the US treasury and commerce departments published the details of the new changes announced by President Obama, including allowing the authorised categories of US travellers to Cuba to bring back small quantities of cigars and rum and to use their credit cards while on the island, as well as green-lighting US exports of telecoms and ICT equipment, building materials for residential construction, and agricultural equipment for small farmers. Permitted remittances from American citizens to Cuba have also been increased sharply. The question is: where is it all heading?

The gradual normalisation of diplomatic and trade relations between Cuba and the United States, after some 53 years of a political stand-off and the US economic embargo, is by no means a done deal. There are big obstacles ahead, including the obstructive position that will be taken by the Republican-controlled US Congress, which has the power to block President Obama's desire to appoint a new ambassador to Havana (although it cannot block appointment of a *chargé de affairs*), as well as to block any subsequent attempt to dismantle additional bits of the decades-long US trade embargo (which can only be lifted fully by an act of congress). But the moves by the White House suggest there has been enough real movement to merit consideration of the economic consequences of a fuller thaw.

One of the key implications of the move is that Cuba, for five-plus decades a centrally controlled and socialist economy, is ready to take some significant steps towards more orthodox, or market-based, economic policies. The normalisation of relations with the US appears to be tied up with plans to unify the two main Cuban currencies, announced a year ago as part of a modernising drive, but still not implemented. At present the main domestic and non-tradable currency is the national peso (CUP), pegged at 25 to the US dollar. Alongside it is the convertible peso, the CUC, which exchanges at a 1-to-1 rate with the dollar. Cubans who wish to buy imported consumer goods must acquire them from special outlets, whether paying with CUCs or using their CUPs at the sharply unfavourable exchange rate. As in other Latin American countries (notably Venezuela and perhaps to a less extreme extent Argentina), the multiple exchange rate system is used to ration scarce foreign currency and, in effect, to protect the less efficient parts of the domestic economy from international competition.

While there have been some trials at state companies in the past year, the currency reform process to date has seemed to be moving very slowly.

“In December, the economy minister and architect of the current reform process, Marino Murillo (sometimes touted as a future presidential contender post-2018, when the octogenarian President Raúl Castro has pledged to step aside), said the country would not meet its 2014 growth target of 2.2%, and would need to use some 30% of its 2015 export revenue to service its US$5.7bn foreign debt.”

However, on recent announcements by the Havana government, it is clear that change is in the air. *Granma*, the main state newspaper, has said that on 1 February new 1,000, 500, and 200 CUP notes will be introduced (at present the largest note in circulation is 100 pesos). *Granma* made clear that the move is part of the process towards currency unification. With virtually no domestic credit card or cheque payment systems in operation, Cubans have had to carry around large quantities of bills for any transactions they wish to make. Francisco Mayobre, a vice-president at Banco Central de Cuba, told *Granma* that "introducing higher denomination notes into circulation will help reduce this problem". In addition, if the country is to cater for rising numbers of credit-card carrying US visitors, it will need to modernise its entire payments system.

While it is not yet clear what currency regime the Cuban authorities might want to introduce for a unified peso (among the possibilities would be a fixed rate, managed peg, or managed or 'dirty' float) it is clear that the country would need greater foreign currency reserves to launch the new system and back up a convertible peso. *LatinNews* examined the prospects for currency reform in a 2013 White Paper entitled '*Cuba's dual currency – the urgent need for reform*', followed by a March 2014 update when the Cuban government confirmed plans to abolish the convertible CUC.

The supposition is that the thaw in trading relations with the US is a way to help boost Cuba's supply of dollars. The measures taken so far move quite significantly in that direction. Under last year's rules, allowing each US citizen to send a maximum of US$500 a quarter, US remittances to Cuba are thought have totalled around US$3bn a year. For 2015, Obama has quadrupled the ceiling for remittances to US$2,000 a quarter: remittances can therefore be expected to grow strongly. Dollar earnings will also increase because US citizens travelling to Cuba are now allowed to bring back goods worth US$400 each trip, including US$100 worth of spirits and tobacco. The decision effectively ends the long-standing restriction on the sale of Cuban cigars in the US. Restrictions on travel to Cuba are also being eased, suggesting the number of US visitors, and the money they spend while on the island, will also grow.

An intriguing aspect of the US-Cuba thaw is that coupled with other developments (such as the recent sharp fall in global crude oil prices) it has the potential to revolutionise some long-standing Latin American and regional economic alignments. Cuban economic policies could end up being less heterodox, and more market friendly, than current Venezuelan or Argentine policies: for economists who have followed the region over a number of decades, this is something rather hard to imagine. How, when and how far the transition to greater orthodoxy will unfold of course remains to be seen. But it is clear that Cuba's current economic model is in difficulty. In December, the economy minister and architect of the current reform process, Marino Murillo (sometimes touted as a future presidential contender post-2018, when the octogenarian President Raúl Castro has pledged to step aside), said the country would not meet its 2014 growth target of 2.2%, and would need to use some 30% of its 2015 export revenue to service its US$5.7bn foreign debt.

The regional energy market may also be on the threshold of deep change. Cuba currently relies on Venezuelan oil, receiving around 115,000bpd under the terms of a preferential deal signed in 2003. Some of the oil is re-exported to boost the island's limited foreign currency earnings. One estimate is that subsidised Venezuelan oil supplies were worth as much as US$3.6bn to Cuba in 2014. But as Venezuela struggles with economic chaos and a collapse in international crude oil prices, there is much speculation that it will have to pare back such deals for Cuba and indeed, that it may have to wind up the entire Petrocaribe programme of discounted oil for the Caribbean and Central America. The US however, in the middle of its shale oil and gas revolution, has plentiful fuel supplies even at these low prices. While the US does

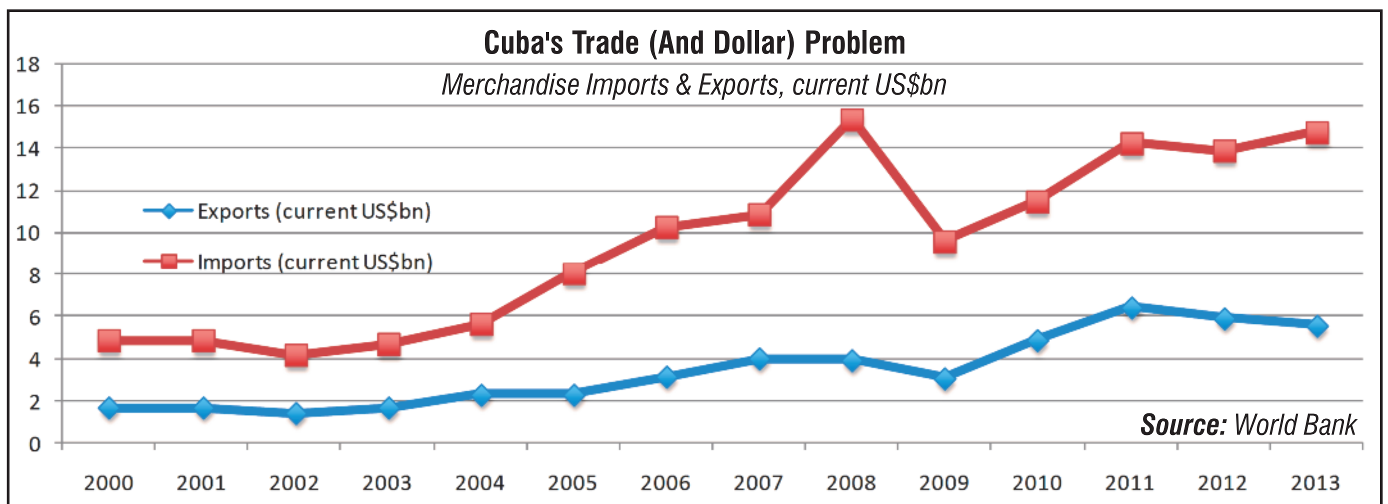
not (yet) formally export oil, increased feedstock supplies mean that US refineries have flooded the Caribbean with cheap petrol and other refined fuels. It is not therefore impossible to imagine a future realignment whereby Cuba could receive US fuel.

A real game-changer may be further down the line, and would consist of a major surge in US foreign direct investment (FDI) into Cuba. Although Cuba's hard-currency purchasing power is currently very limited, it is a market of 11.1m people – the largest in the Caribbean – only 90 miles from the Florida coast. A major surge in US investment into Cuba would significantly alter the economic dynamics of the Caribbean and possibly that of the wider region. Already the Brazilian government's major investment (upwards of US$800m) in developing Cuba's (US-facing) Mariel Port, much criticised at home, is now being seen as a potentially smart strategic move. There will be winners and losers from such a change: in the short term the 'pivot' in US-Cuba relations might lead to a fall in FDI going into other Caribbean and Central American destinations.

"A real game-changer may be further down the line, and would consist of a major surge in US foreign direct investment (FDI) into Cuba."

A number of US business groups are excited about Cuba. New York Governor Andrew Cuomo plans to lead one of the first post-thaw trade missions to Cuba. There is potential in the energy and mining infrastructure sector (Cuba is the world's tenth-largest nickel producer). Among those most interested are US farmers and US food companies. US exports to Cuba (mainly agricultural and health care products, which are allowed under existing US legislation) reached a high point of US$710m in 2008, but were only US$266m in the first 11 months of 2014, on estimates from the New-York based US-Cuba Trade and Economic Council. According to a study by the Peterson Institute for International Economics, US exports to Cuba could soar from this low base to US$4.3bn a year, while Cuba's exports to the US could go from zero now to US$5.8bn. A new US Agriculture Coalition for Cuba has just been formed to boost bilateral trade: members include Cargill and Chicago Foods International. Cuba imports about 60% of its food needs.

The tourism sector is attracting strong interest. It is also possible that US companies will want to invest in telecoms and Internet infrastructure development in Cuba (something that they will now be permitted to do under US legislation). Cuba, however, is likely to have political concerns over giving its citizens unrestricted access to these technologies. Opinions in Florida, home of hard-core Cuban-American opponents of the Castro government, are understandably divided. But Jay Brickman of Crowley Maritime Corp, a company that already ships food to Cuba, says: "People in Florida are networking to figure out who needs to talk to whom and how they can fit in". He said he had attended an foreign embassy reception in Havana on 17 December – the day the diplomatic thaw was announced – and had bumped into Florida and Georgia-based representatives of US telecoms companies: "It shows that telecoms people are very interested, very proactive, and trying to lay the groundwork to see how they can enter into the market" he commented.



VENEZUELA

Storm clouds over Caracas

This year will be challenging for Venezuela, to put it mildly. Here we assess the likelihood of the country defaulting on its foreign debt payments. Asking whether there will or won't be a default is a simple question, but coming up with an answer is rather more complex. A default is probable, but not certain: there is also a 'muddle through' option.

The argument for a Venezuelan default this year is strong. It consists of three main propositions: (i) Venezuela is 95%-plus dependent on oil revenues for its foreign currency earnings; (ii) the price of oil has fallen by over 50% in the last six months and can be expected to remain below US$50 for most of this year; and (iii) the country's unavoidable dollar commitments in 2015 significantly exceed its expected dollar inflows. A not insignificant fourth point can be added (iv): that domestic economic policy under President Nicolás Maduro has been, and for the immediately foreseeable future will remain chaotic, characterised by high domestic inflation, multiple exchange rates, and serious shortages of key goods and services. In short, the argument for default is that Venezuela's dollar numbers just don't add up.

One attempt to quantify the problem was recently made by Siobahn Morden of investment bank Jefferies. She calculates that the country can mobilise a maximum of US$63.8bn in foreign currency this year, against inescapable dollar expenditures of just over US$71bn. So even on her fairly favourable assumptions there is a US$7bn-plus shortfall. On the asset side of the equation, the numbers include US$36.1bn in expected crude oil exports (assuming an average price of US$45 per barrel), some small non-oil exports, a re-profiling of debts to China, and a winding up of Petrocaribe (Venezuela's programme to sell discounted oil to Caribbean and Central American countries). Importantly, she also assumes Venezuela will be able to sell Citgo, its US based refinery operation, for US$10bn, as well as securitising some of its gold holdings and mobilising other non-reserve assets. On the liabilities side, she makes the assumption that imports can be compressed to around US$38.1bn (similar to sharply reduced 2014 levels), and that other balance of payment commitments (including significant debt service payments) will be close to US$30bn, and that there will be some relatively small capital flight.

"A number of other indicators point to a default this year..."

An initial comment is that mobilising some of the dollars on the assets side of the equation may be more complicated and time consuming than might be anticipated. So far the government has said nothing definitive about winding up Petrocaribe and has specifically committed itself *not* to sell Citgo. That could change quickly of course, but even if Caracas wanted to do both things rapidly there could be problems and hold-ups. Selling Citgo could take time. A rushed sale would not get the best price. And there could be legal complications. Lawyers for US oil company ConocoPhillips are arguing in US courts that the state oil company Petróleos de Venezuela (Pdvsa) must not be allowed to sell Citgo and repatriate the proceeds if that is part of a plan to avoid paying compensation for some of the company's assets that were nationalised by Venezuela in 2007.

A number of other indicators point to a default this year. The government has admitted that oil exports were down last year, at 2.3m barrels per day (b/d), from 2.4m b/d in 2013. The government says it is sending up to 560,000 b/d to China, of which about half is payment in kind for accumulated loans worth some US$50bn since 2008 (of which an estimated US$29bn is outstanding).

Debt maturities are quite heavily concentrated in the second half of this year (some US$5.8bn in sovereign bond capital and interest repayments are due, while Pdvsa also has about US$6bn due in debt payments this year). According to premiums on default insurance, in mid January derivatives traders were calculating that there was a 75% chance of Venezuela defaulting within one year, and a 97% change of its defaulting in five years. The international ratings agency Moody's Investors Service in mid January downgraded Venezuelan bonds from Caa1 to Caa2 (putting it on a par with the likes of Ukraine), with a negative outlook. This is the world's worst rating among countries not in default (only Argentina, which partially defaulted last year, has a lower rating). Warning of a "very high credit risk", the agency said: "The principal driver of Moody's decision to downgrade Venezuela's sovereign rating is a marked increase in default risk owing to lower oil prices. The recent oil price shock has exerted pressure on Venezuela's balance of payments and dwindling foreign reserves". In December, Fitch Ratings had also downgraded Venezuela from B to CCC, making similar comments: CCC signals an increased risk of default.

A complicating factor is that the country's economic and financial accounts are far from transparent, meaning it is hard for private economists to assess its true ability to pay. There could be upside or downside surprises. After a long period without publishing data, in December the Banco Central de Venezuela (BCV, central bank) reported that real GDP had slumped by 4% year-on-year in the first nine months of 2014 (private sector GDP was down by a higher 5.8%). The IMF estimates that the Venezuelan economy contracted 3% in calendar 2014 and, troublingly, expects it to contact by a further 7% year-on-year in 2015. The 12-month rate of consumer price inflation to November was 63.9%, with food price inflation pushing up above 90%. While the government has promised spending cuts and new economic measures, and may allow further devaluation of the Bolívar through the multiple exchange rate system (*see box overleaf*), few analysts see it being able to substantially change the situation. Some fear domestic mis-management will push Venezuela into full hyperinflation this year. Bank of America economist Francisco Rodríguez commented at the end of December "if we do not see a large adjustment of the exchange rate, we're almost certain to have triple-digit inflation, and I would not be surprised to see the economy veering into four-digit annual inflation".

> "But despite all this, there are credible arguments that Venezuela will not default in 2015..."

But despite all this, there are credible arguments that Venezuela will not default in 2015. Whatever the more critical analysts may make of it, the government has insisted it will meet its commitments. "Sometimes there's an international conspiracy to try making Venezuela look like it's bankrupt," President Maduro said in January, adding "Venezuela has its own economic power, with a productive people, with gigantic economic potential, with the largest oil reserves in the world".

Those who maintain that the country will muddle its way through give various reasons. Some believe president Maduro's long January tour of China, Russia, Qatar, Algeria, and Iran may have unlocked some crucial financial aid. After four days in China the Venezuelan President said he had secured pledges of US$20bn in new investment. Daniel Chodos of Credit Suisse commented: "We're not saying this solves Venezuela's problems but at least in the near term it reduces the risk of default". Mark Schaltuper of Business Monitor International (BMI) believes back door devaluations and reductions of fuel subsidies might control dollar demand: "I think they have more time than the market thinks. We don't think a default is inevitable," he says.

One of the stronger arguments against default is that, for an oil exporting country, the costs of defaulting might exceed the potential benefits. "Maduro is not a very competent leader and lacks the charisma that [his predecessor Hugo] Chávez had, but he is doing the right thing. It is not rational for them

to default", says Michael Ganske of Rogge Global Partners. This argument assumes that after defaulting, Venezuela would be unable to receive dollars for its export oil (in other words, if a default makes the dollar scarcity worse than it would otherwise be – why do it?). But some question this, noting the ability of a number of countries to continue selling oil and receiving revenue despite international embargoes (the case of Iraq in the 1990s being one example). Some lawyers believe it would be difficult for creditors to seize oil shipments or tankers (many of the latter are rented, not owned by state oil company Pdvsa). And Argentina has been in partial default since mid-2014, while continuing to trade and earn export dollars.

A further point needs to be made. Venezuela faces mid-term elections in September, and a possible short-term upsurge in opposition demonstrations. For more than a decade the country has been polarised between *chavista* and anti-*chavista* forces in approximately equal numerical strength. While it has not exactly been a level contest, the *chavistas* have held the upper hand and have shown themselves able to get the support of a large share of the electorate. If some of the latest opinion polls are to be believed, however, this balance of forces may now be shifting. According to leading local pollsters Datanálisis, Maduro's approval rating, which touched 50% in late 2013, had by December slumped to just over 20%. Many predict renewed political turbulence in the country this year, and this may make the financial outlook even more unpredictable.

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Is there a plan?

On 21 January President Maduro gave his delayed state of the nation address to the national assembly. Despite all the anticipation – and promises of the specifics of Maduro's international tour – the president had little to offer by way of a solution to Venezuela's deep economic crisis on a day that the IMF forecast a GDP contraction of 7% for the country in 2015. There was a glaring omission of any new financing from Venezuela's key strategic partner, China. Instead, Maduro touted the same old conspiratorial rhetoric and the same old recipe – devaluation via fresh tinkering with the tiered exchange rate system, and hand-over-foot money printing to meet social spending commitments – inflationary measures that will rile consumers.

Signalling the depth of the cash flow crisis facing the government this legislative election year, Maduro's biggest announcement was that the time had come to increase fuel prices in Venezuela – an also inflationary move long considered politically impossible, given the shadow of the 'Caracazo' riots in 1989, in which hundreds died in protests against fuel price increases proposed under an IMF-styled package of measures. "Crucify me, kill me… but the time has come", a resigned Maduro stated. If fuel price rises go ahead, the ruling Partido Socialista Unido de Venezuela (PSUV) may well fear crucifixion at the polls at the midterm legislative elections later this year.

Maduro said the government would maintain the existing three-tier exchange rate model, with the strongest rate (fixed at BF6.3/US$1) available for imports of essential foods and medicines. The two secondary rates (which trade at roughly BF12/US$1 and BF50/US$1 via central bank auctions) will be merged, presumably at the weaker rate; while a third new system will be established to offer foreign currency (i.e. US dollars) to individuals and companies via private brokers, in a bid to undermine the (illegal) black market, where the rate is now roughly BF180/US$1.

The president also said he had approved US$8.1bn for food imports this year at the BF6.3/US$1 preferential rate. Barclays Bank estimates that the authorities allocated US$11.4bn for essential imports at that preferential rate in 2014 – so that's a potential drop of 29% in funds for food and essential goods this year. Maduro also sanctioned a 15% increase in the minimum wage (a token gesture in the face of inflation of 64%) and pledged that the government's social missions would be ring-fenced. "2015 will be the year of victory and economic rebirth", he declared.

Yet with the Venezuelan oil at just US$38/b in late January, it is unclear where the dollars needed to meet domestic demand will come from. Oil export revenues

account for 96 of every 100 dollars coming into the country. When oil was still trading at US$50/b, private economists suggested that total oil export earnings would slump by about US$25bn in 2015, from an estimated US$75bn in 2014. That calculation now looks optimistic.

Fuel subsidies cost the government between US$12bn and US$15bn a year, on estimates by private economists, so even gently lifting prices would free up a huge sum. It's very unclear when the debate will begin – Maduro said Venezuela wasn't "desperate", but needed to have the conversation. But no matter what 'quick fix' measures are put in place in the near term, it will not be enough to rescue the economy before the midterm elections, due from September.

REGION

Argentina and Venezuela topped the 2014 inflation chart

While there were a number of concerns about the performance of the Latin American economies last year, in retrospect inflation – for the vast majority of countries – was not one of them. With two big exceptions: Argentina and Venezuela.

Most of Latin America experienced single digit inflation last year, and for a majority of counties the cost of living increase came in at under 5%. For the region as a whole, this was a vast improvement on the sometimes-hyperinflationary 1980s and a variety of subsequent price spikes. Venezuela and Argentina, however, were exceptions to the rule, with both marked by high inflation, multiple exchange rates, largely ineffective direct price controls and poor quality statistics (with the relevant authorities widely suspected of under-reporting the real extent of price rises).

"Venezuela had the highest inflation rate in the region. Full year numbers had not yet been published in January, but according to the Banco Central de Venezuela (BCV), which is now publishing data only intermittently, the 12-month rate to November 2014 stood at 63.9%, with the food component pushing above 90%."

Venezuela had the highest inflation rate in the region. Full year numbers had not yet been published in January, but according to the Banco Central de Venezuela (BCV), which is now publishing data only intermittently, the 12-month rate to November 2014 stood at 63.9%, with the food component pushing above 90%. The basic explanation for the country's high inflation rate is the monetisation of persistent fiscal deficits via large scale expansion of money supply, a process aggravated by the distortions of a multiple exchange rate system and very serious bottlenecks and scarcities running through the production and distribution system. At a certain level inflation becomes a self-reinforcing process, and the fear is that this is exactly what is happening in Venezuela now. Early January has seen long queues forming outside supermarkets. A number of analysts fear that the rate of price increases will move into three digits in 2015, with the danger of hyperinflation looming on the horizon.

In Argentina, inflation can be described as a serious but not crisis-level problem. Some of the same themes are present as in Venezuela: deficit spending, money printing and the distortions of multiple exchange rates. But Argentina has a more diversified economy, and the deterioration of the productive system is so far much less acute than in Venezuela. While most products are in adequate supply, in January a shortage of tampons in Buenos Aires drugstores and supermarkets led the government and the private sector to exchange accusations. The government accused retailers of holding back supply to push up prices; the retailers blamed the scarcity on the government's slowness to issue import permits. According to the national statistics institute (Indec), inflation was 23.9% in calendar 2014. However, most independent economists say that the Indec, despite the introduction early last year of new index (drawn up with the help of the IMF), still consistently under-reports real inflation: private analysts' estimates for 2014 average around 35%.

It is possible to divide up the rest of the main economies in the region into two camps: one with inflation rates not greater than 5%, and the other with rates in the 5%-10% range. The low inflation group includes Peru (3.2%) Colombia (3.7%), Ecuador (3.7%), Paraguay (3.7%), Mexico (4.1%) and Chile (4.6%). The higher band is occupied by Brazil (6.4%) and Uruguay (8.3%). For the latter two countries, inflation is high enough to require a renewed focus on monetary policy. In the case of Brazil, the government is having to commit to greater fiscal austerity and the central bank can be expected to try and bring prices under greater control in 2015.

An interesting point about this regional landscape is that pursuing 'heterodox' economic policies does not always imply high inflation rates. While Venezuela and Argentina clearly have unorthodox left-wing economic policies and high inflation, Bolivia and Ecuador combine heterodoxy with low inflation – less than 5% in both cases. Ecuador's use of the US dollar as its national currency – which it has done for the last 15 years – forces a degree of fiscal discipline on the government led by President Rafael Correa. Bolivia, on the other hand, retains its own currency and therefore has a freer hand in its monetary and fiscal policy: however, supported by large natural gas revenues – which have helped it build up record foreign currency reserves – it has managed to maintain higher levels of fiscal and monetary discipline.

"A final point is that while lower energy prices in 2015 may cause a general easing of inflationary pressures across Latin America, on a country-by-country basis their effect is not uni-directional."

A final point is that while lower energy prices in 2015 may cause a general easing of inflationary pressures across Latin America, on a country-by-country basis their effect is not uni-directional. In Venezuela domestic factors – and the way the government reacts to its falling oil revenues – may lead to a further increase, rather than a decrease in inflation (despite another year of recession in the real economy). In Mexico, lower oil revenues, by squeezing government finances, may lead to peso depreciation, which will boost the competitiveness of non-oil exports, but which could have undesired inflationary side-effects. Among net energy importers like Chile and Brazil, however, the effect may be to reduce cost-push inflation.

GUYANA

Questions of energy and power

By most metrics, Guyana's economy has performed well in recent years. Progress through 2015-2017 will depend significantly on two factors. One is the arrangement of finances for the Amaila Falls Hydroelectric Project (AFHP). The other is the possible lack of access to credit through Venezuela's discount oil scheme, Petrocaribe. All this is at a time that Guyana's political situation is complex. On 10 November, President Donald Ramotar prorogued (suspended) Guyana's parliament. On 21 January, the president announced that a general election will be held on 11 May next.

According to the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC), Guyana's economy was the fastest growing in the Caribbean in calendar 2014, expanding by an estimated 4.5% year-on-year in real terms. By this measure, Guyana has been a sub-regional outperformer. Real growth was 3.3% in 2009, and has since ranged between 4.4% (in 2010) and 5.4% (in 2011). For the sub-region as a whole, the corresponding figures have been -3.6% and 0.3% (in 2010 and 2011) and 1.9% (in 2014).

The growth has been boosted by expansion in the primary industries that dominate Guyana's export mix. According to the International Monetary Fund (IMF), exports of just six commodities – rice, timber, shrimp, bauxite, gold and sugar – account for around 60% of the total basket. These exports are vulnerable to fluctuations in price and/or adverse weather conditions. By comparison with most other (but not all) countries in the Caribbean sub-

region, Guyana also has the advantage of relatively low gross and net debt ratios (estimated by the IMF at 58% and 53% of GDP respectively for 2014), as **chart 1** shows. The debt ratio fell sharply in 2007, when the Inter-American Development Bank (IDB) cancelled its debt of almost US$470m, at that time equivalent to 21% of GDP. Thanks to this and other debt forgiveness, the gross debt ratio stood at 65% in 2009.

Chart 1: Guyana's economy: as the IMF sees it

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Gross domestic product, constant prices, % change	5.44	4.82	5.22	3.32	3.83	4.85	4.31	4.23	3.23
Gross domestic product, current prices, US$ bn	2.58	2.85	2.99	3.14	3.33	3.56	3.80	4.04	4.26
Gross domestic product per capita, current prices, US$	3,263	3,581	3,755	3,945	4,173	4,445	4,730	5,012	5,271
Total investment, % GDP	19.69	19.09	18.26	19.66	23.12	28.10	32.20	25.94	19.49
Gross national savings, % GDP	6.63	7.51	5.41	5.08	7.24	7.14	16.83	9.18	10.40
Inflation, end of period consumer prices, %	3.25	3.43	0.90	4.27	4.28	4.53	4.28	3.78	3.78
Volume of imports of goods and services, % change	2.95	13.12	-4.65	2.34	8.01	13.11	-2.27	5.62	-8.42
Volume of Imports of goods, % change	4.86	13.54	-7.05	1.45	7.72	14.53	-4.83	5.40	-12.70
Volume of exports of goods and services, % change	6.13	11.33	-2.32	5.38	1.95	1.99	1.80	1.67	1.65
Volume of exports of goods, % change	10.38	19.70	3.09	4.28	1.44	1.54	1.38	1.28	1.24
Population, mn	0.79	0.80	0.80	0.80	0.80	0.80	0.80	0.81	0.81
General government revenue, % GDP	27.62	26.56	26.69	28.37	29.74	28.06	27.92	25.89	25.28
General government total expenditure, % GDP	30.64	31.22	31.10	31.97	32.92	30.97	31.20	29.30	25.86
General government primary net lending/borrowing, % GDP	-1.49	-3.54	-3.23	-2.41	-1.97	-1.79	-2.21	-2.43	0.51
General government net debt, % GDP	63.33	55.86	52.15	52.78	53.29	53.07	52.47	51.51	50.29
General government gross debt, % GDP	65.16	62.56	56.87	57.77	58.86	59.15	59.02	56.44	54.96
Current account balance, US$ bn	-0.34	-0.33	-0.38	-0.46	-0.53	-0.75	-0.58	-0.68	-0.39
Current account balance, % GDP	-13.07	-11.57	-12.85	-14.59	-15.88	-20.96	-15.37	-16.76	-9.09

NB Estimates start after 2012

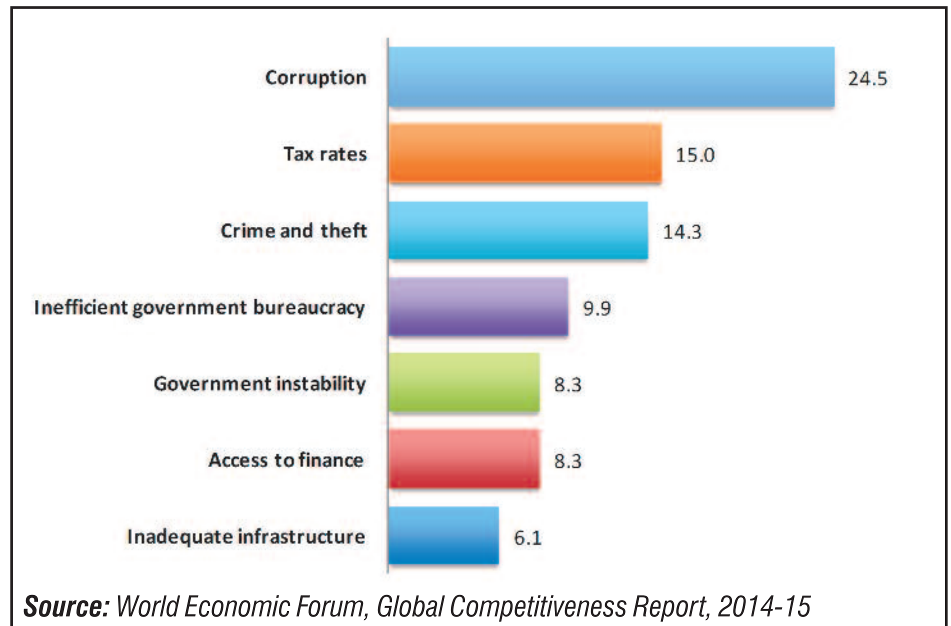
Source: *IMF World Economic Outlook Database*

Still, challenges are considerable. As the IMF notes, per capita GDP (at a little under US$3,400) is the lowest in the British Caribbean. In its 2014-15 Global Competitiveness Report, the World Economic Forum (WEF) assessed Guyana as being the 117th most competitive of the 144 countries it assessed. Relative to other countries, Guyana's competitiveness appears to have been falling over recent years. Areas of comparative weakness include the small size of the local market (ranking 135th of the WEF's 144 assessed countries). Areas of relative strength include financial market development (ranked 82nd); goods market efficiency (83rd) and higher education/training (82nd). As **chart 2** (*overleaf*) indicates, (perceived) corruption is – by quite a margin – the most problematic factor facing businesses, according to those surveyed by the WEF.

Several other aspects of the general economy are worthy of note. The government has been running a fiscal deficit of around 3% of GDP in recent years: however, according in its October 2014 World Economic Outlook, the IMF projected that debt ratios would continue to decline over time. The Bank of Guyana, the central bank, has generally kept inflation under control (and has maintained an exchange rate of around US$1:GYD205 since 2007). Gross reserves of about US$800m are substantial in the context of GDP of a little over US$3.0bn and by most other metrics. Remittances from expatriate Guyanese workers have been running at approximately US$350m or so each year, and are an important source of foreign exchange.

Chart 2: The most problematic factors for doing business in Guyana

Weighted responses (%)



Source: *World Economic Forum, Global Competitiveness Report, 2014-15*

"Unfortunately, developments over the last 18 months with the Amaila Falls Hydroelectric Project (AFHP) mean that the government may have difficulties in attracting significant new FDI in the event of problems with its arrangements with Petrocaribe."

Crucially though, investment (at about 20% of GDP, but expected to rise) has dwarfed domestic savings (of around 5%-7% of GDP in recent years). The corollary of this has been a current account deficit, which has risen from US$340m in 2011 to a projected US$460m in 2014. The current account deficit has been funded mainly by net inwards foreign direct investment (FDI), which was around US$300m in each of 2012 and 2013, and grants (which have been running at about US$50m annually).

Petrocaribe, of which Guyana is a member, has been an important, if variable source of funding for the current account deficit. Over recent years, the norm has been for a minority of the amounts lent to the government of Guyana under its arrangements for Petrocaribe to be actually spent on imports of fuel. The majority has been saved – outside Guyana. In September 2014, at the time of its previous Article IV country report on Guyana, the IMF estimated that the government would save around US$75m in funds advanced from Petrocaribe in each year from 2014 to 2017 inclusive. Amounts lent through Petrocaribe and saved in 2013 were well in excess of US$100m.

The implication of this is that, should events in 2015 result in a disruption to Guyana's arrangements with Petrocaribe, the government would have to consider alternative sources of funds with which it could finance the current account deficit. This challenge would be made more complex if the disruption to Petrocaribe also curtailed growth in other countries in the region: one likely outcome of this would be that remittances from expatriates would shrink.

Unfortunately, developments over the last 18 months with the Amaila Falls Hydroelectric Project (AFHP) mean that the government may have difficulties in attracting significant new FDI in the event of problems with its arrangements with Petrocaribe. The AFHP involves the construction of a dam (and hydro plant) at the confluence of the Amaila and the Kuribrong rivers, about 270km of twin 230 kV high voltage transmission lines from the plant to Georgetown via Linden, along with access roads. According to the government, the AFHP "will generate reliable, affordable and clean energy for the people of Guyana for decades to come". It will reduce the country's carbon footprint, dependence on imported hydrocarbons and vulnerability to disruptions in power supply. In September 2014, the IMF indicated that the AFHP would require investment of about 30% of GDP (or a little under US$900m). The deal has been structured as a public-private partnership

> “In practice, the proroguing of parliament by President Donald Ramotar on 10 November means that it is very unlikely that progress will be made in discussions with Sithe Global (or other interested parties such as China Development Bank and the Inter-American Development Bank [IDB]) prior to the elections in May. We expect that this most important project will remain in limbo for some months to come.”

(PPP) under which the state-owned power utility, Guyana Power Limited (GPL), will operate the AFHP for 20 years, taking all the power generated. GPL will move to take full ownership of the project after that time.

The development and construction risk of the project was to have been borne by a subsidiary of the multinational group Sithe Global. However, Sithe Global withdrew from the project on 11 August 2013. The main problem was that the People's National Congress (PNC), the main party in the opposition coalition, did not support the project. In Sithe Global's words, this had been “a necessary prerequisite [for the AFHP] receiving international development funds required to complete it”.

In discussions with the IMF in relation to the September 2014 Article IV report, the government suggested that, “ongoing reforms and investment in the electricity sector will ensure that the AFHP remains economically and financially viable”. The government also noted the possibility that Sithe Global, which has a long track record of building and developing power stations, might re-engage.

In practice, the proroguing of parliament by President Donald Ramotar on 10 November means that it is very unlikely that progress will be made in discussions with Sithe Global (or other interested parties such as China Development Bank and the Inter-American Development Bank [IDB]) prior to the elections in May. We expect that this most important project will remain in limbo for some months to come.

The trajectory of investment spending and imports over the coming years will be determined to a significant extent by whether the government can get the AFHP back on track, and on what terms. Possible loss of access to Petrocaribe loans and declining remittances from expatriate Guyanese will complicate matters. The coming year will be a challenging year for Guyana's policymakers, regardless of the outcome of the forthcoming elections.

REGIONAL BUSINESS REVIEW

BRAZIL

Difficult times for OAS

OAS, one of Brazil’s top construction companies, failed to make US$16m in bond payments on 2 January, and was seeking to restructure its debts and asset holdings in an attempt to avoid a default.

The 2014/15 period is becoming a roller coaster ride for many of Brazil’s construction companies. At the peak of the ride, they received many large contracts associated with the 2014 World Cup and business boomed. Then came a crash – revelations that many were implicated in the big (and ongoing) corruption scandal involving Brazil’s state oil company Petrobras. It is not just a reputational issue: under existing Brazilian regulations, companies facing corruption allegations can be excluded from further public sector contracts. The scandal may also negatively impact the companies’ ability to issue bonds on the international market.

In November 2014, a group of construction company executives (including some employed by OAS) were arrested on charges of having formed a cartel to win contracts, including BRL59bn (US$23bn) from Petrobras, on which kickbacks were paid. In a press statement, OAS said it sought to operate with integrity and within the law, and would not comment further until the conclusion of the investigations.

The company is one of Brazil's largest contractors. It had a share of the work to build football stadiums for the World Cup in the cities of Natal, Salvador and Porto Alegre. It has been working on improvements to São Paulo's main airport (Guarulhos), and also has a contract to build the world's third-largest hydroelectric dam at Belo Monte, whose construction costs are put at upwards of US$13bn. Among various projects outside of Brazil it is building the US$1bn Point Fortin-San Fernando highway in Trinidad & Tobago.

Other civil engineering companies who had managers arrested included Camargo Correa, Engevix, Galvao Engenharia, Iesa, Mendes Junior, Queiroz Galvao and UTC-Constran. The news had an immediate effect on the bond markets. "The Petrobras bribery scandal is weighing on investor confidence in the country, which could make issues more costly or even prevent a deal" said Camila Abdelmalack from brokers CM Capital. Former Petrobras manager Paulo Roberto Costa, who emerged as a key whistle-blower inside the oil giant, suggested that kickback schemes are widespread. "What happened at Petrobras is occurring all over Brazil: in roads, railways, airports, ports and hydroelectric plants. It is a matter of investigating, because it is happening", he stated.

Then on 2 January OAS failed to make a US$16m coupon payment on its US$400m worth of bonds maturing in 2021. The bonds immediately slumped by 18 US cents to trade at 15 cents to the dollar of nominal value. A separate US$875m series of notes due in 2019 fell 22 cents to trade at 10 cents to the dollar. Company sources said that while it had the cash to make the payment, it was holding onto the funds prior to a wider attempt to restructure its obligations. Carlos Gribel of Andbanc Brokerage interpreted this as meaning that "they probably will skip future payment coupons as well". Two of the three international ratings agencies, Fitch Ratings and Standard & Poor's (S&P) both downgraded the company's credit rating.

Having failed to make the 2 January payment, OAS has a 30-day grace period before entering formal default, and indications are that it is seeking to get a restructuring agreed in principle before that expires. The *Bloomberg* news agency reported that the company was seeking a BRL2bn (US$760m) short-term loan to tide it over, which would be repaid with proceeds from asset sales. In particular, according to this source, OAS was proposing that the loan be backed by its 24.4% shareholding in Invepar, an airport and toll-road operator. To facilitate this, the Invepar holding had been transferred to a subsidiary unit, OAS Infraestrutura. But negotiations will be difficult. OAS was reported to have cash and liquid assets worth around BRL1bn (US$378m) at the end of December, but could face early loan repayment demands (triggered by a formal default) totalling BRL1.5bn (US$572m).

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How the company and the wider industry copes with this downturn in its fortunes will be of key importance to any hoped-for recovery in Brazil. The government believes that after a period of fiscal consolidation in 2015 economic growth will pick up. But it needs the construction companies to be healthy: part of making Brazil more competitive requires a continued major push in infrastructure investment. In this context, a new report from Fitch Ratings makes worrying reading. The report, by Alexandre García, notes: "More Brazilian construction companies are expected to default in the coming months, and numerous downgrades will likely occur. Accessing credit lines, receiving payments for completed projects and recognising claims related to contract amendments has become increasingly more difficult".

COLOMBIA

Peace, Love and *Facebook*

***Facebook* chief executive Mark Zuckerberg paid a flying visit to Colombia on 14 January, where he met President Juan Manuel Santos and launched a free Internet access service in an alliance with Tigo, a local mobile operator. While many responded positively to what they consider a serious initiative to reduce the 'digital exclusion' of Colombia's poor, others were more critical.**

It is widely agreed that extending mobile and Internet access in emerging economies, particularly to poorer communities, is positive for development and social inclusion. The Colombian government has been seeking to do just that. The ministry for information and communications technology (known as MinTIC) has a programme, Vive Digital, which aims to triple Internet connections from an estimated 8.8m at the end of 2014 to 27m by 2018. According to the International Telecommunications Union (ITU), in 2013 mobile penetration in Colombia had reached 104.08 (meaning there are more mobile telephones than members of the population) and Internet penetration had reached 51.7% (over half of the population has access to the web).

"Colombia will be the first country in Latin America and the fourth in the world (after Kenya, Zambia and Tanzania) to launch Zuckerberg's Internet.org service, which is designed to promote Internet access for the poor."

So President Juan Manuel Santos was more than happy to act as host for a flying visit to Colombia by *Facebook* founder Mark Zuckerberg, with whom he co-announced a new initiative that should help further boost connectivity. Colombia will be the first country in Latin America and the fourth in the world (after Kenya, Zambia and Tanzania) to launch Zuckerberg's Internet.org service, which is designed to promote Internet access for the poor. In the Colombian version, the service will be available to customers of the Tigo mobile operator using Android devices. Subscribers will get data-charges-free access to 12 internet services, including *Wikipedia*, job listings, health information and, of course, *Facebook* itself. Referring to entrepreneurs who might be interested in setting up a business, Zuckerberg, who noted that only 30% of the global population has access to the web (while about 85% have mobile phones), said that "by giving these basic tools for free, you're creating an equal playing field. Technology shouldn't just be for rich people who can afford it, but for everyone." He suggested that the service might be able to contribute to the Colombian peace process: "just giving people the tools of connectivity is important by itself in creating communication and a tighter social fabric in creating peace".

Tigo is Colombia's third-largest mobile operator, with around 8m subscribers, equivalent to a 15% market share (after Claro, which is owned by Mexico-based América Móvil and which has a 56% share, and Movistar, controlled by Telefónica of Spain, with a 24% share). Tigo is controlled by Millicom of Sweden, which is in the process of merging its local operation with fixed line operator Une – Empresas Públicas del Medellín (Une – EPM). Arguably, offering data-charge free access to some web services might be seen as giving Tigo an unfair advantage over its rivals. This has as yet elicited no adverse comment from the regulator, Comisión de Regulación de Comunicaciones (CRT), perhaps because Tigo is a smaller operator. CRC had earlier given the green light to the Millicom and Une-EPM merger, but only on condition that the new company should give back 50MHz of spectrum in the 2,500MHz band.

While Zuckerberg's initiative clearly has the support of President Santos, and is viewed by many as a genuine attempt to combat digital exclusion, it also attracted a degree of criticism. *Facebook* has has an estimated 22m

accounts in Colombia, and some see the initiative as a way of boosting them, and of increasing the associated advertising revenues. Costa Rican blogger Pablo Fonseca argued that "every time a new disruptive technology appears we think we've found a way for humanity to have a civilised conversation to resolve its problems and achieve peace". But, he went on, contrary to popular perceptions, neither the Internet nor *Facebook* had really caused the Arab Spring, nor would they solve Colombia's conflict ("both sides are meeting face-to-face and not on *Facebook Messenger*").

MEXICO

Ficrea struck down

While the Mexican financial system is broadly perceived as being in good shape, the collapse last November of Ficrea, a credit union, has raised a number of questions over regulatory weaknesses.

Regulators seized Ficrea in November after finding inconsistencies in its financial statements, and closed it down in December. It had MXN5.8bn (US$395m) worth of outstanding loans, almost all – 98% – made to a single company. As a credit union, rather than a bank, Ficrea came under a separate, and some would say more lax, regulatory regime. For example, credit unions have their own deposit insurance scheme, which guarantees deposits up to a value of MXN131,000 (US$7,738) only about a tenth of the guarantee in place for bank customers. Credit unions also offer higher interest rates on deposits, ranging up to 10% – three times the average offered by banks – and this has helped attract a big inflow of funds. Credit union assets grew 43% in the year to September 2014, reaching a total of US$7.7bn.

The suggestion, therefore, is that credit unions have found themselves at the riskier end of the spectrum and may be attracting less reputable operators. Certainly Ficrea seems to gave been the victim of outright fraud. According to Jaime González of Mexico's financial regulator, Comisión Nacional Bancaria y de Valores (CNBV), Rafael Olvera Amezcua, the majority owner of the credit union, diverted US$184m for his personal use. An arrest warrant for Olvera, whose whereabouts were unknown when the scandal broke, has been issued and circulated to Interpol. He is believed to have siphoned the money off through a number of companies he controls. Some press reports suggest that a network of up to 100 companies was involved. Only 42% of Ficrea's estimated 6,000-plus depositors will get their money back, officials say. Banco Santander of Spain, which is a trustee of the Mexico City Justice Administration Fund, has filed a MXN110m (US$7.5m) fraud complaint against Ficrea. The Fund invests on behalf of the City's judicial employees, and had deposited money with Ficrea.

"According to the CNBV vice-president, Gabriel Díaz, the collapse of Ficrea is the biggest fraud in Mexico's savings and loans sector since 1999."

According to the CNBV vice-president, Gabriel Díaz, the collapse of Ficrea is the biggest fraud in Mexico's savings and loans sector since 1999. He told news agency *Bloomberg* that the regulators initially had been concerned that the collapse could trigger a wider run on credit unions, however markets had remained free from contagion. Díaz said the Ficrea case should prompt regulatory changes, such as tighter asset-concentration regulations (to prevent lending primarily to a single entity). Meanwhile, deputies from the main left-wing opposition Partido de la Revolución Democrática (PRD) argued that the Ficrea collapse demonstrated the failure of regulation subsequent to last year's financial reforms. One of the deputies, Miguel Alonso Raya, said that both the CNBV and the Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros (Condusef) had "failed to alert the thousands of Ficrea victims in a timely manner".

Tough times for the automotive sector

It was a particularly challenging year for Argentina's automobile assembly plants in 2014, for many years considered to lie at the heart of the country's manufacturing sector.

According to the Asociación de Concesionarios de la República Argentina (Acara), the lobby group representing the country's retail vehicle sales outlets, only 683,485 cars were sold in 2014, a steep 28% fall on 2013 and the lowest level registered in the country since 2010. December sales were the worst of the year, at 29,167 units, a fall of 42% on year-earlier levels.

The decline in sales can be attributed to a variety of different factors. One is that the general macroeconomic health of the economy was poor in 2014. While final data is awaited, most analysts believe that real GDP was either flat or negative in 2014. Full year output is estimated to have dropped by 1.5%, according to the World Bank. But there were also a number of industry-specific factors. Following the maxi-devaluation in January 2014, the government slapped extra taxes on high-end cars. If that was a problem for demand, there have also been hold-ups on the supply side. During the year the government deployed a whole series of measures to try and preserve its scarce foreign currency reserves. Among others, it imposed a US$100m ceiling on monthly imports of components by the local automobile industry. Given that Argentine auto-assembly plants are quite closely integrated with the Brazilian industry, this caused major production bottlenecks.

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At the same time, in an effort to boost demand, the government also launched subsidised car-buying programmes, known as Procreauto I and II. The problem, say some analysts, is that the poorly coordinated combination of measures limiting production on the one hand, and boosting demand on the other, had contradictory but ultimately negative effects. Many car sales outlets found that when they had customers ready to buy, they did not have the cars to sell them. The government, for its part, accused the outlets of deliberately holding back vehicles to force increases in prices.

Acara president Abel Bomrad recognises, however, that the Procreauto programme did make a positive contribution: without it, things would have been worse. Of the mass-market manufacturers, the biggest losers were Renault (sales fell by 62.5% over the year), Citroen (down 60%) and Peugeot (down 49.5%), all hard hit because their ranges include more high-end, and therefore more highly taxed, models. Luxury cars sales were almost wiped out: Audi's sales were down 85%, while BMW's fell 81%. This year, cars worth over ARS241,500 (US$28,041 at the official exchange rate) now carry a 50% tax rate.

Dante Sica of a local consultancy, abeceb.com, says he expects car sales in 2015 to be of the order of 630,000 units (representing another annual contraction, of 7.8%). This being an election year, many expect that a new Procreauto financing plan will be launched. Lorenzo Sigaut, of the Ecolatina consultancy, says sales will still be held back by the scarcity of foreign currency. "Buying cars implies using up dollars and the government doesn't have many" he says. Sigaut adds that it is hard to see a liberalisation of automobile component imports "when we are expecting lower dollar revenues from commodity exports, a doubling of foreign debt maturities, and no net change in foreign currency reserve levels".

Correa secures over US$7bn from China

Ecuador secured an impressive US$7.5bn in new lending from China in early January.

Celebrating the deal, Ecuador's President Rafael Correa, who travelled to Beijing in early January with a delegation including his finance minister Fausto Herrero and 16 other cabinet ministers, said that Ecuador's relations with China were "an example for Latin America because their interest in investing in Ecuador shows that we have been efficient". Even if Correa's comment had no intent, it almost seemed like a sideways glance at the Venezuelan government, and indeed it was notable that President Nicolás Maduro did not seem to get such concrete financial commitments from his trip to China, immediately after the Ecuadorean delegation.

Notably, the main tranche of the new lending, a US$5.29bn Eximbank loan, comes on very favourable terms – at a 2% interest rate over a 30-year term. By way of comparison, Ecuador's US$2bn sovereign bond issue in June 2014, the first since the Correa-instructed default on US$3.2bn in bonds in December 2008, carried a coupon of 7.95%.

Funds
Finance Minister Herrero noted that some of the U$1.5bn from the Celac loan could be put towards the Quito metro. The new opposition mayor of Quito, Mauricio Rodas, who took office in May 2014, has been stuck in a major political row with the Correa government over funding for the metro project. Ahead of the 2017 general election in which both Correa and Rodas likely will face off each against each other, delivery of the project in the capital is in the electoral interest of both men.

Eximbank also signed off on a U$250m commercial loan in support of Ecuador's state-sponsored scheme to encourage consumers to switch from gas to electric induction ovens, while a US$1.5bn loan from the China Development Bank – again for strategic infrastructure projects – appears to correspond to 15% of a US$10bn Chinese credit line for the Community of Latin American and Caribbean States (Celac) due to be finalised this week at a China-Celac ministerial forum. Finally, the Bank of China agreed to US$480m for schools and infrastructure.

Separately, Ecuador is also awaiting disbursement of US$3.6bn in funding for the various hydro-electric plants being built in the country, which are due to come on stream from 2016 and are key to Correa's plans to slash domestic energy prices and free up oil for export.

Although the exact disbursement details of the new loans are not yet available, these funds will go some way towards Correa's pledge to ring-fence strategic investment despite the sharp impact on government finances of the downturn in oil prices. In contrast to Venezuela, dollarised Ecuador (it adopted the US currency in 2000 after a banking crisis), is unable to devalue and so has to rely on fiscal measures, the latest of which included a 4% cut in the 2015 budget to just under US$35bn. While Ecuador will suffer in 2015, it is in a better position than Venezuela. The central bank reported real GDP growth of 3.4% year-on-year and 1.1% quarter-on-quarter in the third quarter, and while this marks a continuing slowdown, it is in stark contrast to three consecutive quarterly contractions in Venezuela to Q3 last year.

Correa's protectionist attitude upsets his neighbours

Ecuador is struggling not only with lower oil prices but also with a strong US dollar, which damages its external competitiveness. The trade ministers of Ecuador and Colombia, Francisco Rivadeneira and Cecilia Álvarez-Correa respectively, met in Quito on 14 January in a bid to resolve a row over Ecuador's unilateral imposition of new import safeguards on its Andean Community (CAN) trade partners.

On 5 January Ecuador imposed a temporary levy of 21% on imports from Colombia and a 7% duty on imports from Peru by way of remedial action

Correa – eight years and going strong

President Correa marked eight years in office on 14 January. Correa celebrated the achievements made in education in particular and said that the government's focus now is on developing human talent, science, technology and innovation in the country. He insisted that he would not allow "the past to return", even if that meant staying on in office beyond 2017 (pending approval of a constitutional reform to allow for indefinite election). Ecuador was recently voted the best country in the world to retire to by *InternationalLiving.com*, getting 92.7 of a maximum 100 points for its warm climate, friendly people, affordable living costs and generous government retiree discounts for things like utilities, health care, public transport and airfares, among others.

for currency devaluations. In a statement, the external trade ministry said the measure was in response to the depreciation of the Colombian and Peruvian currencies against the US dollar, and was designed to restore trade competitiveness.

The statement noted that the Colombian peso had depreciated by 25% against the dollar in the second half of 2014, to Col$2.34:US$1, while Peru's nuevo sol had weakened by 5.4% in the same period, to PEN2.79:US$1. A stronger US dollar makes Ecuador's exports less competitive, while imports become cheaper (and import demand rises, as Ecuadoreans' purchasing power increases).

In reaction to immediate complaints by Colombia and Peru about the unilateral measure, which they said they had not been consulted about in advance, the CAN's general secretariat (SCCA in the Spanish acronym) insisted that it should fall to the CAN to determine whether "normal conditions of competition" had been altered to an extent that justified remedial measures. The SGCA said it would review the situation from 6 January. In a tart response, Ecuador replied that it had in fact sent the case to the CAN as an emergency matter on 24 December, and had proceeded to impose the measure after the CAN failed to respond within a statutory seven-day period (which, of course, happened to coincide with the Christmas holidays).

Rivadeneira and Álvarez-Correa admitted that the talks were difficult but said the two sides were looking for a 'win-win' solution. Rivadeneira said Ecuador was proposing to cut its safeguards on Colombian goods to 17.4%, and to exclude certain categories of raw materials, intermediate inputs and consumer goods. He admitted that Colombia was pushing for the tariff to be slashed to 7%. However, both ministers were keen to stress that talks were fluid, with concern on both sides to come to a mutually acceptable resolution.

Following similar talks with Peru's external trade minister Magaly Silva, on 27 January Ecuador's external trade committee, Comité de Comercio Exterior (Comex), which sits under the trade ministry, announced the exclusion of 160 items from the tariff list. Luis Alberto Salvador, vice president of Guayaquil's chamber of industries, said that the Comex decision would avoid additional costs for local manufacturers, who complain that the government's import substitution policies – ostensibly designed to help develop a domestic industrial base – has sometimes hurt rather than helped them.

Ecuador-CAN trade

According to Ecuador's central bank, Ecuador registered a trade deficit with Colombia of US$968.1m in January-October 2014, on exports of US$784.3m and imports of US$1.8bn. However, that deficit was actually lower than in the same period of 2013 (US$1.1bn), reflecting lower imports from Colombia last year (exports rose slightly). In the same period, Ecuador ran a trade surplus of US$583.5m with Peru, on exports of US$1.4bn and imports of US$807.3m. However, that surplus was down by 19% year on year, on lower exports to Peru (imports also fell).

Ecuador insists that its trade policies seek to maintain adequate domestic dollar liquidity. The latest row follows earlier disputes, including Quito's imposition of new labelling rules on imports a year ago. The country registered a moderate trade surplus of US$148.2m in the first 10 months of 2014, a turnaround from a deficit of US$1.2bn in the same year-earlier period, on exports of US$22bn and imports of US$21.9bn. Despite these relatively positive trade figures, with the US dollar continuing to strengthen and oil prices yet to find a price floor, the Correa administration is likely to continue to rely upon protectionist measures, risking continued spats with its next-door neighbours.

Truckers deal at last

> "According to US Department of Transportation figures for 2013, 66% of annual two-way trade between the US and Mexico, some US$335bn, is handled by trucks."

It took 21 years after the signing of the North American Free Trade Agreement (Nafta) but Mexican truckers will soon be able to operate in the US rather than having to unload their cargo at the border to be taken on to its destination in US trucks. Under the 1994 Nafta treaty, Texas, California, New Mexico, and Arizona were meant to be opened up to Mexican trucks by December 1995 and all constraints on their free circulation lifted by 2000. But, invoking fears about low Mexican compliance with safety and environmental standards, the US Teamsters union won support from protectionist politicians in Congress to prevent the liberalisation of the US road haulage market. The policy change should sharpen Mexico's competitive edge in its capacity to make goods available to the US supply chain.

The US Transportation Secretary, Anthony Foxx, confirmed on 15 January that the country had begun accepting applications from Mexican trucking companies seeking authorisation for long-haul, cross-border transportation under Nafta. "Opening the door to a safe cross-border trucking system with Mexico is a major step forward in strengthening our relationship with the nation's third largest trading partner, and in meeting our obligations under Nafta," Foxx said. The Mexican communications and transport ministry (SCT) celebrated the announcement, saying that it would contribute to the creation of "a modern, agile, efficient border, at the same time as strengthening the productive integration of Mexico and the US".

According to US Department of Transportation figures for 2013, 66% of annual two-way trade between the US and Mexico, some US$335bn, is handled by trucks. The change is likely to lower the cost of Mexican products in the US and cut the time taken to deliver them. The previous system, which involved Mexican trucks delivering to warehouses just inside the US border, where the goods were then transferred to US trucks for the onwards journey across the US, added between 3% and 5% to delivery costs.

The policy change will also bring a definitive end to tariffs worth some US$2.3bn a year levied by Mexico on US goods and agricultural products under a favourable ruling by a Nafta dispute settlement panel in 2001. Mexico first applied these in 2009 after a pilot programme launched by the administration of President George W Bush in 2007, enabling 25 Mexican carriers to operate 100 trucks within the US, was halted prematurely. The Mexicans suspended 50% of these tariffs after another pilot programme began in 2011. Involving 15 Mexican trucking companies crossing the border more than 28,000 times, and undergoing more than 5,500 safety inspections by US officials, this programme concluded last October. Foxx said that data from the programme had "proved that Mexican carriers demonstrate a level of safety at least as high as their American and Canadian counterparts".

The Teamsters union was ostensibly motivated by a concern that Mexican trucks were subject to inadequate regulation and that their drivers had poor safety records. The data collated through the pilot programme disproves this argument which was always spurious anyway because Nafta requires Mexican truckers to be certified, along with their companies, and held to the same safety and pollution standards as US trucks. In fact Mexican long-haul trucking companies wanting to operate in the US will now have to pass a safety audit and their trucks a rigorous safety inspection every 90 days for at least four years.

Big uptake?

The Teamsters Union's fear of a big increase in competition might not be realised. While being forced to offload goods to warehouses just inside the US border for US trucks to take onwards added time and money to Mexican deliveries, the long wait crossing the border due to congestion and security checks has meant that several Mexican long-haul trucking companies have been reluctant to send their top trucks to the US just to sit in a queue. Anything other than a top truck, however, is unlikely to pass the rigorous US safety audits and inspections.

TOURISM REVIEW

CARIBBEAN

Stagnating in the sun

In many of the Caribbean countries most dependent on tourism, activity has been stagnating (or worse) over recent years. Unfortunately, there is no sign that conditions are likely to improve – and this is at a time that economies in the sub-region are growing very slowly – if at all.

Travel and tourism matters a lot in many of the economies of the Caribbean sub-region, as **chart 1** highlights. According to a Working Paper released by the International Monetary Fund (IMF) in December last (14/229, '*Revisiting Tourism Flows to the Caribbean: What is Driving Arrivals?*'), Anguilla is the economy in the sub-region most dependent on tourism. Tourism receipts there amount to 37% of GDP. In 10 other economies, including Jamaica, the Bahamas and Barbados, the corresponding figure varies between 13% and 27%. In the Dominican Republic, a crucial tourist destination on a number of metrics, the corresponding figure is 8%.

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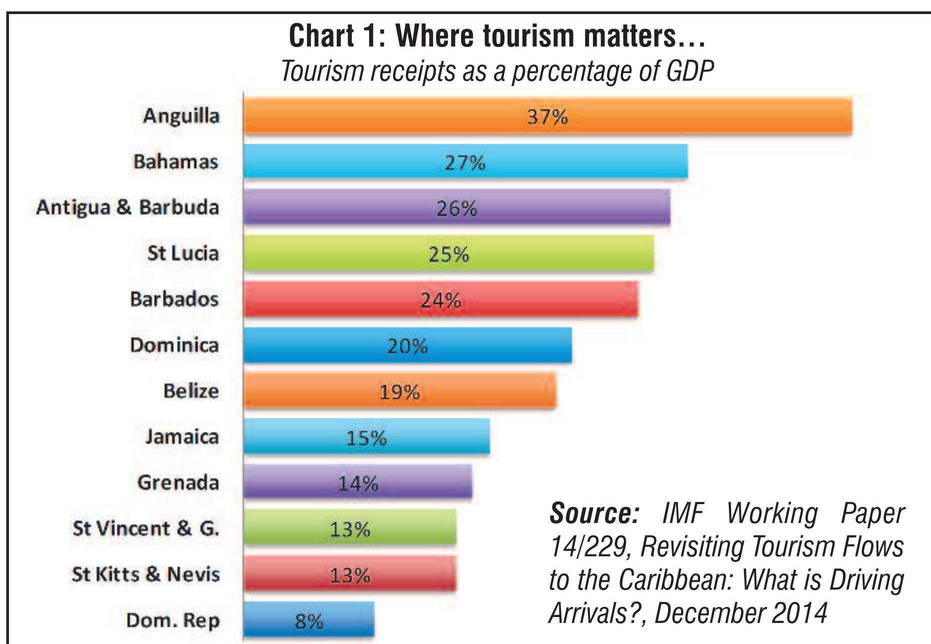
This measure of the importance of tourism is a fairly narrow one. Using the broader definition of the impact of the travel and tourism sector favoured by the World Travel and Tourism Council (WTTC), which takes into account the direct and indirect impacts on the overall economy, it accounted for nearly 43% of the GDP of Barbados in 2012, for instance.



As the IMF's Working Paper indicates, tourism in the Caribbean suffered in the wake of the Global Financial Crisis of 2008-09 due to the sharp rise in unemployment in the US and the UK. As **chart 2** (*overleaf*) shows, the fortunes of tourism sectors have varied quite markedly from economy to

economy over recent years – in terms of both international tourist arrivals and international tourist receipts. Destinations in the Dutch Caribbean – such as Aruba, Sint Maarten and Curaçao – benefited from good growth in terms of both metrics in 2010-2012. The same was true of the Dominican Republic and Cuba. However, these economies were the exception rather than the rule.

Chart 2: Travel and tourism markets in the Caribbean: Selected data

	International Tourist Arrivals ('000)			International Tourist Receipts (US$mn)		
	2010	**2011**	**2012**	**2010**	**2011**	**2012**
Anguilla	62	66	65	99	112	113
Antigua & Barbuda	230	241	247	298	312	319
Aruba	825	869	904	1,253	1,353	1,404
Bahamas	1,370	1,346	1,422	2,163	2,279	2,393
Barbados	532	568	536	1,034	963	916
Bermuda	232	236	232	442	466	454
BVI	330	338	351	389	388	397
Cayman Is.	288	309	322	485	491	
Cuba	2,507	2,688	2,815	2,187	2,283	2,326
Curaçao	342	390	420	385	453	
Dominica	77	76	78	95	113	110
Dom. Rep.	4,125	4,306	4,563	4,209	4,436	4,736
Grenada	110	118	112	112	117	110
Guadeloupe	392	418		510	583	
Jamaica	1,922	1,952	1,986	2,001	2,008	2,070
Martinique	476	495	487	472	516	462
Montserrat	6	5	5	6	5	5
Puerto Rico	3,186	3,048	3,069	3,211	3,143	3,193
St. Lucia	306	312	307	309	321	335
St. Kitts & Nevis	98	102	104	90	94	94
St Maarten	443	424	457	674	719	842
St. Vincent & G.	72	74	74	86	92	93
Trinidad & T.	388	402		450	472	
Turks & Caicos	281	354	299			
USVI	590	532	580	1,013		
Source: *UNWTO Tourism in the Americas - 2013 Edition*						
NB ITA 2012: Americas +4.6% North America +4.5% Carib.+3.7% CA +7.3% SA +5.0%.						
NB ITA 2013 Americas +4% North America +4% CA +4% SA +2% Carib. 1% (per Annual Report of UNWTO for 2013)						
NB Subtotals	19,190	19,669	19,435	21,973	21,719	20,372
BIG FIVE do pr cu jm bs	13,110	13,340	13,855	13,771	14,149	14,718

The IMF notes that, in terms of overall international arrivals, the Caribbean share of the global market slipped from about 2.5% in 2000 to just under 2.0% in 2013. Over the same period, the market share of South American countries rose from a little over 2.0% to 2.5%. North America's market share dropped from almost 14% in 2000 to just over 10% in 2007, but has essentially stabilised since then. Other sources also confirm that the Caribbean's economies have been losing market share to other parts of the Americas. According to the World Travel Organisation (UNWTO), international tourist

arrivals in the Americas grew by 4.6% in 2012 and by 4.0% in 2013. The corresponding figures for the Caribbean was 3.7% and around 1%.

As **chart 2** shows, the various economies vary markedly in terms of the absolute sizes of their travel and tourism sectors. In terms of the number of international arrivals (4.6m in 2012) and international tourism receipts (US$4.74bn), the Dominican Republic is the most important national market in the Caribbean. In terms of the number of international arrivals, the next most important markets are Puerto Rico, Cuba, Jamaica and the Bahamas. These are also the five most important markets in terms of international tourism receipts. However, receipts per inbound tourist are higher in Bahamas than elsewhere. In 2012, total receipts in the Bahamas amounted to US$2.4bn, or more than in Cuba (US$2.3bn) or Jamaica (US$2.0bn). This was despite the fact that the number of arrivals in the Bahamas that year was about half that of Cuba and less than three quarters than the number of arrivals in Jamaica.

In terms of both the number of arrivals and receipts, the five large markets gained market share relative to the smaller markets in the Caribbean. Data compiled by the Eastern Caribbean Central Bank (ECCB) for the eight countries of the Eastern Caribbean Currency Union (ECCU – Anguilla, Antigua & Barbuda, St Lucia, St Kitts & Nevis, St Vincent & the Grenadines, Montserrat, Dominica and Grenada) reveals a depressing picture in the smaller markets. As **chart 3** (*overleaf*) shows, the total number of visitors peaked at nearly 4m in 2009, and has since been falling steadily. This is in spite of the economic recovery in the US (in particular) and the UK, and appears to be due to a decline in the number of cruise ships visiting the ECCU countries and, therefore, seaborne arrivals.

In 2008, the number of visitors arriving by air and then staying for one or more nights was 1.047,877. In 2013, it was 1,004,616. The number of such visitors flying in from the US increased from 375,575 to 401,803. The number of Canadians grew strongly, rising from 66,927 to 96,943. However, this growth was not sufficient to offset a decline in visitors from other countries. The number of airborne visitors from the UK slumped from 246,433 in 2008 to 193,178 in 2013. Ominously, spending per visitor in 2013 was lower than in 2007.

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In short, it seems reasonable to suggest that currency movements – and, in particular the rise in the US dollar and other regional currencies linked to it – has taken its toll. As a part of its December 2014 Working Paper, the IMF constructed a 'Week at the Beach Index'. This measure examined a basket of typical expenditures during a beach holiday. Spending is assumed to include: (1) the average room rate in a three star hotel (as rated by one tour operator); (2) the average taxi fare from the airport to the hotel; (3) two inexpensive meals and one mid-price meal; and (4) beverages – a two litre bottle of water, one imported beer and one coffee per day.

The IMF found that, in terms of this index, the average nominal costs of a holiday in the Caribbean are higher than in other regions of the world. Calibrating the index so that Bahamas = 100, the average cost across all the Caribbean destinations considered was about 80. The only destinations in which the index was significantly lower than the regional average (at about 60) were Dominica, Belize, the Dominican Republic, Curaçao and Puerto Rico Across 13 other destinations outside the Caribbean – Seychelles, Spain (Barcelona), Miami, Mexico (Cancun), Cape Verde (Praia), Mauritius, Fiji, Maldives, Nicaragua (Managua), Bali (Uluwatu), Malaysia (Penang), Gambia (Banjul) and Thailand (Phuket) – the average cost was about 45. Only the first four named non-Caribbean destinations had costs that were significantly above this level. The Seychelles (with a cost index of over 80) was far more expensive by this measure than the other non-Caribbean destinations considered.

The IMF reached a number of other conclusions. "Relatively higher costs in the Caribbean region suggest that the level of product and service quality is

critical when competing with low cost destinations in other regions". There appears to have been a 'Caribbean premium' since 2007 (if not before). Many of the more costly destinations (e.g. the Bahamas) are geographically closer to the US. Any gains that might have been available from lower travel costs appear to have been absorbed by airlines and package tour operators or somehow lost over time in the destination country.

Chart 3: Eastern Caribbean Currency Union (ECCU) countries:Selected travel data - 2000-2013

	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total Visitors[1]	2,672,676	3,037,648	3,096,444	3,577,705	3,651,204	3,975,881	3,864,592	3,775,446	3,467,965	3,454,187
Stay Over Visitors[2]	894,764	1,048,911	1,076,536	1,048,498	1,047,877	925,264	951,846	986,196	991,804	1,004,616
Stay-Over Visitors By Air	871,621	1,048,911	1,076,536	1,048,498	1,047,877	925,264	951,846	986,196	991,804	1,004,616
USA	n.a	375,246	392,911	379,661	375,575	329,044	370,340	378,112	385,630	401,805
Canada	n.a	49,530	53,473	54,382	66,927	66,169	75,358	83,358	90,562	96,943
UK	n.a	230,857	227,071	251,660	246,433	201,183	189,449	201,479	201,242	193,178
Caribbean	217,635	304,083	309,153	255,706	257,652	232,077	215,759	219,344	208,101	207,953
Other Countries	113,575	89,195	93,928	107,089	101,290	96,791	100,940	103,903	106,269	104,737
Excursionists	119,147	112,052	122,580	115,366	86,423	72,837	77,909	80,654	89,381	102,115
Cruise Ship Passengers	1,543,301	1,723,084	1,739,100	2,301,876	2,406,808	2,868,562	2,705,962	2,581,320	2,252,860	2,211,376
Yacht Passengers[3]	115,464	153,601	158,228	111,965	110,096	109,218	128,875	127,276	133,920	136,080
Number of Cruise Ship Calls	1,710	1,501	1,679	1,728	1,464	1,673	1,585	1,537	1,462	1,484
Total Visitor Expenditure[4] / (US$ mn)	920	1,143	1,140	1,201	1,182	1,061	1,093	1,158	1,163	1,194

Source: *Tourist Boards, Central Statistics Offices, ECCU and ECCB*

Data as at 24 November 2014

N.A. means not available

1 Includes stay over by sea for Antigua and Barbuda which not available monthly. Summation of Monthly therefore is not equal to the annual data.

2 Stay Over visitors by Sea for Antigua and Barbuda are available only annual from 2000 to 2004. No monthly data are available.

3 Yacht passengers excludes Montserrat for 2000 to 2003 and excludes Dominica from 2000 to 2004. Yacht passengers for Grenada are estimated for 2012 and 2013

4 Visitor Expenditure are ECCB's estimates

The World Economic Forum (WEF) examined the travel and tourism (T&T) competitiveness of 140 countries globally in a report in 2013. Caribbean countries in the study included Barbados, the Dominican Republic, Jamaica, Puerto Rico and Trinidad & Tobago. Because of the importance of the energy industry (especially) in Trinidad, Trinidad & Tobago was rated as 117th in terms of its prioritisation of travel and tourism. In terms of its affinity for travel and tourism, that country was rated at 133rd. Obviously, travel and tourism is much more important for the other countries. Barbados was rated as having the second highest affinity for tourism of all countries considered globally. The details are shown in **chart 4**.

Three aspects of the data in the chart are worth noting. The first is that none of the five countries have really been gaining ground since 2009 in terms of their global competitiveness as travel and tourist destinations. Barbados' position in the overall rankings improved by two places to 27th overall, out of 140. Puerto Rico's position improved in the two years to 2011, but then deteriorated. There have been marked falls in the competitiveness of the Dominican Republic and Jamaica. The second is that none are particularly price competitive – which is consistent with the general conclusions reached by the IMF. Finally, the various aspects that contribute to the overall travel and tourism competitiveness rating vary quite markedly between the various countries.

Chart 4: Travel & tourism competitiveness of selected countries - as the World Economic Forum sees it

	Barbados	Dom. Rep.	Jamaica	Puerto Rico	Trinidad & T.
T&T Economy GDP US$mn, 2012*	1,815	8,706	3,992	6,510	1,938
and as percentage of total GDP	42.7	14.7	25.7	6.4	7.2
T&T Employment (1,000 jobs)	60	555	285	62	58
and as percentage of total	41.9	13.6	23.8	5.5	9.5
2013 T&T Comp. Index Rank/140	27	86	67	52	83
2011 T&T Comp. Index Rank	28	72	65	45	79
2009 T&T Comp. Index Rank	29	67	60	53	84
Rankings:					
T&T regulatory framework	13	67	59	40	103
Policy rules	41	51	20	19	30
Environmental sustainability	27	106	98	16	138
Safety & security	32	111	95	62	105
Health & hygiene	28	85	92	68	74
Prioritisation of T&T	8	9	7	41	117
Business environ't & infrastructure	18	75	64	43	54
Air transport infrastructure	32	59	63	40	56
Ground transport infrastructure	9	71	45	32	34
Tourism infrastructure	26	70	59	41	77
ICT infrastructure	19	85	92	62	61
Price Competitiveness in T&T	113	104	95	79	13
T&T human, cultural & natural res.	50	108	87	81	95
Human resources	23	85	84	47	74
Education & training	22	103	80	44	49
Availability of qualified labour	43	39	82	59	102
Affinity for T&T	2	36	27	30	133
Natural resources	133	130	80	104	75
Cultural resources	50	100	108	92	69

*Broadly defined, including direct and indirect impacts

Source: *World Economic Forum, The Travel & Tourism Competitiveness Report 2013*

The stagnation of the travel and tourism sectors in many of the Caribbean economies, and their loss of competitiveness in a global context would not necessarily matter if other sectors were likely to expand rapidly. Unfortunately, there is no sign that this is the case. According to data published by the UN's Economic Commission for Latin America and the Caribbean (ECLAC) in late 2014, the Caribbean sub-region achieved real

annual GDP growth of less than 2% in each of 2012 and 2013, and GDP was likely to expand by just 1.9% in 2014 as a whole. ECLAC is looking for 2.2% growth in 2015. The rates would have been lower in 2012 and 2013 but for the performance of energy-rich Trinidad & Tobago. The performance of the region has also been boosted by the growth of Suriname and Guyana, two economies in which travel and tourism is relatively unimportant. **Chart 5** shows the details.

In short, it is difficult to see how the travel and tourism dependent economies of the Caribbean can gain momentum unless and until there is a sharp fall in the US dollar relative to the Euro and the currencies of most emerging markets outside the sub-region. Given the relative strength of the US economy and the end of quantitative easing by the Federal Reserve through 2014, this outcome appears unlikely. In the coming months, the normalisation of relations between the US and Cuba is something of a wildcard. Cuba may attract additional tourists from the US and other places) who may otherwise have considered other destinations in the sub-region.

Chart 5: Real GDP growth rates of selected countries

With forecasts from ECLAC

	2012	2013	2014e	2015e
Antigua & Barbuda	4.0	-0.1	2.7	2.5
Bahamas	1.0	0.7	2.3	2.8
Barbados	0.2	0.3	0.0	1.2
Belize	3.8	1.5	3.4	2.1
Dominica	-1.4	-0.9	1.1	1.3
Grenada	-1.2	2.4	1.3	1.7
Guyana	4.8	5.2	4.5	4.2
Jamaica	-0.6	0.6	1.2	1.6
St Kitts & Nevis	-1.2	4.2	2.8	3.9
St Lucia	-1.6	-0.4	-1.4	0.5
St Vincent & G.	1.2	1.7	2.2	2.4
Suriname	3.0	2.9	3.5	3.6
Trinidad & T.	1.2	2.6	1.8	1.9
Caribbean Sub-region	1.0	1.4	1.9	2.2

Source: *ECLAC, Preliminary Overview of the Economies of Latin America and the Caribbean, 2014*

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