Canning House

LatAm Outlook 2020

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Introduction

Beatriz Araujo, Chair, Canning House

Welcome to the first edition of the Canning House Latin American Outlook!

The Canning House LatAm Outlook is a forward-looking overview of the fundamental forces shaping Latin America's political, economic, social and business environment over the next five years and beyond – examined through the lens of the region's six largest economies: Brazil, Mexico, Argentina, Colombia, Chile and Peru.

The LatAm Outlook is principally aimed at businesses wrestling with decisions about whether or not to trade, invest or offer services to these countries, and to those businesses already invested who are seeking to stay resilient in the face of potential changes. However, its insights will also be of considerable value to government ministers and parliamentarians, policymakers and regulators, opinion-formers, think-tanks, media representatives, students and academics whether in the UK, EU, USA, Asia or Africa – in fact, wherever there is interest or potential interest in the region - even, we would suggest, in Latin America itself.

Canning House has been successfully dedicated to the promotion of understanding and relationships with Latin America for over 75 years. Part of our longevity is due to the dedication of successive teams at Canning House itself; the rest is explained by our unparalleled links with expert partners.

Canning House is particularly proud to have as its LatAm Outlook partners the Financial Times's Latin America editor Michael Stott, Ipsos, Itaú Bank and Control Risks. Each of them has contributed their immense expertise - on political and social trends, economic and financial developments, security and corruption risks - to the scenarios which we have considered and evaluated jointly.

Canning House's intention is to refresh and publish The LatAm Outlook at least annually. We welcome feedback on further countries, sectors and themes that our audiences would like us to examine in depth for future editions.

Biographies

Cristina Cortes, CEO, Canning House

A commercial director with international experience in government, finance and energy. 30 years' expertise in strategy, business development, government relations, commercial negotiations and financial management. Her career as Commercial Director with BP included international business development, acquisitions and divestments, joint venture management, government relations, and commercial negotiations with a wide range of businesses and governments. Of Anglo-Brazilian descent, Cristina speaks English, Spanish and Portuguese and has lived and worked in Europe, the USA and extensively in Latin America.

For over 75 years, Canning House's Mission has been to build understanding and relationships between the UK, Latin America & Iberia. We are the UK's leading forum for contacts, thought-leadership and pragmatic debate on Latin American political, economic and social trends and issues, and business risks and opportunities.

Michael Stott, Latin America Editor, Financial Times

Michael Stott is the Latin America Editor of the Financial Times based in London and has reported from more than 60 countries in more than three decades as a foreign correspondent and news executive. He covered Latin America between 1990-1998, living in Brazil, Colombia and Mexico. Michael graduated from Cambridge University with an MA in Modern Languages and speaks fluent Spanish, Portuguese, French, German and Russian.

The Financial Times (FT) is an English-language international daily newspaper owned by Japanese company Nikkei, Inc., headquartered in London, with a special emphasis on business and economic news. The paper was founded in 1888 by James Sheridan and Horatio Bottomley, and as of the fourth quarter of 2019, digital circulation was 916,000 subscribers and print circulation another 174,000 subscribers, making a total of 1.09 million.

João Pedro Bumachar Resende, Senior Latin America Economist, Itaú Unibanco

João Pedro Bumachar Resende is responsible for covering Latin American economies at Banco Itaú. He holds a Business Management degree from FGV-SP (2003) and a master's degree in Economics from PUC-RJ (2006). He worked in the economics department of Banco BBM for two years before joining Unibanco, also in the economics department, in October 2008.

Itaú BBA is Latin America's largest Corporate & Investment Bank and is part of the Itaú Unibanco group, one of the world's largest financial conglomerates. It is the 10th largest bank in the world by market value, and is listed on the São Paulo and New York stock exchanges.

Alex Grönberger, CEO Latin America, Ipsos

Originally from Argentina, Alex was educated at Pontificia Universidad Católica Argentina, Santa María de los Buenos Aires. His brand and marketing expertise was initially honed at Unilever where he spent 10 years managing various brands across Argentina, Colombia and the United States. He joined Ipsos in 1995 as a partner and founder of Ipsos Advertising Research in Latin America, building advertising research specialist teams in Argentina, Brazil, Mexico, Colombia, Venezuela and Chile. His work in Latin America helped drive Ipsos ASI to the leading position in the region.

Ipsos is a leading global survey-based market research company founded in 1975, owned and managed by research professionals. Ipsos helps interpret, simulate, and anticipate the needs and responses of consumers, customers, and citizens around the world. It is the world's third largest research agency, and has offices in 88 countries, employing 16,530 people.

Oliver Wack, Partner, Control Risks

Oliver is a Partner for Control Risks' Global Risk Analysis team for the Americas. In this position Oliver leads a team of risk analysts and consultants whose focus areas include the development of corporate market-entry assessments, sector risk analysis, stakeholder mapping and other tailored risk analysis and consulting work across North and South America.

Control Risks is a global specialist risk consulting firm that helps clients create organisations that are secure, compliant and resilient in an age of ever-changing risk and connectivity. Its experts across 36 offices help clients investigate wrongdoing and resolve crises, and provide the insight and intelligence companies need to realize opportunities and grow.

Overview

Cristina Cortes, CEO, Canning House

Nothing happens in a vacuum. We cannot assess, let alone anticipate, risks unless we have a good understanding of the factors driving them. Business conditions are driven by economics which in turn tend to be governed by political forces; the latter are the result of (often not clearly articulated) social pressures which, in their turn, are deeply influenced by culture and history. If you have a good grip on all these inter-related forces, then very few things should come as a complete surprise. The best antidotes to risk are research and understanding.

The Canning House LatAm Outlook seeks to get beneath superficial headlines to what is really going on in Latin America. It addresses fundamental questions such as:

- What are the forces shaping Latin America's social, political, economic and business environment?
- What are the likely impacts on society, government policies and economic development, and trade and investment?
- What are the resulting risks and uncertainties facing the major countries of interest to businesses and investors?

In the process, the report and its associated events will seek to address questions such as:

- Where is populism headed for in Latin America?
- Will growth return to the Region?
- Will President Bolsonaro's structural reforms be sufficient to revive Brazil?
- What are the prospects for AMLO's "Fourth Transformation" of Mexico?

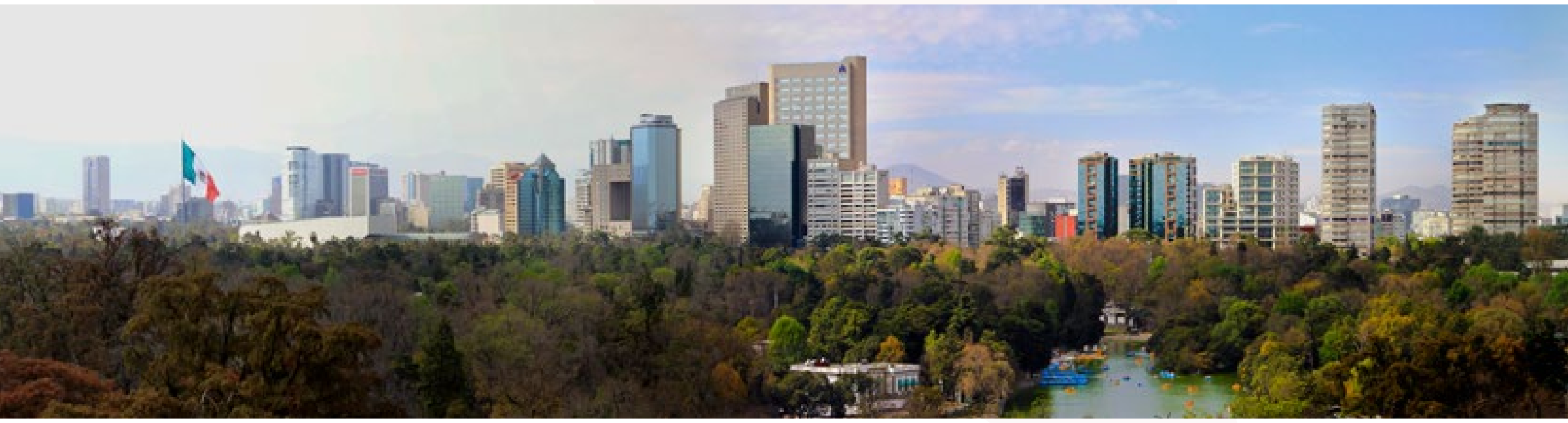
We will also consider what forces - or surprises - might knock current trends off-course.

Most of the focus will be on the next five years. However, because there are strategic structural issues impacting the region which will take more than one presidential or congressional term to fix, we have dared to look further and consider mega-trends out to a 10-year horizon.

This first Canning House LatAm Outlook focuses on the six major countries - Brazil, Mexico, Argentina, Colombia, Chile and Peru. Wider Regional developments are considered through the lens of their impact on those countries. Similarly, developments in the wider world – e.g., emanating from the USA or China – are also looked at in terms of their impact on "the big six".

The rationale for this focus is that these are the countries that businesses have told us and our partners that they are predominantly interested in. No value judgements are implied as to the intrinsic importance of other countries; nor does it imply that there are not perfectly good individual business opportunities to be found elsewhere in LatAm.

Some might be disappointed that, in this first edition, we have not drilled down into specific business sectors – e.g., renewables & sustainable development, oil & gas, food & drink - or into further themes such as sustainable development or gender issues and violence. This is, in part, because they are already covered in other parts of Canning House's 2020 programme; it is, however, our firm intention to add chapters (and corresponding expert partners) from year to year as our LatAm Outlook develops.



Introductory Highlights

The Region is, and is likely to remain, heterogeneous – the LatAm label is effectively a simplifying fiction. The history of similar languages, shared histories and cultures is no longer a sufficient practical guide to future trends and developments of the major countries. Indeed, the future might ultimately come to demonstrate that some of the countries labelled as LatAm will have more in common with the US, EU, UK or Asia-Pacific than with one another.

We have therefore tried to be very careful to distinguish between the genuinely common factors and those that differentiate them.

Broadly common issues faced by the six countries include:

- Continued vulnerability to commodity markets (agriculture, extractives) - albeit to a lesser extent for Mexico with its manufacturing base
- Acute exposure to climate change and associated sustainability pressures – e.g., agriculture, forestry – alongside the potential to lead the climate change agenda through environmental initiatives (at COP26 and beyond)
- Exposure to US protectionism and trade 'punishments' (most immediate for Mexico), to Chinese growth (especially for Chile and Peru) and the potential fallout from US-China trade spats
- Severe inequality and under-investment in human capital dating back centuries - not easy to remedy in a timescale that meets popular expectations. Combined with fragmented politics and voter disillusion with elites, this means that popular protests orchestrated through social media can be expected to continue in several countries; and, albeit they might not bring down more governments, they will restrict the scope for fiscal austerity intended to strengthen public finances
- The rise of populism (in common with US, UK, parts of EU) of both left-wing and right-wing varieties – adding to traditional institutional weaknesses in Congress and the judiciary
- Endemic corruption, violence & insecurity.

Factors that differentiate them include:

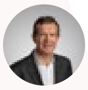
- Inherited economic conditions – debt, inflation, size of the public sector, size of the informal sector (including drug money)
- Government responses to recent and ongoing social tensions and public protests
- Diligence and effectiveness of the response to public demand to weed out corruption and bring down violence and crime
- Commitment to democratic processes not just at home but in the Region (e.g., with respect to Venezuela)
- Commitment to structural reforms to reduce dominance of the public sector and increase productivity (pensions, labour laws, tax incidence, bureaucracy)
- Investment in human capital (education, business training)
- Impact and management of migration (especially Central American and Venezuelan).

Of particular concern to businesses and investors are:

- The balance struck between, on the one hand, fiscal responsibility in terms of fiscal and trade balances, reserves and international debt and, on the other hand, the reduction of inequality by lifting people out of poverty, stopping the middle classes sliding backwards and averting street protests
- Openness to trade and foreign investment - not just an eagerness to sign Free Trade Agreements, but also fair tender processes and reduced bureaucratic red tape
- Transparency, consistency in the fight against corruption, and good governance in both the public and private sectors
- The active influence that these countries could, even should, exercise in the wider world – not just with respect to seeking OECD membership but also with respect to participation or even leadership of COP26 and Sustainable Development Goals (SDGs).

We will be examining all of the above factors in the chapters that follow – and in the debates that we hope this LatAm Outlook will engender at our associated events.

Political Outlook



Michael Stott, Latin America Editor, Financial Times

Regional Trends

Economic Stagnation

A persistent hangover from the end of the commodities boom defines regional politics; populations are dissatisfied with stagnant growth and deteriorating living standards. Economic growth in the past five years was the worst across Latin America since WW2, averaging just 0.4%. In the largest economy, Brazil, growth was the worst in a century. Demands for more welfare from populations are clashing with the need for structural adjustment to shaky government finances. There is little prospect of another commodities boom in coming years; indeed slowing Chinese growth and growing moves to limit fossil fuel use are more likely to keep prices weak. To escape this vicious circle, Latin American economies will need to invest heavily in the industries of the future - particularly in technology and renewable energy – and in better infrastructure and technical education.

Populism

Given the scale of popular discontent and the size of the economic challenges, it is no surprise that populist leaders govern Latin America's top three economies (Jair Bolsonaro of the right in Brazil, Alberto Fernández in Argentina, and Andrés Manuel López Obrador (AMLO) from the left in Mexico) and populist outsiders may present a strong challenge to presidential candidates in Colombia, Peru and Chile in 2021/22. Incumbent leaders face big challenges: stagnant living standards, a perception of deep societal unfairness and inadequate social safety nets. The traditional left-right divide has broken down in much of the region and anti-establishment insurgents are benefiting.

The New Middle Class: Better-Educated But Still Precarious

The strong growth seen during the first decade of this century helped to reduce poverty sharply and create a much larger middle class in most of the region's major nations. Far more citizens than before have access to university education and to opportunities to travel. This new expanded middle class, however, is anxious because it is not yet economically secure. It has seen progress in improving living standards halt in recent years and now fears falling back into poverty.

Mass Protests

The uncertain economic outlook, coupled with much higher expectations, means mass protests are set to continue in the Andean nations in particular and may spread to Mexico and Argentina if their leaders fail to meet voters' expectations. Risks are higher in Argentina than in Mexico because of the weakness of the economy, which is in its third year of recession. Brazil is less likely to experience a strong wave of protests, having lived through unrest only a few years ago (2013) and having elected a populist outsider as president. Colombia is also not expected to see protests of the strength and violence of those in Ecuador and Chile, unless the government makes serious mistakes during 2020/21.

Governability Challenges

Governability across the region is becoming more difficult, as leaders weigh the competing demands for more social spending with the need for fiscal austerity in a low-growth environment. There is a risk of continual policy zig-zags, as polarising governments of one stripe are voted out and replaced by opponents who dismantle most of their achievements regardless of merit (recent examples being Mexico and Argentina).



Resilient Democrats And Institutions

Support for democratic values and freedom of speech remains strong despite rising popular dissatisfaction with the established political class. Outsiders have been winning election on platforms of challenging entrenched elites (presidents in Brazil and Mexico, legislators in Peru, mayors in Colombia). Surveys consistently show that most Latin Americans have no appetite for a return to military rule. Although the military has assumed a greater role in countries such as Brazil (the vice president, the chief of staff and several cabinet members) and Mexico (a frontline role in policing and in construction of presidential prestige projects) this should not be confused with a nostalgia for dictatorship. In countries which have experienced mass protests, citizen support for freedom of expression remains high.

Polarisation

Recent progress in the fight against corruption demonstrated by the Odebrecht scandal across the continent and the UN anti-corruption commission in Guatemala has been eroded over the past year amid a backlash from the elites, increasing popular frustration. Brazil has changed court procedures to make it harder to jail those accused of corruption, while in Argentina Cristina Fernández has escaped numerous graft cases by being elected vice-president. Guatemala has expelled the UN anti-corruption commission and Honduras has a president whose brother was found guilty last year of drug trafficking in the US.

Popular anger against corruption is one of the biggest single causes of discontent across the continent but strong vested interests and weak institutions mean progress will be slow, fitful and prone to setbacks.

Venezuela

Venezuela has regional importance for two main reasons:-

a) The migration crisis, which has seen nearly 5m Venezuelans flee their country, mostly to other Latin American nations. This has created sizeable Venezuelan refugee populations in Colombia, Ecuador, Peru, Chile and some of the Caribbean islands.

b) Political and diplomatic divisions between the majority of Latam nations which have accepted the US/EU position that opposition leader Juan Guaidó should be recognised as the country's interim leader and a minority who are trying either to stay neutral (Mexico and Argentina) or back Maduro (Cuba and Nicaragua).

The evolution of Venezuela's crisis has implications across Latin America. If the status quo continues, Colombia and the other host nations face rising problems from large refugee populations competing for jobs in a difficult labour market, and from the extensive drug trafficking and guerrilla activity hosted by Venezuela. Conversely if Maduro falls and a democratic government comes to power, the reactivation of the oil economy could provide a big economic boost. The latter scenario seems less likely than the former.

US Influence Fading

US influence in the region has waned, partly because Latin American countries do not identify with President Trump's values (which are seen as racist and xenophobic) and because the Trump administration's "maximum pressure" Venezuela policy has so far failed to deliver results. Washington's hard line against Cuba, reversing Obama-era policies of détente, also has little support in the region. Traditional free-market policies, particularly those associated with the Chicago school, are being challenged by mass unrest (President Macri's 2019 election defeat in Argentina, President Piñera's record low ratings after the Chile riots).

President Trump's unpopularity in the region, as well as long-standing traditional hostility to the US and the current US president's transactional approach to trade deals, makes many Latin American leaders reluctant to be seen as close to Washington. Exceptions include Colombia, a long-time close ally bound more tightly to the US as a result of the Venezuela crisis and – surprisingly – Mexico, for pragmatic reasons of common interest.

US policy towards Latin America under Trump has focused on Mexico because of its importance for trade and migration and on Venezuela for political reasons (the Florida Latino vote). On Mexico, fellow populists Trump and AMLO have cooperated surprisingly well, mainly because Mexico has ceded to most US demands on issues such as policing Central American migration to stop refugees reaching the US border and agreeing to US demands in the new USMCA trade pact which has replaced NAFTA. This unlikely pairing is likely to hold as it suits both sides.

LatAm's Political Influence

The continent has historically been challenged to unite on either trade or diplomacy, lacking suitable credible and permanent institutions to do so. This is unlikely to change. On trade, a patchwork of separate groupings and negotiating strategies (Mercosur, Pacific Alliance, USMCA) mean the region punches below its weight on the global stage and the lack of political consensus across the region makes it unlikely that this will change in the near future. Brazil, which has been the region's diplomatic leader, has lost global and regional soft power influence because of Bolsonaro's perceived extremism on matters such as the environment and gay rights. However, more Latin American countries are likely to join the OECD following the example of Mexico and Chile. Colombia and Costa Rica are in the process of joining and US backing means Brazil's application is being viewed sympathetically, probably ahead of that of Argentina.

China Partnership Important But Awkward

China is taking the opportunity to move closer to Latin America and increase its influence by investing in major infrastructure projects and in key assets in power generation and the extractive sector. Most Latam nations have adopted pragmatic policies towards Beijing because of its economic weight and importance for trade and investment (including Bolsonaro's Brazil, which was initially hostile).

However China has been reluctant to deal with sometimes unstable Latin American governments, hostile regulatory/judicial environments and vocal NGOs who may oppose key extractive and infrastructure projects. The sums invested so far have been much smaller than those committed in Asia. Beijing finds it hard to understand that presidents in Latin America cannot guarantee the passage of key projects through Congress and the courts in the way that many Asian and African leaders can.

Latin American elections 2020-24

Country Political Outlooks

Argentina

The Peronists returned to power in December 2019, after pro-business president Mauricio Macri lost his bid for re-election amid a deep economic crisis. The new government is a broad coalition including radical leftist VP (and ex-president) Cristina Fernández de Kirchner and radical social organisations linked to her but headed by President Alberto Fernández, who was invited by Cristina to head their joint ticket. Fernández is a relatively pragmatic former cabinet chief who resigned from Cristina's government near its start amid disagreements over policy.

The Fernández-Fernández government will be challenged to satisfy popular demands for the easing of austerity and a return to the free spending of the commodity boom era while renegotiating over $332 bn of debt and trying to pull the economy out of a deep recession. Inflation is among the world's highest at over 50% in 2019 and business confidence is fragile.

The Peronist strategy for renegotiating Argentina's foreign debt and for re-activating the economy is not yet completely clear. Economy minister Martin Guzmán faces competing demands from leftist Peronists such as Cristina who want a hard line ending in default to avoid any fiscal adjustment and pragmatists who prefer trying to persuade creditors to extend maturities and take a small haircut on principal to keep Argentina open for business. Current prices signal a haircut of around 50%.

The government has so far given priority to negotiating with the IMF, winning an IMF endorsement for the idea that private creditors should take a haircut of around 30% on the value of their paper. The IMF appears to be hopeful that backing the government now will make it easier to successfully negotiate a reprofiling of its own loans to Argentina later on. It is also far from clear that private creditors will accept the haircut of 30-40% that the Fernández government has been signalling in early 2020.

The Alberto Fernández administration has tightened exchange controls, leading to a flourishing black market, and is imposing price controls and higher export taxes – all policies which failed in the previous Cristina Fernández government which preceded Macri.

Relations with the US have been awkward because of the history of Cristina Fernández' antipathy towards Washington and are likely to be complicated by the Fernández administration's backing for Bolivia's former leftist president Evo Morales (who fled after committing election fraud and has sought refuge in Argentina), its neutrality over Venezuela, its affinity for other Latam leftist movements and its dislike of Trump administration foreign policy. This could complicate debt talks and investment. The Fernández administration may be tempted in future to make a pivot to China to secure loans and investment if negotiations with US and European creditors break down.

Brazil is one of Argentina's main trading partners and the other key nation in the Mercosur customs union but relations between Fernández and Bolsonaro are poor due to their political differences. There is a risk that these contaminate the wider trading relationship and paralyse Mercosur and the EU trade treaty, though officials on both sides are making efforts to avoid this.

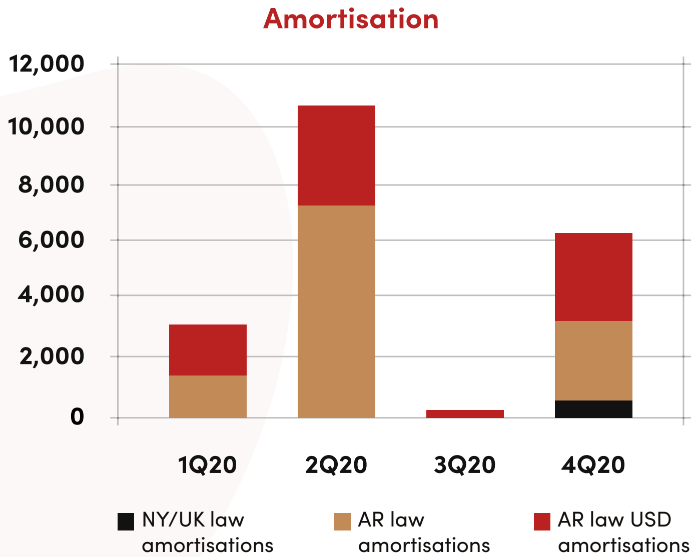
On foreign policy more generally, Fernández has signalled a traditional Peronist stance of seeking links with other left-wing leaders in the region (eg Mexico) but has few other natural allies among the other major Latam countries, which are all ruled by right or centre-right leaders. The change of governments last year in Bolivia and Uruguay robbed him of two natural allies. Fernández has taken a more neutral stance over Venezuela but poor relations with Washington prevent him from being a credible mediator on this issue.

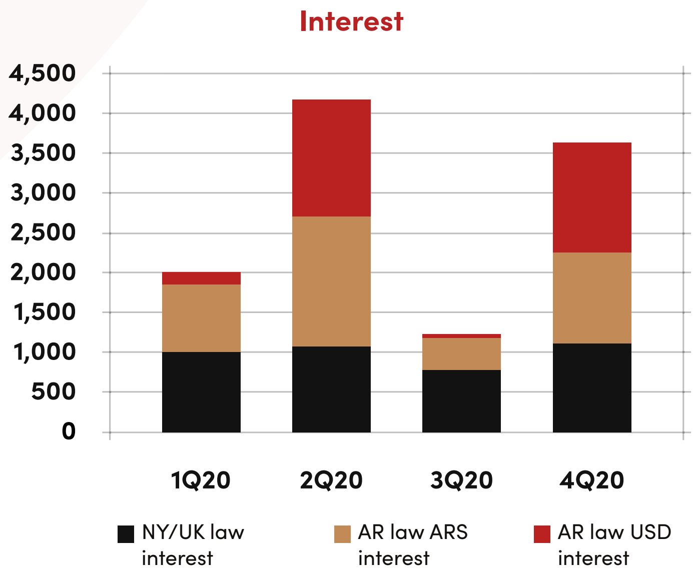
The Cristina Fernández administration from 2007-15 was notorious for corruption and institutional decay, including manipulated economic statistics; early signs from Alberto Fernández are not promising on this front. His recent shift of position over the 2015 murder of Alberto Nisman, the chief investigator of the Buenos Aires Jewish centre bombing of 1994 is a signal, as is Cristina's dismissiveness towards judges trying her on corruption charges. She is likely to be absolved of all charges and there will be heavy pressure on the judiciary not to press corruption charges against serving government officials.

The opposition starts the new session of Congress in a relatively strong position in terms of numbers but hamstrung by Macri's insistence so far on leading it and his poor economic legacy. It will be challenged to regain credibility in time for the October 2021 midterm congressional elections unless there is a change of leadership. Buenos Aires mayor Horacio Rodríguez Larreta is a possible contender but the opposition still lacks a genuinely popular and credible leader.

More tax rises are likely on the wealthy and on business, given the weak fiscal position. The government will create a special fiscal regime for oil development in the Vaca Muerta shale area in Patagonia, given its importance to the national economy, but it remains to be seen whether Argentina proves attractive enough to bring in the $5-10bn a year of investment needed to develop it fully.

Argentina Debt Repayment Schedule For 2020





Source: MECON, USD billions (based on data available through 3Q19)

Brazil

The Bolsonaro government appears "Jekyll and Hyde": the noise from the president's "Bible and Bullets" social agenda, intended to bolster his political base, risks drowning out the signals of promising economic and structural reforms led by Finance Minister Paolo Guedes with the help of Congress. Foreigners tend to focus on the negatives while locals are more interested in the positive economic story.

Strongly critical media coverage of President Bolsonaro (reinforced by his dislike of traditional media and his frequent insults to journalists) obscures the fact that he remains quite popular and many Brazilians would vote for him again. A Veja poll in Decemeber 2019 shows him as the most popular candidate for 2022, three points ahead of former president Lula – the same poll shows Bolsonaro winning the runoff against Lula by five percentage points.

The government's fate is likely to be decided by how strong the economic recovery is; renewed prosperity will favour Bolsonaro's re-election but a weak economy would probably mean a return by the hard left workers party (PT) in 2022.

The future PT candidate is unclear. Since his release from jail pending appeal, Lula has reasserted himself as the leader of the left but his age and past corruption cases may prevent him from running again in 2022. The strongest centrist candidate at present is TV host Luciano Huck, but he trails far behind Bolsonaro and Lula in current polling and would not make the run-off.

Bolsonaro has proved pragmatic on the economy; he has kept popular PT-era social subsidies such as Bolsa Familia, has raised the minimum wage and has slowed down radical austerity to prevent unrest. He is helped by the rapid growth of the evangelical churches, which support his moral programme and economic philosophy. Though accused of extremism, he was quick to sack a minister who made a speech with Nazi echoes.

However, Bolsonaro is not personally invested in Guedes' reform agenda and re-election is his main priority. The successful passage of the pension reform last year creates the risk that Congress sits on its laurels and avoids further complex and controversial changes which are vital to boost growth and investment, such as tax reform, privatisation and reform of the state. These changes have all been held over from last year to this year but the window for passing them is closing ahead of local elections in the autumn. Campaigning starts in the summer so little controversial legislation is likely to pass in the second half of 2020, though some could still be approved in 2021. Some reforms are likely to pass in the first half of 2020, probably a version of tax reform and some of the fiscal measures. Reform of the public sector and privatisation of the electricity firm Eletrobras may be harder.

Bolsonaro's push for Amazon economic development, intended to please his nationalist domestic base, is scaring foreign investors because of the environmental risks and could damage the wider Brazil investment story. Some Brazilians can underplay this risk, which is increasing as ESG investment goes mainstream, though others, particularly in agribusiness, are acutely aware of it.

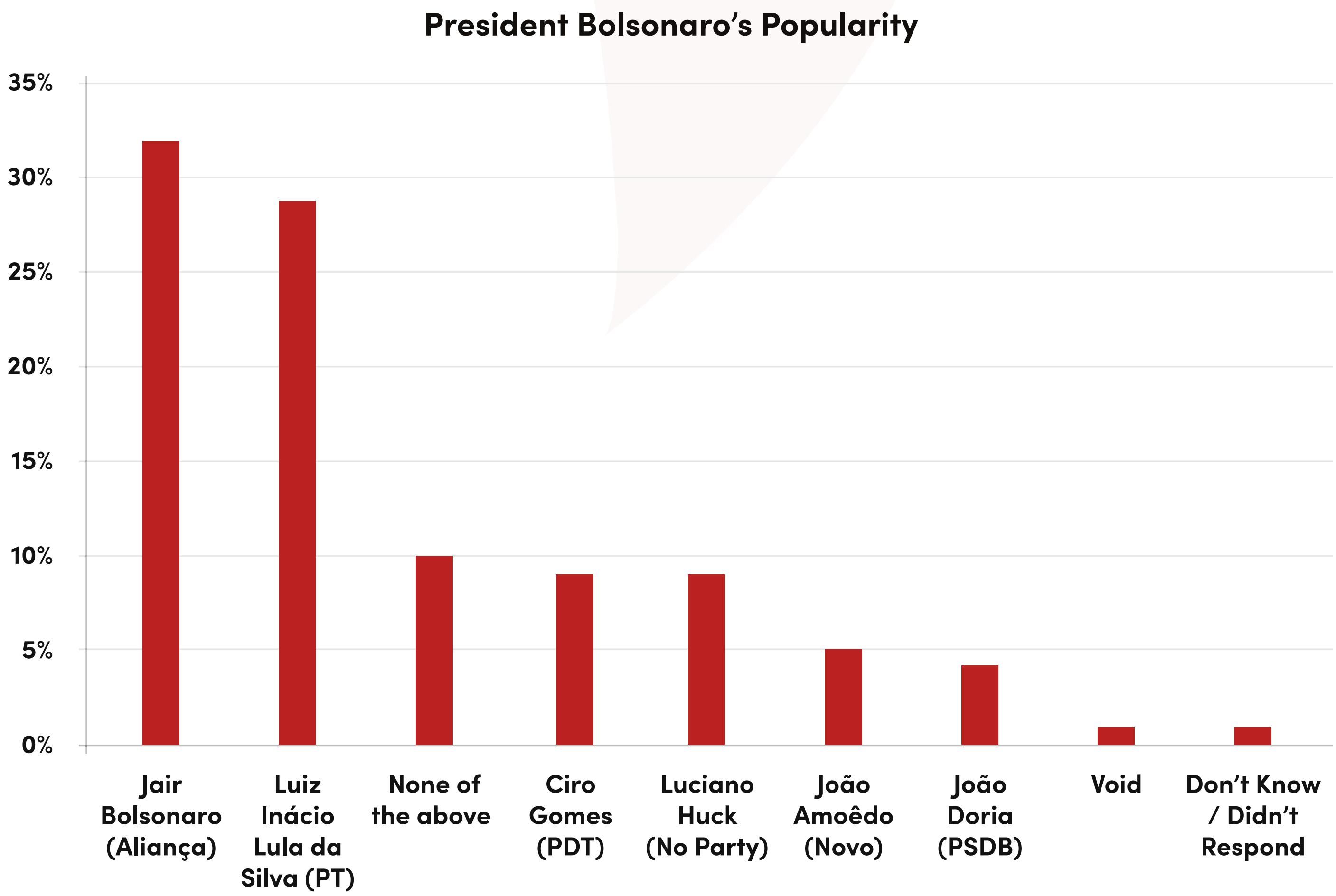
A few large investors, particularly in Scandinavia, have already boycotted Brazilian assets because of Amazon deforestation and this trend may gather momentum unless the government addresses it robustly.

ESG issues have also been exploited by agricultural protectionists within the EU to lobby against the recently agreed Mercosur-EU trade deal, which already faces a difficult ratification process in France and Ireland. Brazil's powerful agribusiness lobby is aware of the risks and is lobbying the government to ensure the country does not become an environmental pariah.

Foreign policy is guided mainly by pragmatic commercial considerations, as evidenced by Bolsonaro's trips to India, China, and Saudi Arabia. There has been little interest so far in pursuing regional leadership and poor relations with the leaders of the other major powers (Argentina and Mexico) would make that hard.

The risk of major unrest is not as high as in other nations, despite Brazil's high levels of inequality. Bolsonaro has strong anti-establishment credentials and is sensitive to the risks of too much austerity too fast, having observed Macri's and Piñera's fates. Brazil already had a wave of big protests in 2013, which released some of the social pressure, as well as the cathartic experience of the Car Wash corruption scandal, which embroiled two presidents.

It is more likely that Bolsonaro will move cautiously on major economic reform than that he will push ahead too hard too quickly. The fragmentation of Congress and Bolsonaro's creation of his own new party also make reforms harder to pass. This means that Guedes' position may become increasingly difficult; his frequent gaffes and lack of political antennae could also make him vulnerable.



Source: Veja poll, December 2019

Chile

President Sebastián Piñera's authority suffered a heavy blow with the sudden, violent and prolonged eruption of protests in 2019 and it is unlikely to recover significantly. His ratings at the start of 2020 were below 10%, though they have since crept up to 14%. The damage done by the protests to the economy (a contraction of 3.3% in November, 2019 annual growth of only 1.2 per percent - the worst in a decade and less than half what had been predicted for the year), a sudden jump in job losses, and an extra $5bn cost of promised government concessions makes it harder to generate the extra prosperity needed to fund a bigger welfare state.

Piñera's pro-investment reforms (aimed at improving the tax climate for foreign investors and liberalising working hours) are effectively dead because of a lack of political and popular support. The political agenda for 2020 and 2021 will be dominated by increased spending to pacify protests and by plans for the new constituent assembly including a plebiscite in April 2020 to decide how it will be chosen and then elections to the assembly in October. The slow pace – a new constitution will not be in place until mid-2022 - is likely to frustrate protesters, who may return to the streets to demand Piñera's resignation if they are not satisfied. It is also a potential issue for investors.

The damage done to Chile's reputation as the poster child for sound and sensible pro-investment policy will be hard to repair and will likely have an impact across the region. Despite the international image of Chile as a success story, most protesters want to see big and costly changes in economic and social policy to strengthen the welfare state and these are unlikely to make the country more attractive to investors.

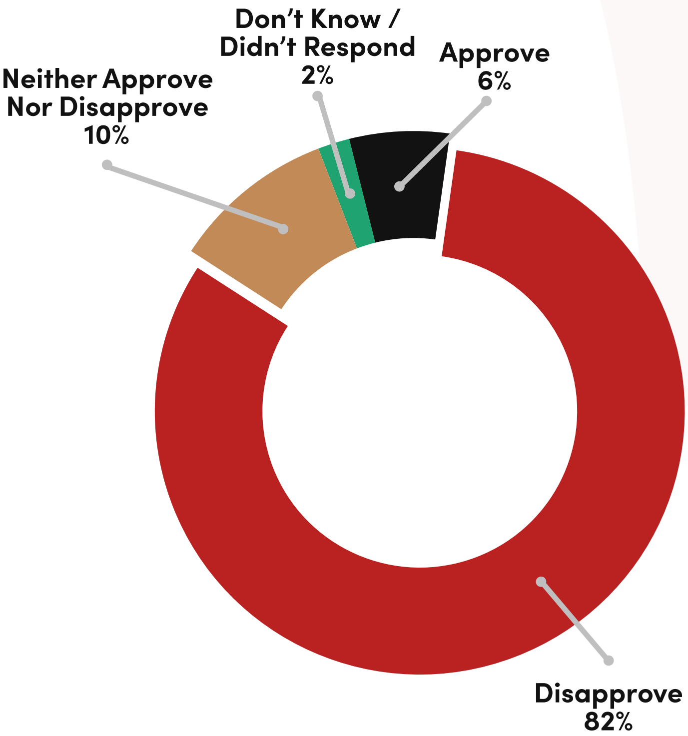
The protesters' anger at the entire political and economic establishment means that the November 2021 presidential election may favour a populist candidate of either the hard left or hard right, which could herald significant changes in the model of governance. Foreign investors are unlikely to find such a friendly climate in the coming years as they have become accustomed to.

Strong independent institutions have been Chile's saving grace in the past three decades; these could be under threat from a constitutional congress which may try to politicise them under the guise of increasing democratic scrutiny. The constitutional congress may also write expensive social commitments into the new constitution, further constraining future governments.

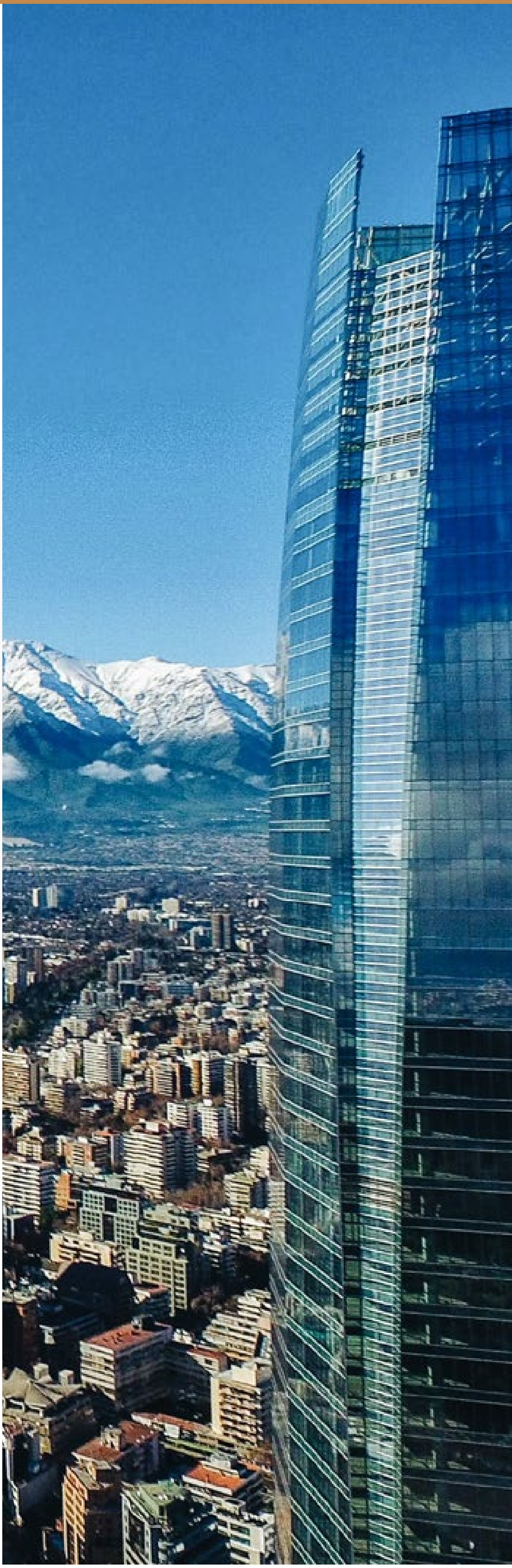
Chile's foreign policy of an open nation looking to trade globally is not currently likely to change. Chile has been happy to seek alliances with the US and with China and will not pick between the two. Piñera was personally close to former Argentine President Mauricio Macri but will develop a pragmatic working relationship with Macri's successor Alberto Fernández.

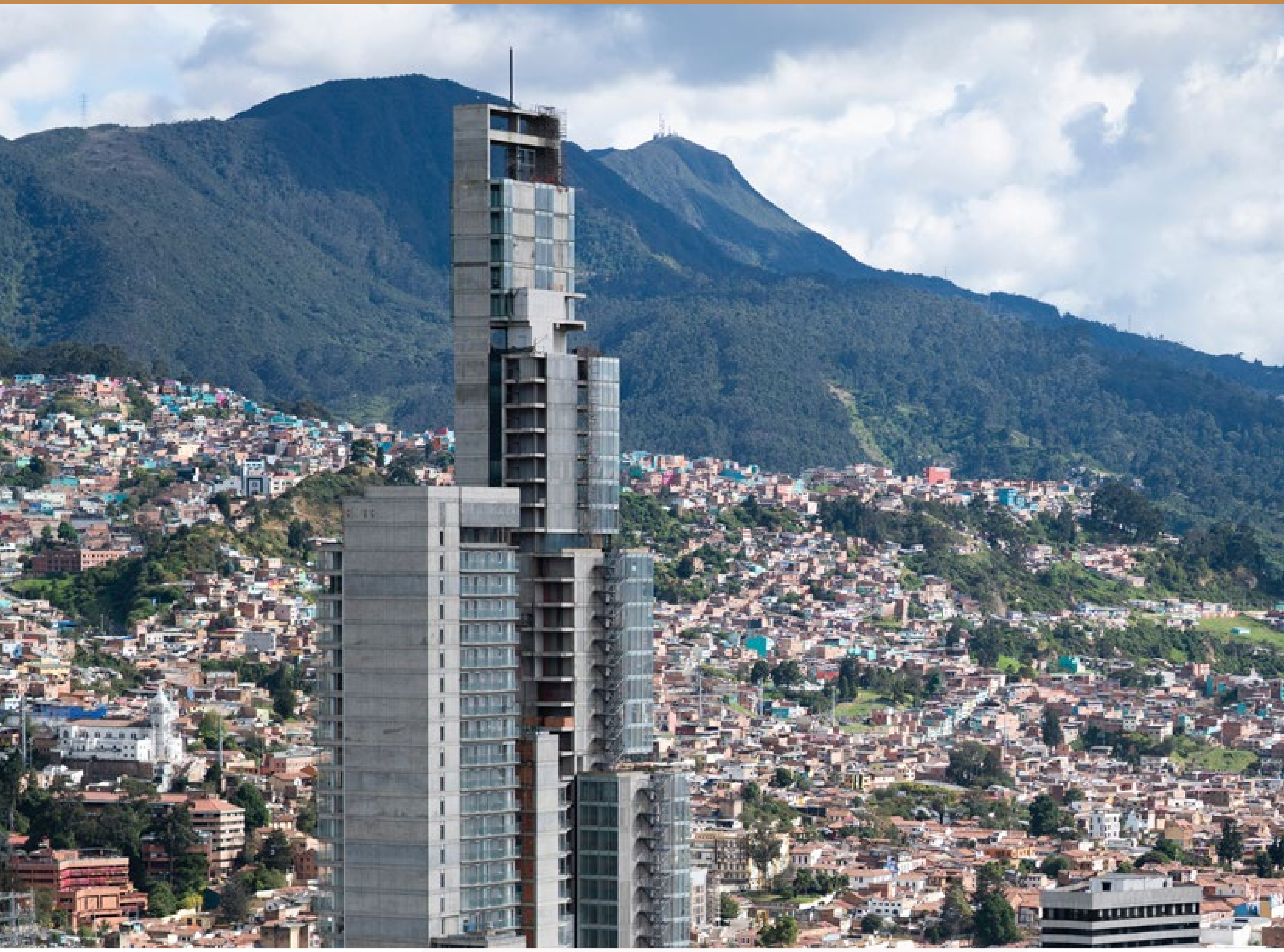
Within Latin America, Chile's main influence now is as an example of what can go wrong if apparently successful free-market policies pay too little regard to social issues and elites become too complacent: other nations are studying its experience to learn how to avoid similar protests.

President Piñera's Popularity



Source: CEP, Dec 2019





Colombia

Colombia was Latin America's strongest major economy in 2019 with growth of 3.3% percent and is likely to perform similarly in 2020. This is a considerable achievement in the current global environment and builds further on the country's reputation for steady progress and overcoming challenges successfully.

President Ivan Duque, a moderate centre-right technocrat, is popular with investors for his pro-business agenda but has struggled in his first year to win broad public support or to forge a strong alliance in Congress via his Democratic Centre party, despite the relatively strong economy. As a result, Duque could be vulnerable to renewed street protests and to a populist challenger at the next presidential election in May 2022. This is a concern because Colombia needs structural changes to put public finances on a sounder footing as oil production declines in coming years.

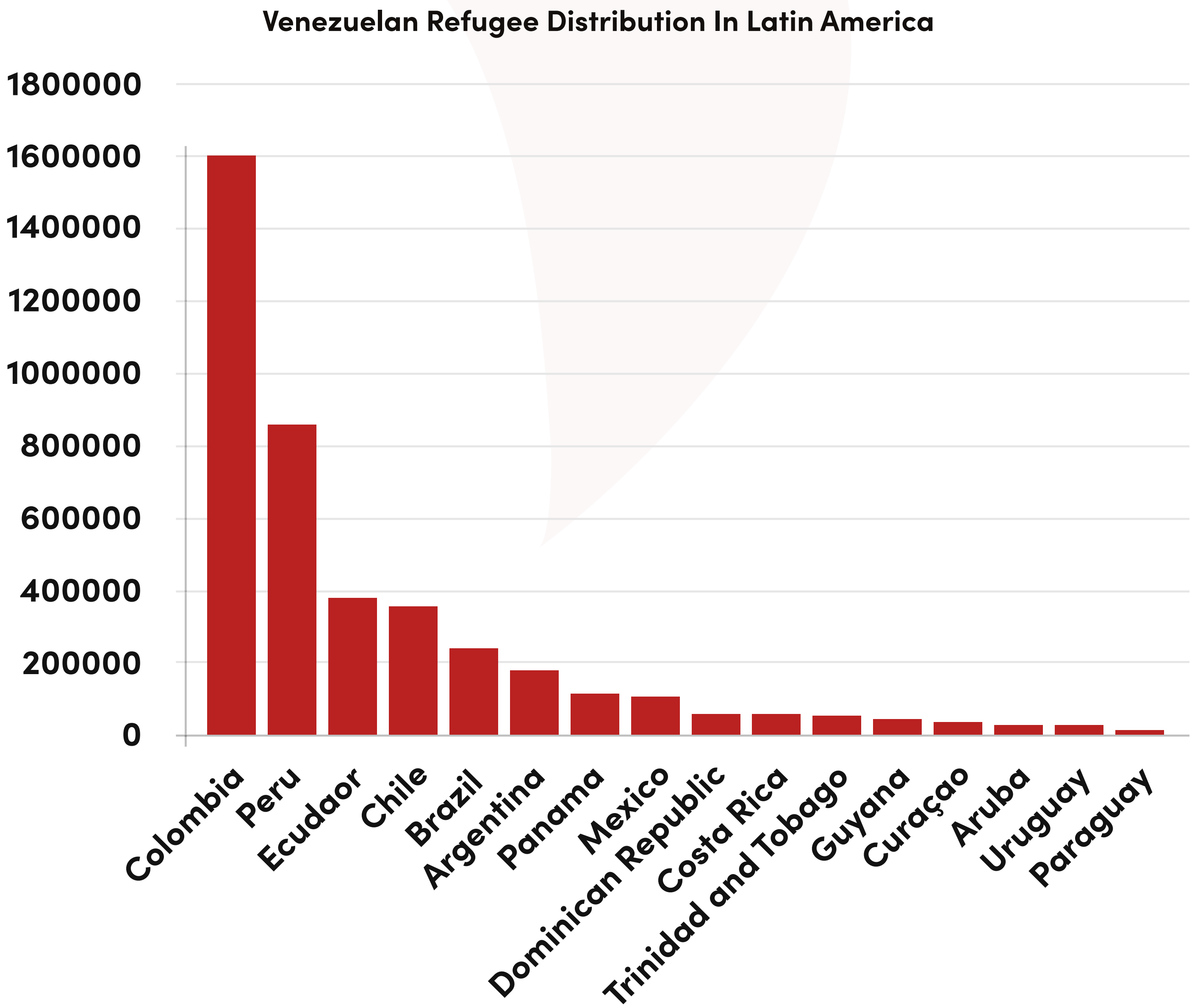
The growing presence of Venezuelan refugees in Colombia (1.6m at the start of 2020 and still increasing) could become a threat to social and political stability if the influx continues and aid agencies fail to win adequate funding to support the refugees (only just over half the 2019 requirements were met). Resentment at the refugees is growing in Colombia after a generous initial welcome and relatively high unemployment is making the problem worse. Political leaders have so far avoided making the refugees an issue but this may change.

The peace deal with the FARC rebels signed under Duque's predecessor Juan Manuel Santos is likely to hold, albeit shakily. Like previous such deals (for example with the M-19/EPL rebels in 1990), splinter groups will break off and continue to fight, often aided by the Venezuelan government. A lack of adequate government investment in infrastructure and social projects such as coca crop substitution in conflict areas will mean continued low-level violence.

Historically conservative, Colombia has not elected a populist left-wing leader in its modern history. This could change in 2022 if Duque fails to deliver a more effective response to popular demands for a better welfare state and greater social justice. Colombia is vulnerable because of the concentration of economic, business and political power in the hands of a small number of families (similar to Chile).

Greater political diversity is becoming evident at the municipal level (the recently elected mayors of Bogotá and Medellín are an example) and could help release some of the popular pressure for greater institutional change. There remains a big gap between the more diverse and better educated younger society which is emerging and the more traditional political establishment.

Foreign policy has traditionally been strongly pro-US and this is likely to continue until the next presidential election. Colombia trades pragmatically with China but is not likely to emerge as a major destination for Chinese investment, a recent major contract for the Bogota metro notwithstanding. Colombia's very strong and uncritical support for the US, especially over Venezuela, complicates matters when it comes to exercising diplomatic leadership within the Andean bloc. Colombia did however successfully lead a summit of Amazon countries to discuss deforestation last year.



Source: UN Inter-agency platform

Mexico

Veteran leftist Andrés Manuel López Obrador (AMLO) was elected with a landslide victory in 2018 and his Morena coalition dominates Congress, with a solid majority. The two main opposition parties, PRI and PAN, are both weak after an electoral drubbing and lack strong leaders. AMLO hence has enormous personal power for his six-year term, which ends in December 2024.

Despite his sweeping mandate, AMLO's first year in power was a major disappointment for investors, with economic growth stalling and investment stunted by his nationalist economic policies, poorly justified major programmes and weak budget execution. A deteriorating security situation increased the challenges.

Investors and business are concerned by AMLO's hostility to foreign investment in the oil sector and his desire to direct extra state funds instead into the national oil company Pemex for economically questionable projects such as a new oil refinery.

His plan to repurpose a military airport to improve Mexico City's airport capacity lacks credibility, as does his plan for a costly and environmentally damaging new train line across the Mayan peninsula. These three "megaprojects" are viewed by analysts as vanity projects without sound economic justification and there are considerable execution risks around all of them. On the other hand, his insistence on austerity and on keeping government finances tight has mitigated risks of a spending spree so far, to the annoyance of some of his supporters.

AMLO remains popular with the Mexican people mainly because of his excellent communications skills and modest "man of the people" style, which contrasts with the traditional aloofness of previous Mexican presidents. However, his ratings have slipped since his inauguration and are likely to slide further in 2020/21 if there continues to be little progress on fighting violent crime and the economy does not revive.

The key question is how AMLO will respond to sagging popularity and difficulties with his main initiatives: he is more likely to radicalise and boost spending/increase state interference in the economy than to tack towards the free market and foreign investment. His moves so far on electricity and oil are strong clues. He may also pursue high-profile corruption cases against key figures in the previous government to distract attention from other issues.

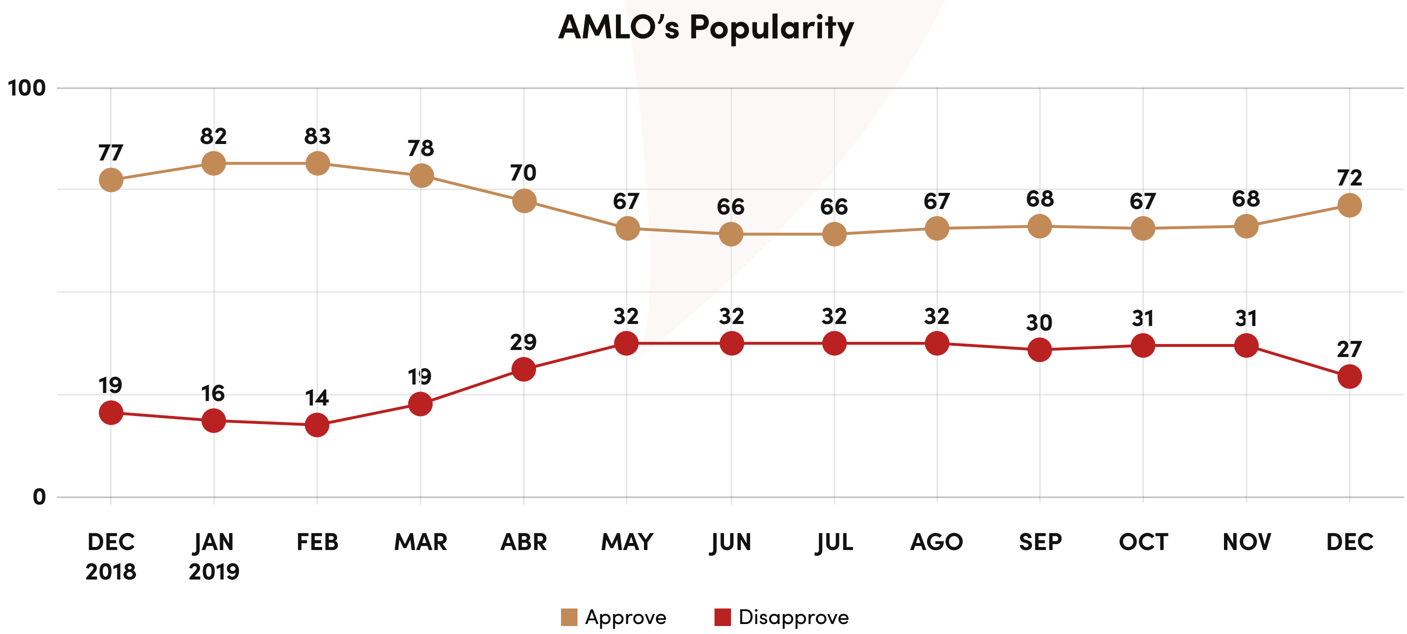
AMLO's marriage of convenience with Donald Trump is likely to endure. Positives are that it delivered USMCA and control of the Central American migration issue; negatives are that these things only happened because AMLO delivered numerous concessions to Trump. Pressure from his base to stop conceding will grow.

On foreign policy more generally, AMLO has repeatedly signalled that "the best foreign policy is domestic policy". He has refused to travel abroad (even to attend summits such as the G20) and has little interest in regional leadership. However, his foreign minister Marcelo Ebrard is a capable diplomat and Mexico's traditional position of neutrality in the region could allow opportunities for mediation over issues such as Venezuela.

The two main opposition parties will only benefit from AMLO's shortcomings at the 2021 midterm congressional election if they can coalesce around a strong and credible leader; that person is not yet visible and time for he/she to emerge is short.

The risks in Mexico include a radicalisation of economic policy under AMLO, a continuing rapid rise in violent crime and in the power of drug cartels (the authorities have so far been unwilling to confront them) and the president's attacks on the independence and credibility of institutions such as the supreme court, the election body and the human rights commission. This could be very damaging in the medium term if unchecked.

An additional risk stems from the concentration of power in AMLO's hands. The Morena coalition is fractious and disparate and only functions when he exerts control. Moreover, AMLO is 66 and his health is not good; he suffered a heart attack in 2013.



Source: El Financiero newspaper

Peru

Peru presents a paradox of political turmoil (four living former presidents jailed or on trial for corruption, one former president committed suicide when under investigation, Congress shut down by the president and fresh elections called) and a relatively strong economy (average growth above 5% for 15 years, though 2019 was a disappointment at around 2.4%). The fate of the economy depends on whether a parliament emerges which can work effectively with President Vizcarra for the remainder of his term until 2021 and on whether Vizcarra's successor has a credible plan for economic growth. The new Congress elected at the end of January is highly fragmented (more than 20 parties ran and no grouping received more than 11% of the vote) and will only serve 16 months; among the winners was an evangelical Christian sect.

President Vizcarra remains popular because of his war on corruption and on the political establishment but his ratings have declined over the past year and he cannot run in the April 2021 presidential election; so it remains unclear who will benefit from his political inheritance. It is likely that populist challengers will emerge as the strongest contenders for the presidency given the discrediting of the traditional political establishment.

Among the president's opponents Keiko Fujimori managed to win freedom from jail on bail but she and her Fuerza Popular party have surrendered much of their credibility over the corruption charges and were the biggest losers of the January congressional election. Peruvians are tired of the entire traditional political class and keen for fresh faces. A poll taken two weeks before the January

2020 congressional election showed that more than half of voters had not decided who to vote for.

Compared to its neighbours, Peru's relatively stronger economy should help the country ride out political turmoil better. There is no need for a major fiscal adjustment, the president is popular, debt levels are low, the anti-corruption campaign is strong and continued growth gives the government more room for manoeuvre.

However, Peru remains highly dependent on mining (10% of GDP and 60% of exports) and there are questions over its continued ability to attract investment in this area amid growing public opposition to mining projects because of their environmental impact. The country has a strong NGO sector.

In terms of foreign policy, Peru's main contribution to the region has been the formation of the Lima Group of Latin American countries to pursue diplomatic avenues to help solve the Venezuela crisis. Trade issues have for the time being taken a back seat to the domestic political drama.

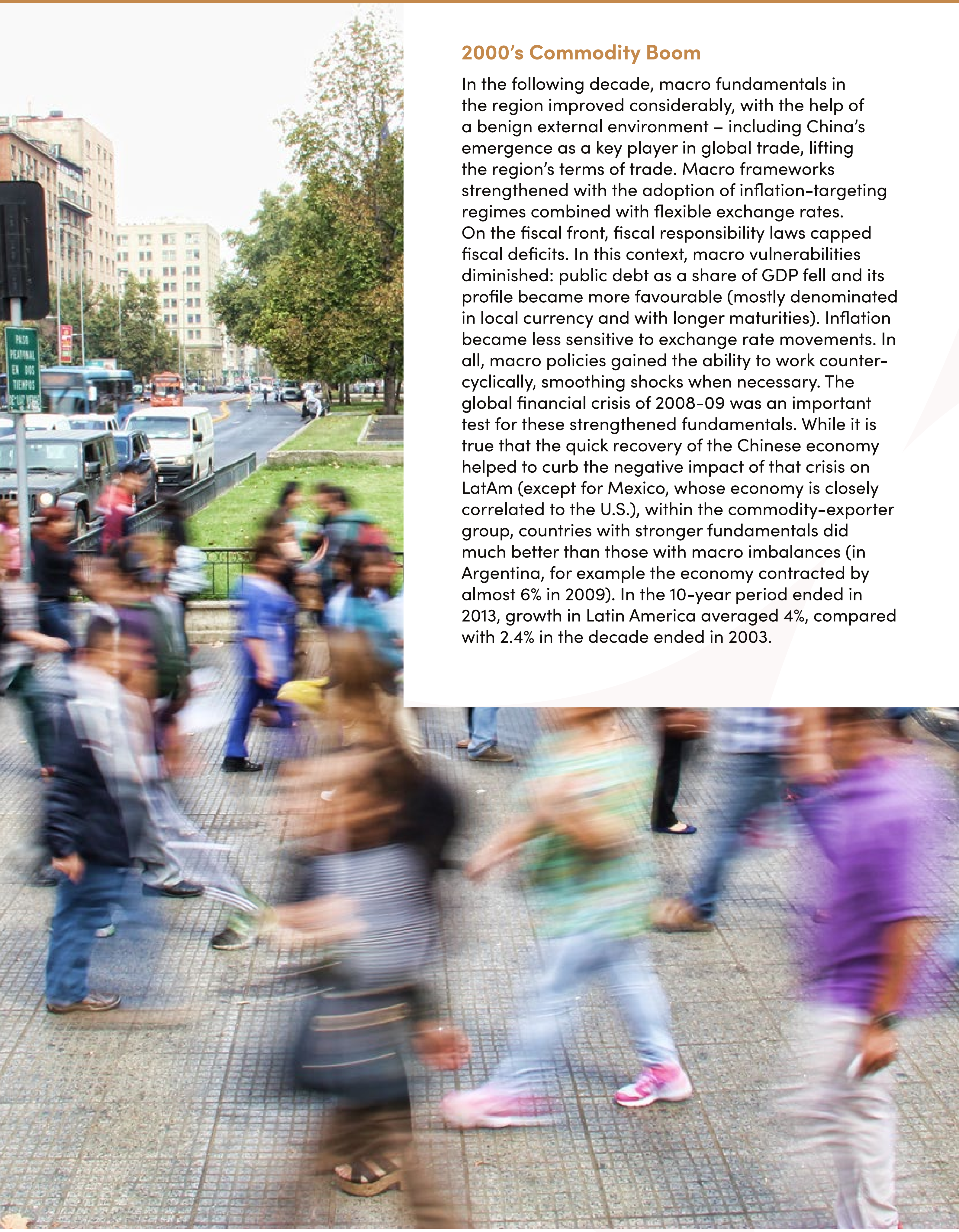
Economic Outlook

João Pedro Bumachar Resende, Senior Latin America Economist, Itaú Unibanco

Regional Trends

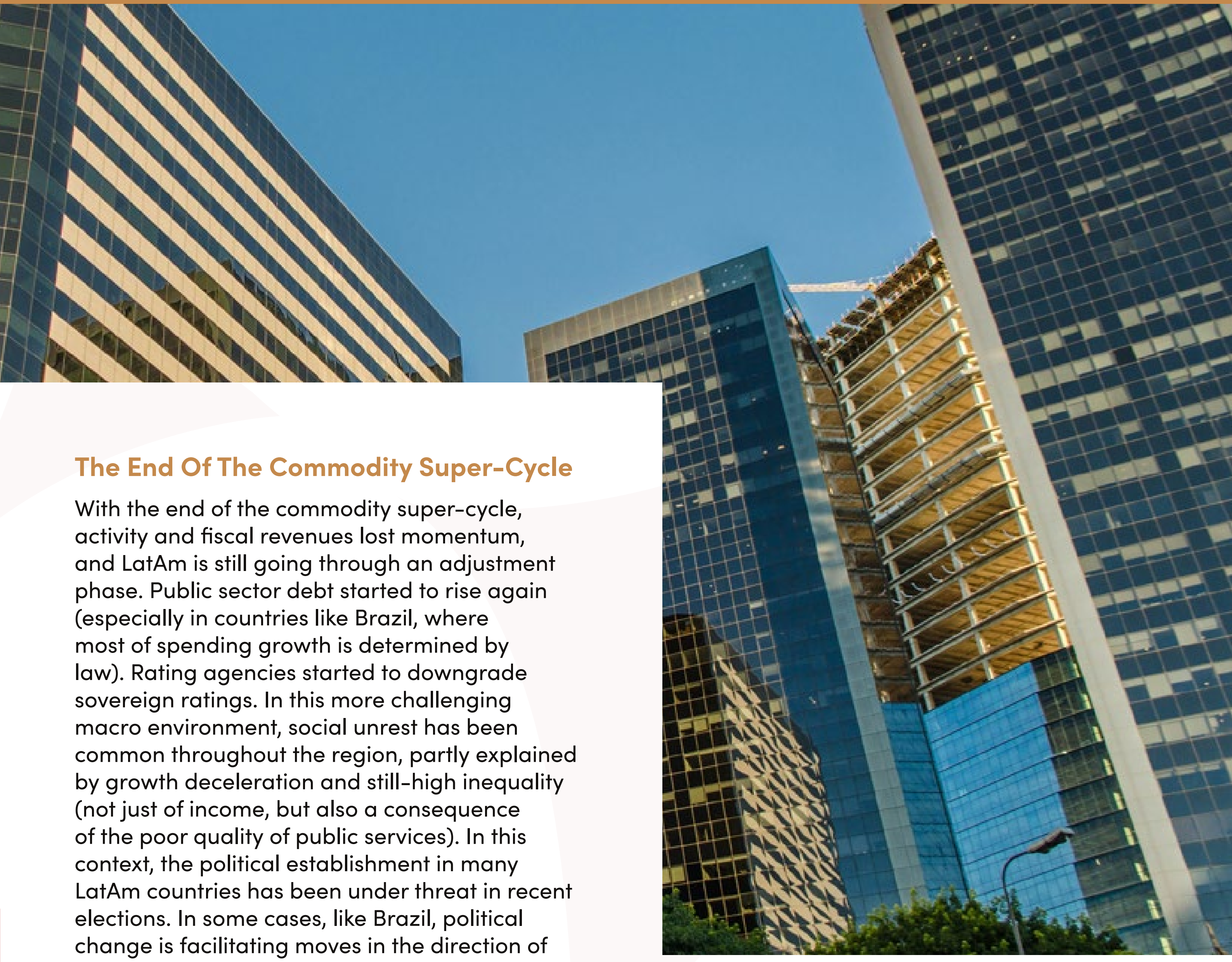
1990's Macro Reforms

During the 1990s, Latin American countries pursued macro reforms, including monetary stabilization (through different forms of fixed or quasi-fixed exchange rate regimes), privatizations, trade openness, capital account liberalization, etc. There was a capital inflow boom to the region that, when reversed in the second part of the decade, triggered a meaningful economic slowdown and exchange rate depreciation (breaking many fixed exchange rate frameworks). Currency mismatches in public and/or private sector balance sheets occurred in many countries, leading to a banking crisis in some economies and, in the case of Argentina, a sovereign default.



2000's Commodity Boom

In the following decade, macro fundamentals in the region improved considerably, with the help of a benign external environment – including China's emergence as a key player in global trade, lifting the region's terms of trade. Macro frameworks strengthened with the adoption of inflation-targeting regimes combined with flexible exchange rates. On the fiscal front, fiscal responsibility laws capped fiscal deficits. In this context, macro vulnerabilities diminished: public debt as a share of GDP fell and its profile became more favourable (mostly denominated in local currency and with longer maturities). Inflation became less sensitive to exchange rate movements. In all, macro policies gained the ability to work counter-cyclically, smoothing shocks when necessary. The global financial crisis of 2008-09 was an important test for these strengthened fundamentals. While it is true that the quick recovery of the Chinese economy helped to curb the negative impact of that crisis on LatAm (except for Mexico, whose economy is closely correlated to the U.S.), within the commodity-exporter group, countries with stronger fundamentals did much better than those with macro imbalances (in Argentina, for example the economy contracted by almost 6% in 2009). In the 10-year period ended in 2013, growth in Latin America averaged 4%, compared with 2.4% in the decade ended in 2003.



The End Of The Commodity Super-Cycle

With the end of the commodity super-cycle, activity and fiscal revenues lost momentum, and LatAm is still going through an adjustment phase. Public sector debt started to rise again (especially in countries like Brazil, where most of spending growth is determined by law). Rating agencies started to downgrade sovereign ratings. In this more challenging macro environment, social unrest has been common throughout the region, partly explained by growth deceleration and still-high inequality (not just of income, but also a consequence of the poor quality of public services). In this context, the political establishment in many LatAm countries has been under threat in recent elections. In some cases, like Brazil, political change is facilitating moves in the direction of fixing the country's imbalances by reforming its costly and sizable public sector. On the other hand, in Mexico – the second largest economy of the region – the new administration is opposing some important reforms passed in recent years (such as the opening of the oil industry for private investment). In Argentina, the attempt to pursue a more market-oriented economic model did not yield the expected results, and once again the country is facing a tough negotiation with its creditors. In Chile and Colombia, anti-establishment candidates lost in the most recent presidential elections but still performed well, which together with the more adverse social mood, indicates that a political change in the next elections is possible. While Chile has room to accommodate social demands, given a low tax burden and low public debt, Colombia's fundamentals are less robust. In Peru, the so-called car-wash investigations affected a large portion of the political class, generating further uncertainty over the economic outcome of the next presidential elections.

Gradual Recovery

While fiscal policy is more limited, there is room for monetary policy to support growth almost everywhere. In Brazil, for example, the benchmark Selic rate is at record lows, partly offsetting the negative effect of fiscal policy. Thus, over the next few years, growth should improve relative to 2019. Idiosyncratic shocks such as protests and trade conflicts that affected economic growth in 2019 are at least not expected to get significantly worse, even if they do not dissipate. Nonetheless, the recovery will be gradual. A lukewarm global economy and lingering domestic uncertainties in some countries will curb growth. In the long term, it is crucial that Latin America advances with productivity-enhancing reforms, especially in education, as it seeks to resume a path of GDP per capita convergence with advanced economies.

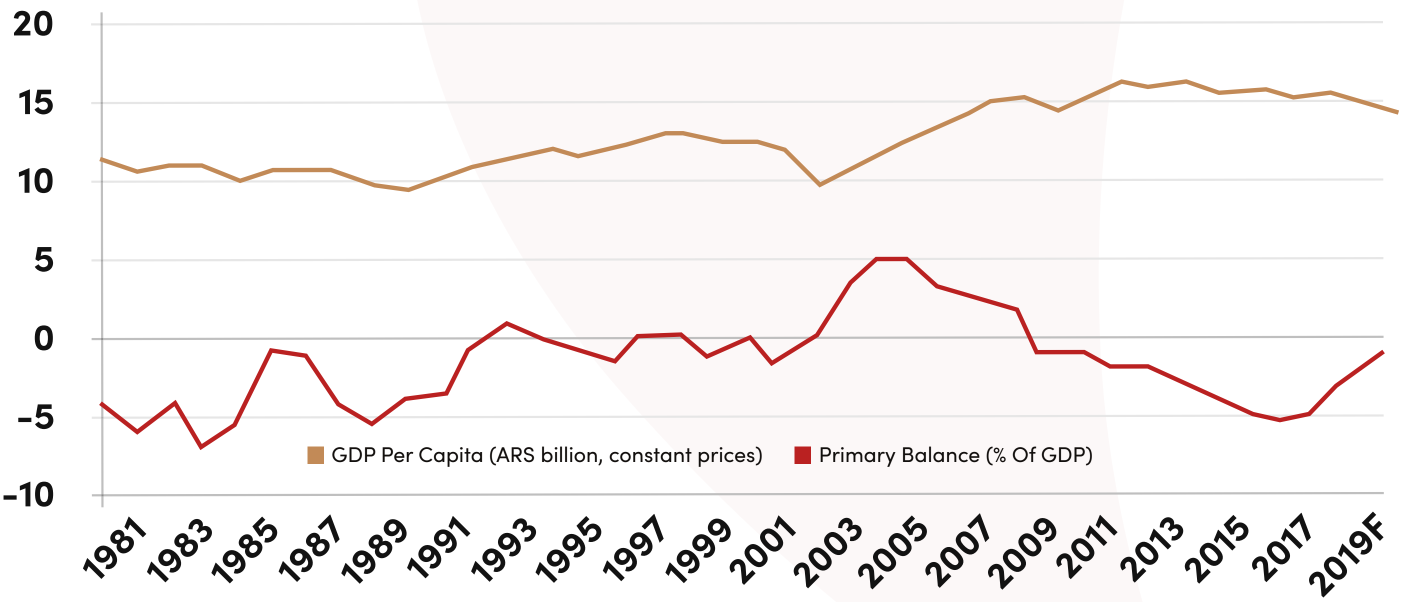
Argentina

In Argentina, the pro-market reforms of the '90s, including trade and financial account liberalization, were accompanied by a de-facto unilateral currency union with the U.S. (through a currency board). This, in the absence of a consistent fiscal policy and with extensive foreign borrowing, produced major vulnerabilities. By the end of the decade, Argentina was living with severe macro imbalances. A strong real-exchange-rate depreciation, a banking crisis and a large sovereign default produced a 10.9% GDP drop in 2002, after three years of milder GDP contractions.

In the years that followed, Argentina's economy expanded at a very fast pace, benefited by the terms-of-trade boom. Loose fiscal and monetary policies contributed to produce average annual GDP growth of 5.9% between 2003 and 2011. During this period, real interest rates remained negative, and primary consolidated expenditures jumped from 25% of GDP to 38%. Inflation increased fast.

Facing a more-adverse external scenario starting in 2012, the government of Cristina Kirchner doubled down on unorthodox economic policies. Harsh exchange-rate and import controls were implemented, and monetary financing of the fiscal deficits became more frequent. There was another sovereign default in 2014 as the government failed to enter into an agreement with the holdouts among its international bondholders.

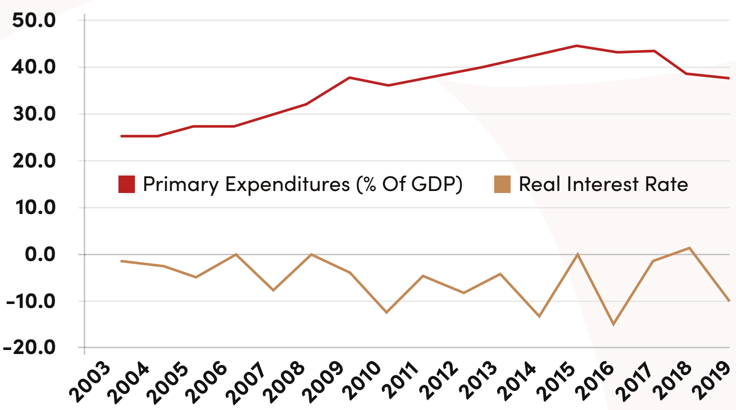
GDP Per Capita And Primary Fiscal Balance



Source: IMF and OJF

In this challenging macro environment, Mauricio Macri took office at the end of 2015. Within months of the new government, a deal was reached with the holdouts; the exchange-rate market was liberalized; utility prices increased, reducing the large fiscal expenditures on subsidies; central-bank lending to the treasury was gradually reduced and real interest rates went up into positive territory; once again Indec (the official statistics institute) was publishing credible numbers for the economy; and interventionist micro policies were eliminated.

Unbalanced Macro Policies



Source: Ministry Of Economy, INDEC and BCRA

Then what went wrong? Economic performance during Macri's term was poor. In only one out of his four years in office was GDP growth positive. Inflation ended 2019 at 55%, almost twice the rate inherited from the previous administration. During the last months of the government, exchange-rate controls were reintroduced and the government unilaterally postponed short-term bond payments issued under local law, putting the sovereign rating into selective default. The government's key miscalculation was the bet on a slow correction of a wide fiscal deficit, which forced a tight monetary policy to curb demand growth and inflation. In the absence of a local debt market, deficit was financed mostly by foreign-currency bond issuance abroad, strengthening the real exchange rate and producing a wide current-account deficit (5.1% of GDP in 2018). When financial conditions for emerging markets tightened in early 2018, financing dried up and international reserves were low, leading to a sharp depreciation of the peso. This brought federal debt owed to multilaterals and private creditors to 57% of GDP today, from 25% at the beginning of Macri's term, and necessitated a rescue package from the IMF. Monetary and fiscal policies had to be tightened fast, and this fed through to inflation and the exchange rate which entered into a feedback loop.

With dismal economic results, Argentina's experience with a non-Peronist president was short-lived. The elections of 2019 brought Alberto Fernandez to power, with former-President Cristina Kirchner returning to the government, now as vice president. Axel Kicillof, former Economy Minister under Cristina Kirchner, was elected Governor of the Province of Buenos Aires, home to 38% of Argentina's population. Fernandez's first set of announcements on the economic front included additional measures to control the exchange rate (taxing purchases of dollars for credit card, travel etc.), taxes on exports, utility price freezes and other consumer price controls, a temporary pause on pension adjustments and wage increases, and a new payment postponement of local law short-term bills. With tight controls on exchange-rate transactions, there is once again a wide spread in the parallel market for dollars (with a stable official exchange rate), interest rates are falling, the central bank is accumulating reserves, and the government is able to place debt in pesos. In all, the government is resorting to financial repression.

Sovereign debt restructuring will be the main challenge for the new administration. In 2020, foreign-currency federal debt service (excluding debt held by the public-sector financial sector) amounts to USD 22.3 billion, compared with USD 7 billion of net reserves. As the government has stated clearly that it is unwilling to tighten fiscal policy significantly, negotiations with bondholders will not be easy. In addition, the government will likely need a new arrangement with the IMF to smooth its heavy payment schedule, something that will likely require a new arrangement with the IMF and commitments that the new administration may not be willing to assume. Under these circumstances, the risk of failing to service debt before a deal is reached is high.

Another big challenge is to bring inflation down permanently. The adverse consequences of the strategy pursued so far (price controls, especially of the exchange rate) will likely start to appear soon: a combination of real-exchange-rate appreciation, higher spending on subsidies and weak investment. In addition, loosening monetary policy will play against disinflation.

Inflation in Argentina

Source: INDEC And Private Estimates

The outlook for the next few years is subject to a lot of uncertainty. We expect another GDP contraction this year, largely due to lower investment. Looking ahead, we expect growth to remain weak, explained by low business confidence, narrow access to foreign financing and macro distortions (including high inflation). A quick and friendly resolution with debt holders is an upside risk to this baseline scenario, which could also help to attract financing to explore the country's vast shale-gas reserves (Vaca Muerta). On the other hand, a downside scenario would include prolonged debt negotiations, intensification of exchange-rate and consumer price controls, import restrictions and business interventions.

Key long-term challenges include: Economic stabilization (convergence of fundamentals to the average of the region); development of a domestic capital/financial market; and exploration of Vaca Muerta.

Forecast: Argentina

	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F
Economic activity											
Real GDP growth - %	2.7	-2.1	2.7	-2.5	-2.1	-2.0	1.0	2.0	2.5	2.5	2.5
Unemployment Rate (year avg) - %	6.5	8.5	8.3	9.2	11.0	11.0	11.0	10.5	10.0	9.5	9.0
Inflation											
CPI - %	26.9	41.0	24.8	47.6	53.8	43.0	43.0	30.0	25.0	20.0	15.0
Monetary policy											
Monetary Policy Rate - eop - %		24.8	28.8	59.3	55.0	30.0	30.0	20.0	15.0	10.0	10.0
Exchange rate & external accounts											
ARS / USD - eop	13	16	19	38	60	80	112	143	175	206	232
Trade Balance - USD Billion	-3.0	2.0	-8.5	-3.7	16.0	14.5	12.0	11.0	10.0	9.0	7.5
Trade Balance - % of GDP	-0.5	0.4	-1.3	-0.7	3.6	3.2	2.6	2.2	1.9	1.6	1.3
Exports + Imports - % of GDP	18.1	20.4	19.6	24.5	25.8	27.0	27.7	27.9	28.1	28.4	28.7
Current Account - % of GDP	-2.7	-2.7	-4.8	-5.3	-0.6	0.4	0.0	-0.3	-0.6	-0.9	-1.3
Foreign Direct Investment - % of GDP	1.8	0.6	1.9	2.0	1.0	0.5	0.8	1.0	1.5	1.5	1.5
Fiscal accounts											
Nominal Balance - % of GDP	-3.9	-5.8	-5.9	-5.2	-3.8	-3.8	-3.8	-3.8	-3.4	-2.9	-2.9
Primary Balance - % of GDP	-4.0	-4.2	-3.8	-2.6	-0.4	-0.4	-0.4	-0.4	0.0	0.5	0.5
Gross Public Debt - % of GDP	55.5	55.6	59.0	89.4	91.6	87.9	89.1	90.7	91.8	92.3	92.9
Net Public Debt - % of GDP	25.4	27.6	31.5	56.7	57.0	56.1	58.3	60.4	62.3	63.6	64.8

* National CPI for 2017 and 2018.

** Excludes central bank transfer of profits from 2016.

*** Excludes central bank and social security holding.

Source: Central Bank, INDEC and Itaú

Canning House

Brazil

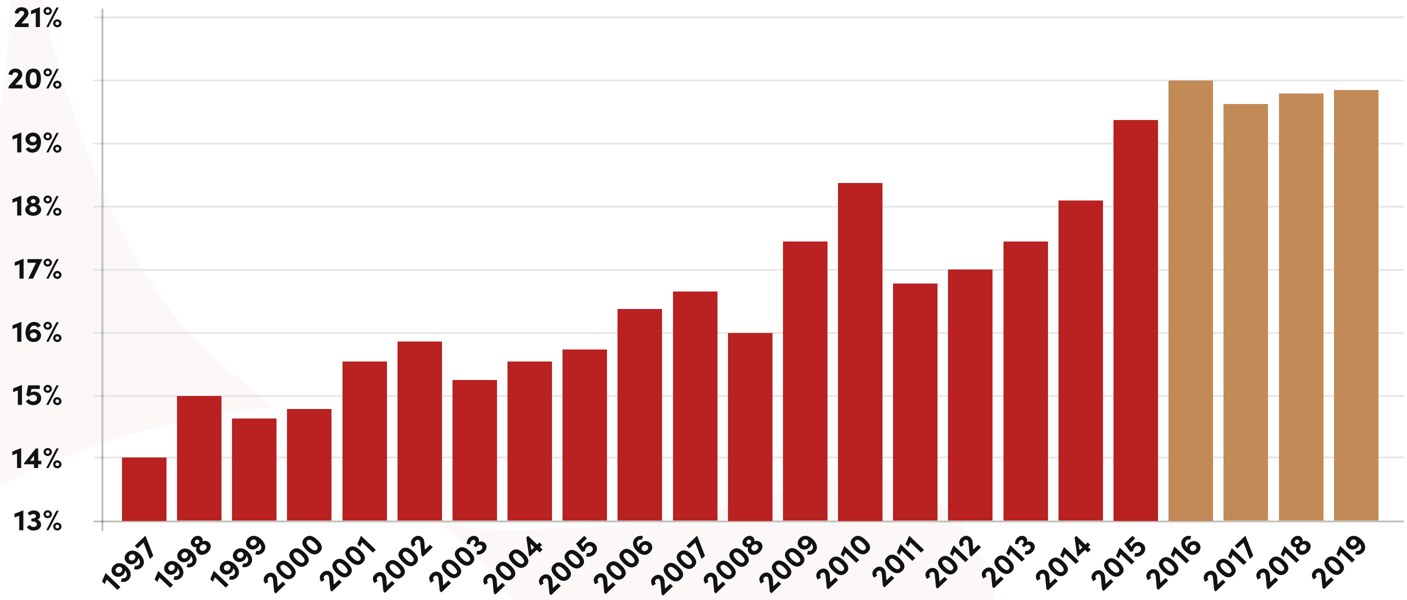
After the end of the military regime, Brazil continued to face the malaise of hyperinflation and dull growth. It was only after at least six failed monetary plans that the country started to tame inflation, in 1994. The Plano Real, a set of measures taken to prompt monetary rationality, brought the inflation in the New Republic from a high of 4900%, in 1994, to one-digit figures.

The effort to control inflation continued with the adoption of the macroeconomic tripod, in 1999. Amidst a handful of emerging-market crises that culminated in a near 35% drop in the value of the Brazilian Real (BRL), three major guidelines for macroeconomic policy were adopted. First, a floating exchange rate regime. Second, fiscal targets, in which the Executive branch committed to pre-determined levels of primary balance each year. Third, inflation targeting. Privatizations and some opening of the economy were also enacted. The growth rate in this period was anaemic (2% from 1995 to 1999, on average), but the foundations for the stronger growth observed in the 2000's were being laid down.

Election-related stress in 2002 presented the first test to the new macroeconomic regime. The BRL depreciated over 50%, prompting the central bank (BCB) to hike interest rates by 600 basis points. However, the crisis was short-lived, and the period that followed saw solid growth rates (above 3% in 2003-2006, on average) and continuous currency appreciation, allowed by the previous decade's reforms – and significantly boosted by the commodity super-cycle. With growing tax revenues, the size of the federal government started to increase (from 15% in 2003, to 18% in 2010, as share of GDP). Additionally, the government reacted to the global financial crisis with fiscal stimuli and sector-specific subsidies, many of which were not reversed until recently. Quasi-fiscal expenditures through the Brazilian National Development Bank (BNDES) also started to increase in role and size, as its total disbursements went from 6% of GDP in 2003 to a peak of 11% in 2015. That was not a pressing issue with record-high growth rates and soaring commodity prices, but eventually problems began to emerge.

From 2011 onwards, macroeconomic policies started to become increasingly interventionist and public spending accelerated. The new framework consisted of artificially low interest rates, weaker exchange rate, tax breaks for industry and credit subsidies (mainly through BNDES), a policy mix that resulted in many imbalances and led to a confidence crisis in 2014. As a result, per capita GDP receded more than 9% in three years. In a context of a sharp economic slowdown, rising unemployment (13% at its peak, in 2017) and low government popularity rates, the Congress impeached President Dilma Rousseff in 2016, with charges of breaching the Fiscal Responsibility Law.

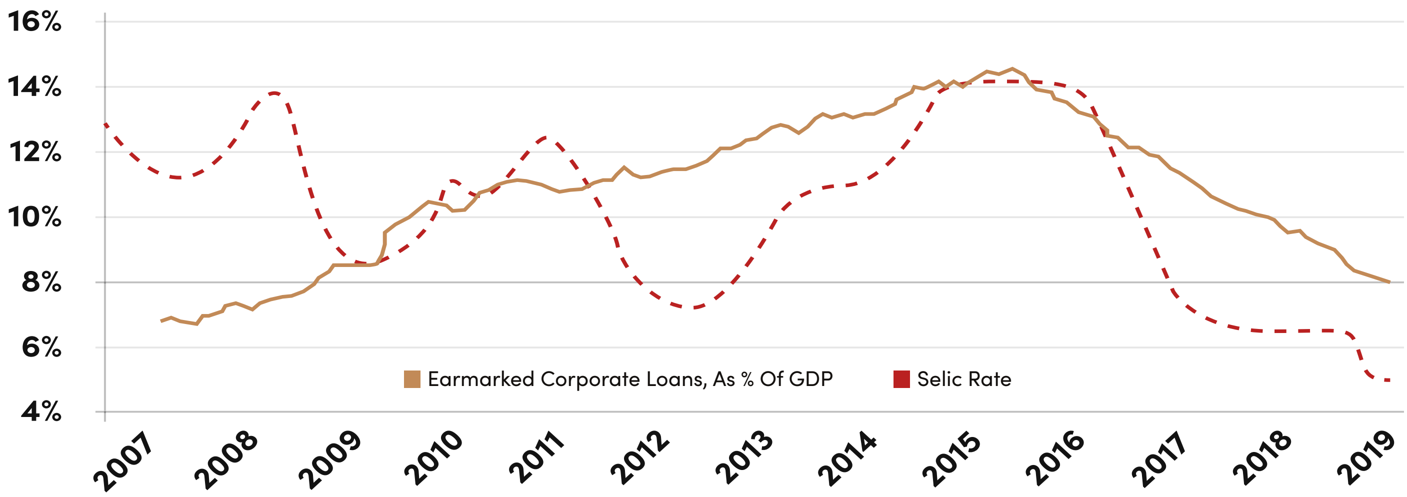
Federal Goverment Spending, as % Of GDP



Source: National Treasury, Itaú

In recent years, the official economic agenda shifted toward fiscal sustainability, re-anchoring expectations and reducing the reliance of the economy on public stimulus. The size of the BNDES started to recede, allowing increased participation of private credit. Microeconomic measures, such as the labour reform (to increase national labour legislation flexibility) and concessions (handing the control of some public services to the private sector) started to take place. The new framework allowed the central bank to fuel a drastic reduction of inflation expectations and loosen monetary policy. The spending cap – a rule that prevents public expenditure from increasing in real terms – was put in place, a watershed for the fiscal adjustment effort. Cuts to comply with the ceiling were first made on public investment, but that was not enough. The bulk of the adjustment had to come from mandatory spending, which accounts for over 90% of the federal government's budget. With no minimum age requirements and an aging population, the pension system was the obvious candidate – also the biggest and fastest growing part of public spending, without which no sustainable adjustment would be complete. Indeed, while the pension reform wasn't approved, the country had to live with high uncertainty and sluggish growth, despite the positive economic changes that were already in place and the low starting point set by 2015-16's deep recession (after falling nearly 7% in 2015-16, GDP grew only 1.3% in 2017, 1.3% in 2018 and an estimated 1.2% in 2019).

Structural Drop In Interest Rates Accompanied Relevant Changes In Subsidized Credit

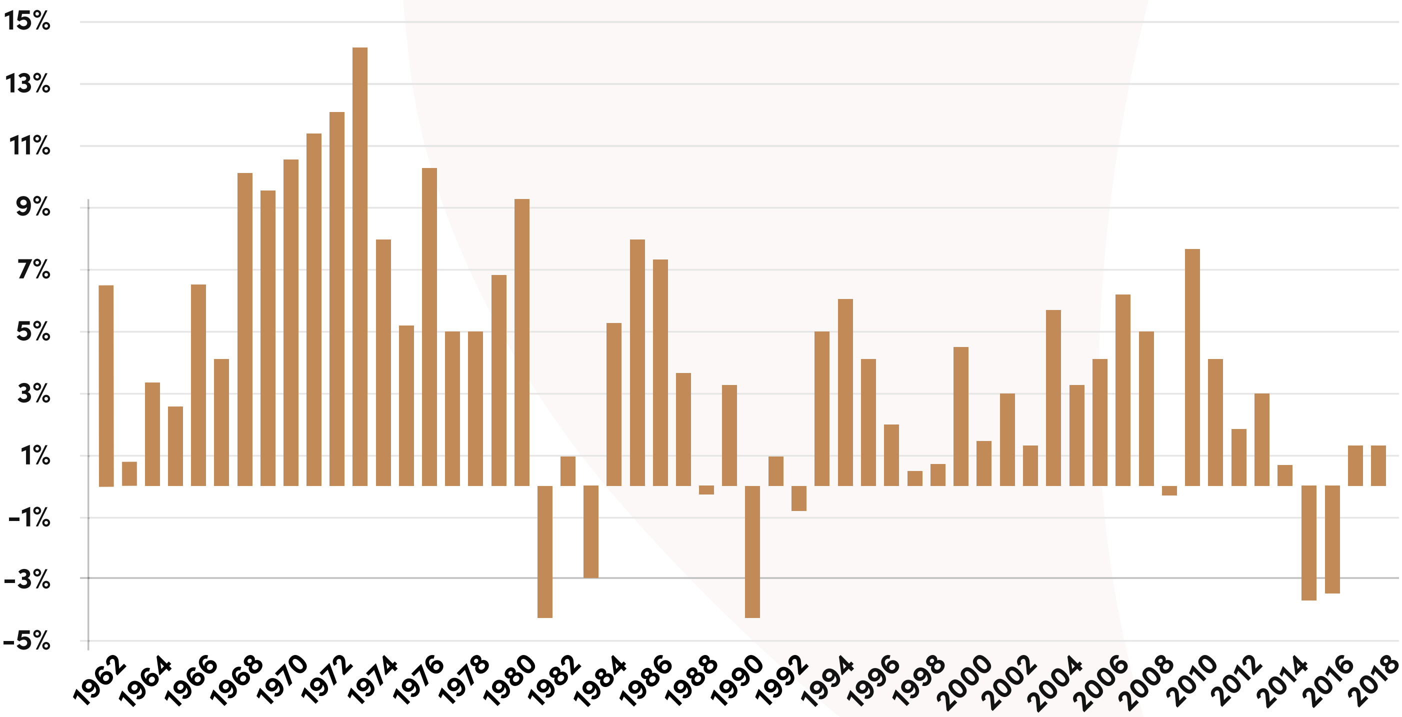


Source: BCB, Itaú

Market-friendly policies continued to be implemented in 2019, culminating in the approval of the pension reform. With significantly lower risks related to fiscal sustainability and low inflation levels, the Central Bank had further room to provide stimulus to the economy, taking the benchmark Selic rate to an all-time low of 4.25% p.a. Lower interest rates are boosting the private credit and capital markets, making room for an expected pick-up in investment and continuation of the ongoing recovery in consumption. Recent indicators show that the economy gained some momentum in the second half of 2019, with increasing confidence indicators, stronger formal job creation and upward revisions of market expectations for GDP growth, after a long sequence of frustrations. The economic team continues to push forward to deepen the fiscal adjustment and promote an efficiency agenda, with privatizations, opening of the economy, public concessions and a tax reform. The latter, in particular, has seen an increasingly positive momentum for its approval in Congress, especially after regional and federal governments reached an agreement. While other proposals do not enjoy such a positive outlook, some of them, such as infrastructure concessions, may still be approved in 2020.

Going forward, we expect the Brazilian economy to remain in a gradual, but healthy, private sector-driven recovery. We forecast that the country will grow by 2.2% in 2020 and accelerate to 3.0% in 2021, even when taking account of the sluggish global growth and the continued fiscal consolidation. There are still several challenges ahead, especially from a fiscal adjustment standpoint, to ensure that the recovery is sustainable. Nevertheless, after years of waiting for a rebound, companies appear to be preparing for a gear upshift, without aid from the government.

GDP Growth, % YOY



Source: BCB, Itaú

That said, the key risk in the short term is the possibility that the economy fails to recover considerably, which may decrease support for further fiscal adjustment. The pension reform, albeit crucial, was only the first step. Now, other measures are required to maintain the public spending on a downward trend, such as mandatory expenses control. The scenario of low interest rates and faster economic growth may create conditions to reduce public debt in the short term, but these are temporary factors. The control of government expenditure is the main way to ensure the structural stabilization of the fiscal accounts.

For the longer term, Brazil needs to increase its productivity. Tax simplification, opening the economy and cutting red tape are measures needed to improve the economy's outlook in the medium and long term. In that sense, the main risk is that, once the fiscal reforms agenda is approved, the country loses its reformist momentum and falls short of approving other micro-economic improvements. Without an efficiency agenda, it is unlikely that Brazil will ever reach growth rates capable of catching up with other developed economies.

Forecast: Brazil

	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F	2024F	2025F
Economic activity											
Real GDP growth - %	-3.5	-3.3	1.3	1.3	1.2	2.2	3.0	3.0	2.3	2.2	2.0
Unemployment Rate (year avg) - %	8.5	11.5	12.7	12.3	11.9	11.6	11.2	10.6	9.5	8.8	7.9
Inflation											
IPCA - %	10.7	6.3	2.9	3.7	4.3	3.3	3.5	3.5	3.3	3.0	3.0
IGP–M - %	10.5	7.2	-0.5	7.5	7.3	4.0	4.0	3.5	3.3	3.0	3.0
Monetary policy											
Monetary Policy Rate - eop - %	14.25	13.75	7.00	6.50	4.50	4.25	4.50	5.00	5.75	6.00	6.00
Exchange rate & external accounts											
BRL / USD - eop	3.96	3.26	3.31	3.88	4.03	4.15	4.15	4.15	4.15	4.15	4.15
Trade Balance - USD Billion	19.7	47.7	67.1	58.3	46.7	40.3	39.8	53.5	60.7	77.1	85.1
Trade Balance - % of GDP	1.1	2.7	3.3	3.1	2.5	2.2	2.0	2.5	2.7	3.2	3.3
Exports + Imports - % of GDP	20.1	18.0	17.9	22.3	21.8	22.2	22.3	23.1	22.4	22.6	22.3
Current Account - % of GDP	-3.0	-1.3	-0.7	-2.2	-2.8	-2.7	-2.6	-1.9	-1.0	-0.2	0.3
Foreign Direct Investment - % of GDP	3.6	4.1	3.3	4.1	4.5	4.6	4.3	5.6	5.9	6.3	6.6
Fiscal accounts											
Nominal Balance - % of GDP	-10.2	-9.0	-7.8	-7.1	-5.9	-5.1	-4.2	-2.7	-2.1	-2.2	-1.9
Primary Balance - % of GDP	-1.9	-2.5	-1.7	-1.6	-0.9	-1.0	-0.5	1.5	1.9	2.1	2.4
Gross Public Debt - % of GDP	65.5	69.9	73.7	76.5	75.7	75.0	74.1	71.4	69.3	67.8	66.0
Net Public Debt - % of GDP	36.0	46.2	51.4	53.6	55.6	56.9	57.4	58.1	55.8	55.5	54.3

Source: IBGE, FGV, BCB and Itaú

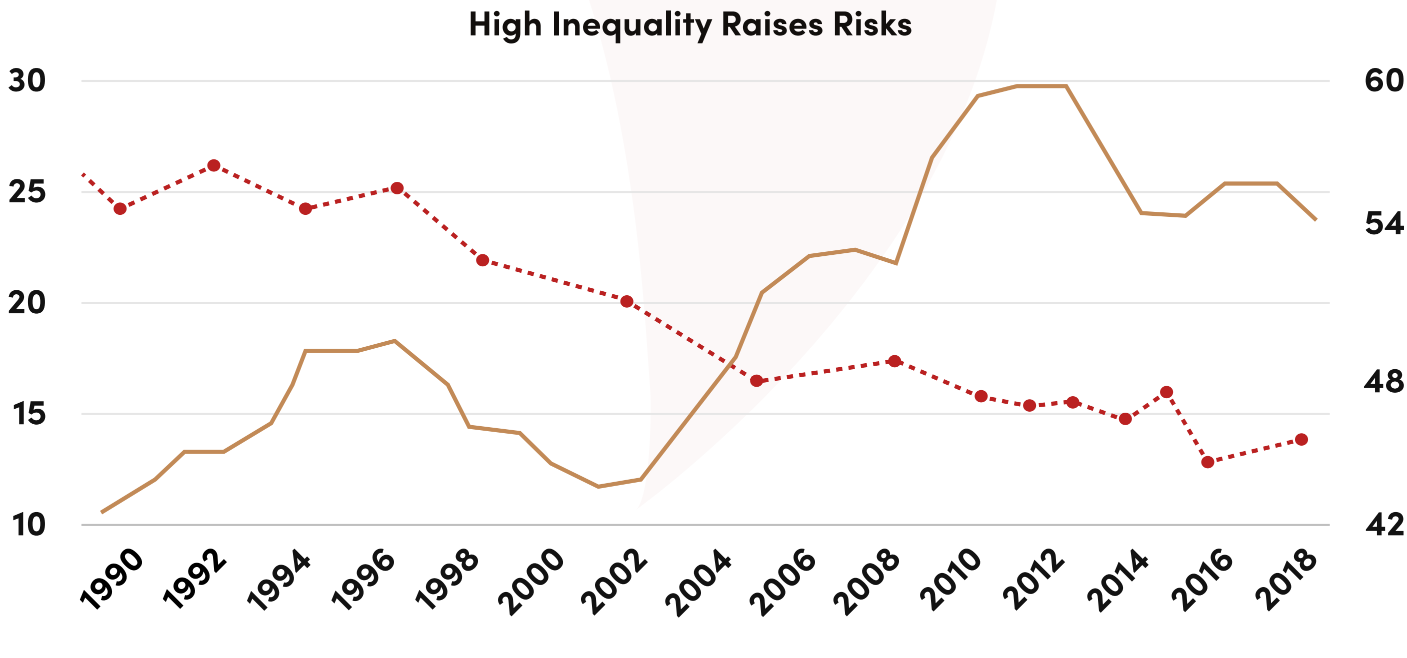
Chile

The final decade of the twentieth century saw Chile implementing reforms that strengthened its institutional framework, aiding solid economic growth that funded poverty reduction. Following the decision to give the central bank autonomy at the close of the ’80s, the ’90s saw greater integration into the global economy with tariff reductions and numerous free-trade agreements. Privatization plans ensued. During the decade, Chile recorded its highest average growth rate in a hundred years at more than 6%. However, at the end of the 1990s, Chile entered a mild recession as the Asian crisis spread to the region, amid deteriorating terms of trade.

In the mid-2000s, the commodity super-cycle provided further impetus for Chile’s economic advancement. The government established the Economic and Social Stabilization Fund, utilizing a structural balance rule to provide greater fiscal stability by saving transitory windfalls for use in years of low growth and/or lower copper prices. Government assets peaked at close to 25% of GDP, making Chile a net creditor.

During the global financial crisis, Chile was severely impacted, but solid fundamentals allowed a strong policy response. Automatic adjustment mechanisms (i.e., floating exchange rates), alongside an ambitious fiscal stimulus package and a historically supportive monetary-policy stance (including a quantitative easing program), contributed to lifting the economy quickly out of recession.

While Chile's solid economic performance brought its GDP-per-capita close to those of advanced economies and greatly reduced poverty, inequality has remained high. In addition, the end of the commodity super-cycle reduced growth rates significantly. This is the context for the recent episodes of intensified social unrest. Specifically, those who took to the streets demanded a greater presence of the state in areas such as education and pensions. While some reforms in the past few years (especially in education and labour) sought to address people's concerns, the environment of poorer fiscal revenues (due to lower growth and lower copper prices) and the lack of political consensus meant that reforms did not advance as fast as demanded. In 2019, strong protests erupted, leading the government to announce an ambitious stimulus package that dips into its Sovereign Wealth Funds (SWFs - buffers accumulated over the past decades because of a low tax burden and low public debt) in a bid to boost pensions and lower healthcare costs, among other areas. Furthermore, political actors entered into an agreement to organize a plebiscite on a new constitution, as the current one dates back to the dictatorship years. Tax hikes for the richer part of the population were also announced.

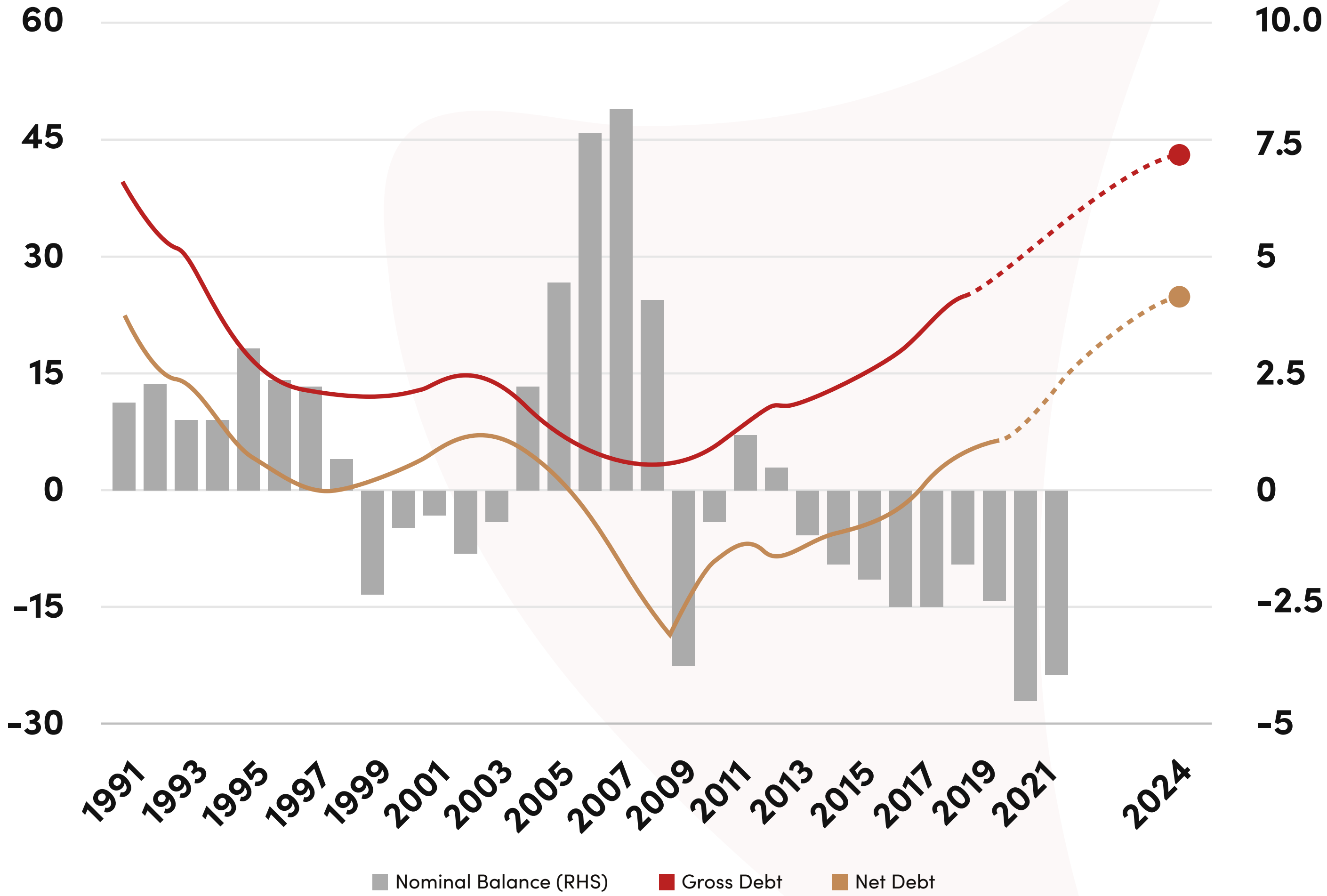


Source: IMF, OECD

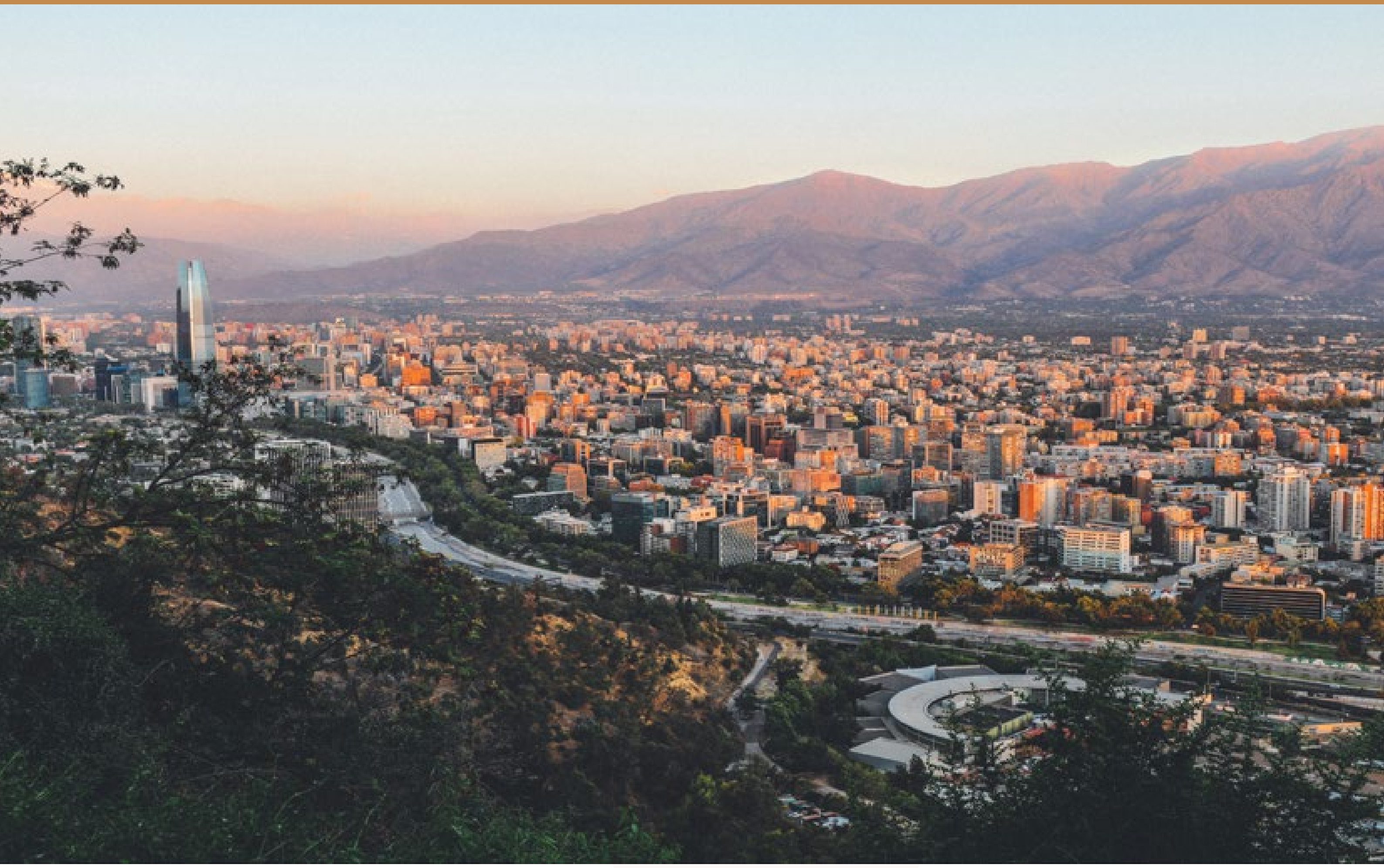
Uncertainty stemming from the process to revamp the constitution, rising public debt and the stability of the business operating climate will have an impact on growth in the short term. Despite supportive fiscal and monetary policies (the fiscal package announced is around 2% of GDP and market real interest rates remain at negative levels), uncertainty will likely stand in the way of a meaningful recovery in the short term. During 2020-21, the electoral calendar will be robust, including the plebiscite for a constitutional rewrite (April 2020), the election of constitutional representatives – depending on the result of the plebiscite – and municipal and regional authorities (October 2020), primary presidential and congressional elections (mid-2021), another plebiscite to approve the new constitution (3Q21 if the new document is ready by then), and a general (presidential and congressional) election in November 2021. Over the medium term (2022-25), as long as uncertainty diminishes (our base scenario), a cyclical recovery is likely.

If the reform agenda eases social tensions sooner than we expect, with the implementation followed by a fiscally prudent approach and the new constitution still viewed in broadly market-friendly terms, growth in Chile could rebound faster than we forecast. On the other hand, a meaningful increase of electric car production might boost the demand for copper (while lowering demand for oil) and lithium (used in batteries) an abundant commodity in Chile – lifting Chile's terms of trade since, besides exporting metals, Chile is an oil importer.

Debt On The Rise (% Of GDP)



Source: BCCh, Itaú



Over the long term, copper supply from Chile as well as demand for copper may suffer structural changes. With social demands attracting greater fiscal expenditure (utilizing SWFs and raising debt), the flagship state-owned copper producer Codelco would struggle to find a capital injection that would help modernize its mines and maintain production. Given that the ore-grade quality of copper extracted is decreasing, processing costs would increase, posing a risk to the sustainability of copper-related fiscal revenue, while debt metrics for the company could increase. At the same time, private investment in mining may encounter a more challenging scenario, especially considering environmental issues. On the other hand, a meaningful increase of electric car production might boost the demand for copper (while lowering demand for oil) and lithium (used in batteries) an abundant commodity in Chile – lifting Chile's terms of trade since, besides exporting metals, Chile is an oil importer.

Forecast: Chile

	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F
Economic activity											
Real GDP growth - %	2.3	1.6	1.5	4.0	1.2	1.2	1.9	2.5	3.2	3.2	3.2
Unemployment Rate (year avg) - %	6.2	6.5	6.7	7.0	7.0	8.5	8.0	7.4	7.0	7.0	7.0
Inflation											
CPI - %	4.4	2.7	2.3	2.6	3.0	3.3	3.0	3.0	3.0	3.0	3.0
Monetary policy											
Monetary Policy Rate - eop - %	3.50	3.50	2.50	2.75	1.75	1.25	1.25	2.25	3.25	4.00	4.00
Exchange rate & external accounts											
CLP / USD - eop	709	670	615	694	753	780	770	750	740	730	730
Trade Balance - USD Billion	3.4	4.9	7.4	4.7	4.2	11.6	11.8	7.5	4.0	3.0	3.0
Trade Balance - % of GDP	1.4	1.9	2.6	1.6	1.5	4.3	4.2	2.5	1.2	0.8	0.8
Exports + Imports - % of GDP	50.5	45.8	46.6	49.1	48.7	48.4	49.1	49.5	50.5	52.0	52.0
Current Account - % of GDP	-2.4	-1.6	-2.1	-3.1	-2.9	-0.4	-0.6	-1.5	-2.0	-2.5	-2.5
Foreign Direct Investment - % of GDP	8.8	4.8	2.1	2.0	3.9	2.1	2.2	2.2	3.7	4.2	4.0
Fiscal accounts											
Nominal Balance - % of GDP	-2.1	-2.7	-2.7	-1.6	-2.8	-4.4	-4.0	-3.5	-3.0	-2.5	-2.5
Gross Public Debt - % of GDP	17.3	21.0	23.5	25.6	26.8	29.4	32.0	34.6	37.2	40.0	42.0

Source: Central Bank, INDEC and Itaú

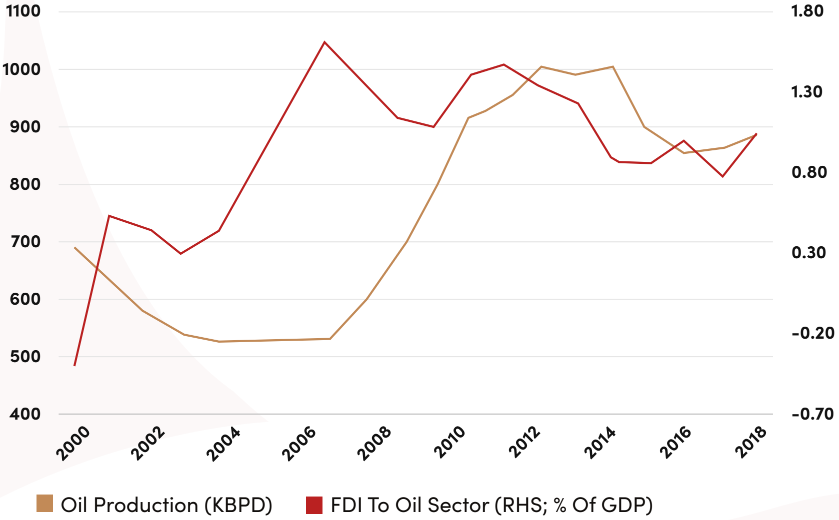
Colombia

During the '90s, Colombia changed its constitution, opened the economy and implemented important economic reforms. A new Constitution was written in 1991, introducing an autonomous central bank. Economic growth at the beginning of the '90s recorded rates similar to those posted in the 1980s (around 3.7%); however, from 1993 to 1996, the discovery of extensive oil deposits, the opening of the economy and external capital inflows contributed to a boom in private and public spending. The excess financing requirement led to a wide current-account deficit.

At the end of the 1990s, Colombia faced its worst economic crisis. GDP fell by 4.2% in 1999 and its trading-band exchange-rate regime collapsed.

During the 2000s, the opening of the oil industry and an improvement in the security situation combined with high oil prices produced strong growth rates. A newly created National Hydrocarbons Agency was made responsible for assigning blocks for exploration. At the same time, as the government fought guerrilla activity, attacks against oil pipelines fell drastically. Oil production almost doubled between 2004 and 2013, with FDI flows to the oil sector totaling USD 31 billion in the same period. Colombia was one of the few Latin American economies that avoided a GDP contraction in 2009 (during the global financial crisis). By 2011, Colombia's sovereign debt reached investment-grade status at the three major rating agencies.

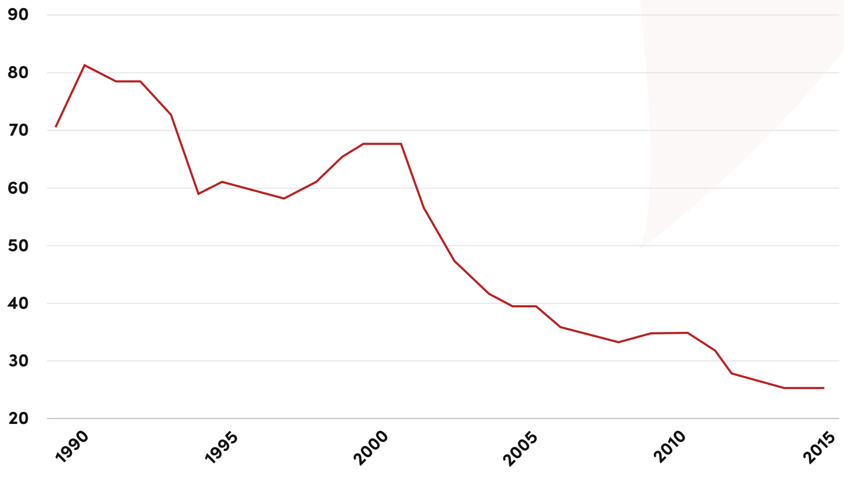
Increased Dependence On Oil



Source: Banrep; Bloomberg

With lower oil prices, vulnerabilities have re-emerged over the past 5 years. Government income was considerably affected, and public expenditure was only supported by increasing indebtedness (gross central government debt is approaching 50% of GDP). Wide fiscal deficits put pressure on external accounts, and the current-account deficit averaged 4.4% of GDP in 2015-18. While the peace agreement with the FARC reached in 2016 was a milestone, the bulk of the benefits of lower guerrilla activity for the economy had already been received in the prior years.

Intentional Homicides (Per 1000)



Source: UN

We expect, growth will remain close to potential in the years ahead. Like much of the rest of the region, Colombia's economy lost its allure following the end of the commodity super-cycle. Still, growth has performed better than expectations. In 2019, the economy expanded by 3.3% (the highest rate among the six countries covered in this report). Strong credit growth and consumption by Venezuelans migrating to Colombia are likely the reasons behind the growth outperformance.

So far protests (and their impact) have been mild. Joining the regional wave of demonstrations, Colombians took to the streets in November 2019. A general strike had already been called months earlier, but it gained momentum through the Chilean protests. The mixed bag of social issues at play included the rejection of potential reforms to pension laws (later retirement) and labour laws (more flexibility), support for increased spending on education, the slow progress of the peace-deal implementation, and challenges for the indigenous community. But unlike regional peers, the protests were generally peaceful, with only isolated incidents in some cities, including Bogotá, and curfews declared by local authorities (most notably in the city of Cali). Hence, an abrupt disruption of business operations did not occur. However, fundamentals in Colombia are more fragile than in Chile, making it challenging to address growing social-spending demands without risking sovereign ratings. In all, fiscal deficit reduction in the years ahead will be difficult, and will increase the government's dependence on one-off revenue sources (such as privatizations).

Risks for the Colombian economic outlook include the domestic political scenario, Venezuela's crisis, and external financial conditions. The troubled political environment makes fiscal consolidation difficult, increasing the probability that Colombia could lose its investment-grade status at some point. A victory by an anti-establishment candidate in the 2022 presidential elections is a possibility. A further increase in the flow of Venezuelans into the country may put additional pressure on fiscal accounts. Also, given wide twin (fiscal and current account) deficits, the Colombian economy is vulnerable to changes in external financial conditions. On the other hand, an orderly integration of Venezuelan immigrants into the economy constitutes an upside risk.

The long-term challenges include export diversification, labour-market formalization and infrastructure advancement. Proven oil reserves (less than 10 years of current production) are low, so export diversification and increasing oil reserves are crucial. Meanwhile, informality plays against productivity growth in addition to its adverse effect on tax collection. Finally, poor infrastructure (mainly related to transportation) will continue to be on the government agenda in the long term.

Forecast: Colombia

	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F	2024F	2025F
Economic activity											
Real GDP growth - %	3.0	2.1	1.4	2.5	3.3	3.1	3.0	3.5	3.3	3.3	3.2
Unemployment Rate (year avg) - %	8.9	9.2	9.4	9.7	10.5	10.0	9.6	9.4	9.2	9.0	9.0
Inflation											
CPI - %	6.8	5.8	4.1	3.2	3.8	3.3	3.0	3.0	3.0	3.0	3.0
Monetary policy											
Monetary Policy Rate - eop - %	5.75	7.50	4.75	4.25	4.25	4.25	4.50	4.50	4.50	4.50	4.50
Exchange rate & external accounts											
COP / USD - eop	3,175	3,002	2,932	3,254	3,287	3,320	3,320	3,250	3,220	3,190	3,150
Trade Balance - USD Billion	-15.6	-11.1	-6.0	-7.0	-10.8	-9.2	-7.0	-5.5	-4.0	-3.0	-3.0
Trade Balance - % of GDP	-5.3	-3.9	-1.9	-2.1	-3.3	-2.8	-2.0	-1.4	-0.9	-0.7	-0.6
Exports + Imports - % of GDP	29.8	26.4	26.4	27.5	28.2	28.3	28.3	28.8	29.0	29.3	29.5
Current Account - % of GDP	-6.3	-4.3	-3.3	-3.9	-4.5	-4.4	-4.0	-3.7	-3.5	-3.2	-2.7
Foreign Direct Investment - % of GDP	4.0	4.9	4.5	3.5	4.4	4.2	4.0	3.8	4.0	3.8	3.5
Fiscal accounts											
Nominal Balance - % of GDP	-3.0	-4.0	-3.6	-3.1	-2.5	-2.2	-2.0	-1.8	-1.8	-1.8	-1.8
Gross Public Debt - % of GDP	45.0	46.0	47.0	50.2	52.9	53.4	54.3	54.1	53.1	52.1	51.1

Mexico

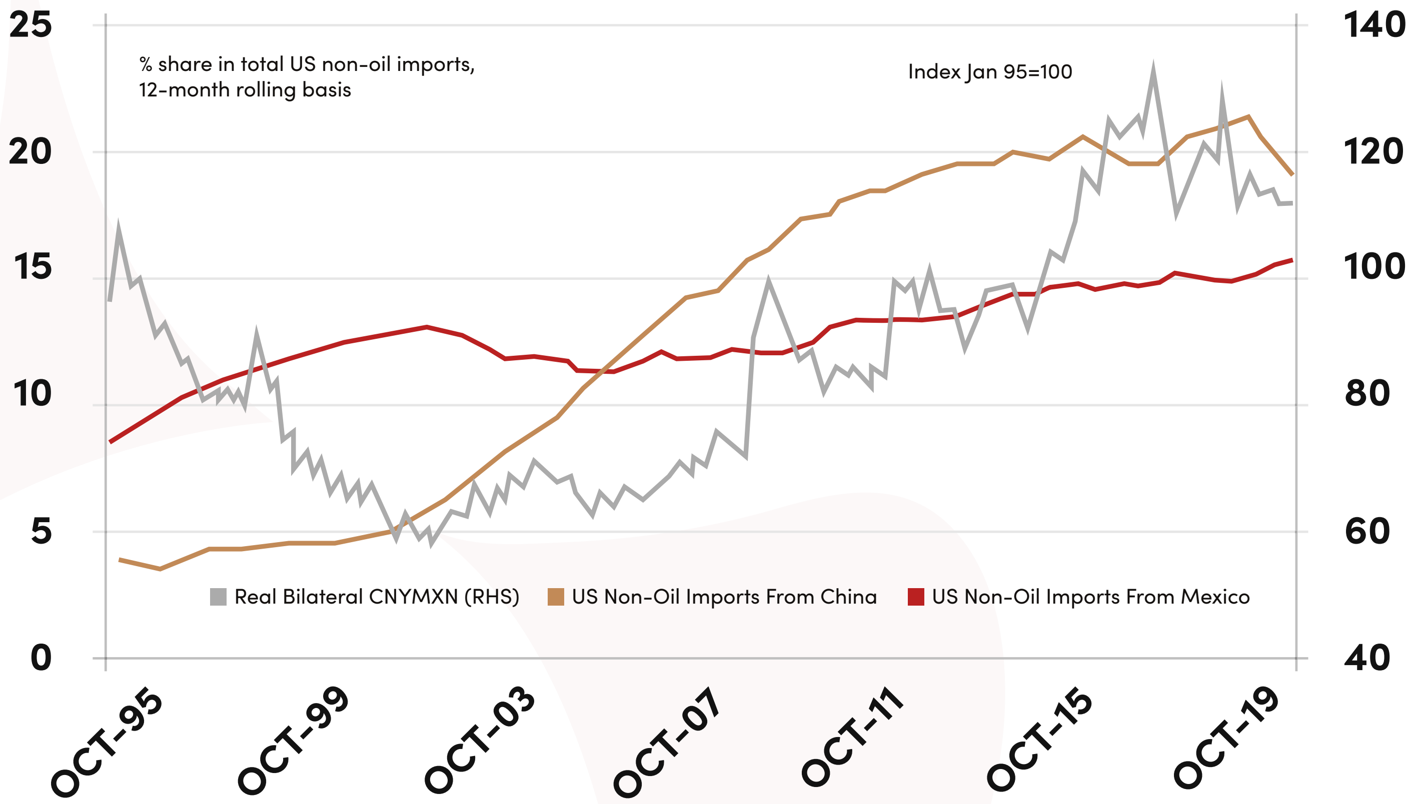
Mexico's Tequila crisis was triggered in a context of the US Federal Reserve increasing rates, and political turbulence amid strong unbalanced growth. Mexico's GDP grew at strong pace in the early '90s. However, growth was accompanied by a deterioration of macro fundamentals: a wide current-account deficit funded mostly by portfolio flows; low international reserves; and rapid credit expansion with poor oversight. Although net public debt before the crisis was low, it was short-term and largely dollarized.

Unlike most Latin American countries, Mexico did not benefit from the commodity boom and China's economic expansion during the 2000s. On the contrary, China's entry into the World Trade Organization (WTO) in December 2001 was a negative shock for Mexico, as it competed with Mexico's manufacturing exports. As a result, US non-oil imports from Mexico declined to 12.2% in 2009, from 12.6% in 2001, while US non-oil imports from China went to 16.8% from 5.2%. At the same time, the state monopoly on oil, combined with the fiscal reliance on oil revenues, meant that investment in Mexico couldn't benefit much from higher oil prices. In fact, oil output fell by 23.5% from 2005 to 2012, despite an increase of more than 200% in the Mexican oil price mix during the period.

Post-Tequila-crisis recovery was supported by a US-IMF financial package and the implementation of the North American Free Trade Agreement (NAFTA). Alongside the rescue package, Mexico continued to liberalize trade. The NAFTA trade agreement helped the development of Mexico's manufacturing sector, synchronizing the Mexico and US business cycles.

In this context, the global financial crisis hit Mexico harder than other countries in the region, as China recovered from the crisis faster than the US did. Mexico's post-global-crisis economic recovery was supported mainly by the US industrial sector and China's loss of trade competitiveness. A relative-price adjustment between China and Mexico (in real terms, the Mexican peso has weakened by more than 30% against the Chinese yuan since the beginning of 2010) led Mexico to regain market share in the U.S. economy. At the same time, Mexico embarked on a series of pro-market reforms (including opening of the oil industry to private investment, and labour, telecom and financial reforms) that benefited productivity and investment; informality in the labour market declined from 60% in 2012 to 56.1% currently, while telecom service fees have fallen by around 30% since 2012.

Mexico And China Trade Competition



Source: Banxico, Bloomberg, Haver, Itaú

However, in 2019, Mexico's economy slowed down sharply. Uncertainty over the direction of domestic policy and trade relations with the U.S. (tariff threats and doubts over the approval of the USMCA in the U.S. Congress) weighed on investment during the year; gross fixed investment contracted 5.1% year-on-year as of November 2019. Moreover, the effect of the government transition on fiscal execution affected construction (something frequent in the first year of a new administration), while Mexico's manufacturing sector decelerated due to the slowing down of US industrial production. In contrast, private consumption has performed somewhat better (0.9% YoY as of November 2019). Lower inflation and the hike in the minimum wage at the beginning of 2019, which spilled over to overall formal sector wages, boosted the real wage bill despite the deceleration in employment, providing support for private consumption.

We expect economic activity to recover gradually after 2019, but with a growth rate below potential. A less restrictive fiscal stance (the government-transition effect should be gone) and the approved USMCA in the U.S. Congress, reducing uncertainty, should support some recovery.

The government's approval rate remains high, while fiscal accounts are solid, but risks of fiscal slippage remain. The government's popularity sits at around 70% even with weak economic growth and rising violence. Moreover, despite a fall in tax revenues due to weak economic activity and the decline in oil production and revenues, fiscal accounts remain solid, partly because of the above-mentioned transition effect and the use of sovereign funds (recorded as revenues when used). However, there are important fiscal challenges. Specifically, the fiscal balance can deteriorate if growth continues to disappoint amid many spending promises made by the current administration. Our base scenario is that Mexico will face a combination of moderately higher fiscal deficits and a higher tax burden, although AMLO has committed to no tax changes during the first three years of his mandate. In fact, non-oil tax revenues in Mexico stand at a low 13.2% of GDP. Still, the low tax burden can be attributed to a high degree of income concentration, informality and a long list of tax exemptions (specifically, food and medicines are exempted from VAT and a lower VAT rate is in effect on the northern frontier) – factors that will be hard to reverse. So, a potential fiscal reform may target that part of society that is already taxed, eroding the country's competitiveness.

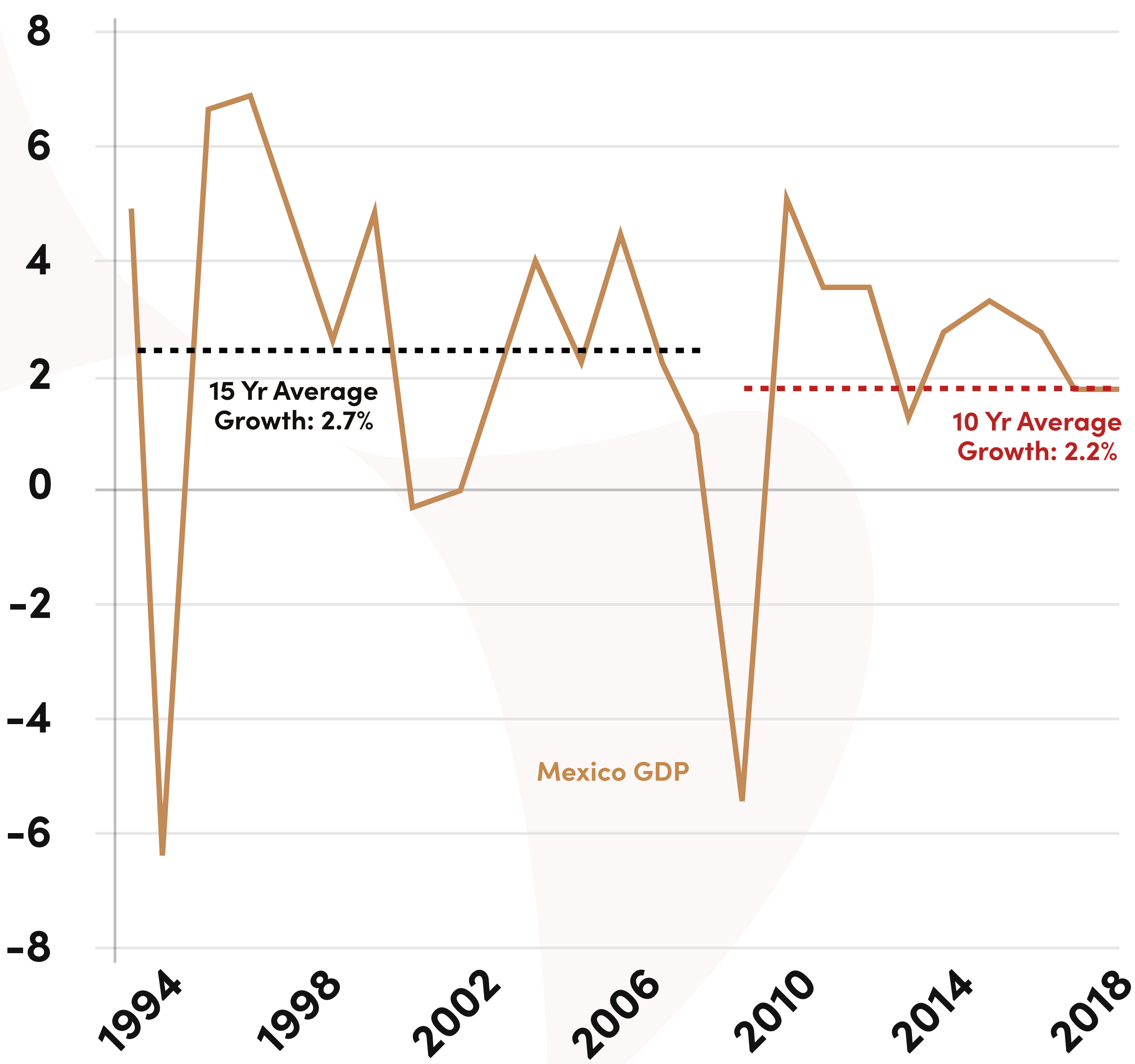
Pemex's financial health is another challenge for the fiscal accounts. It will be hard for the government to stabilize oil production and thus fiscal oil revenues, while preserving Pemex's credit ratings, considering its unwillingness to let the private sector participate in oil exploration and production (E&P). The tax burden on Pemex (at around 60% of its gross sales) is already too large, leaving it with insufficient resources to make the necessary E&P investment to stabilize oil output.

Upside risks to our economic outlook are mainly related to the current administration becoming more pragmatic with economic policy, which would reduce uncertainty. In particular, allowing private participation in the energy sector and joint ventures with Pemex would reduce the need for fiscal resources for E&P, and also send a reconciliation signal to the private sector. On the fiscal front, the announcement of a tax reform that eliminates tax exemptions would reinforce public finances, without much damage to competitiveness.

On the other hand, downside risks to our scenario include deterioration in trade relations with the US and a deterioration of economic fundamentals. While the USMCA was signed and approved by the U.S. Congress, we cannot discount further trade threats similar to those made in May 2019. Moreover, persistent weak economic activity could lead the administration to implement stronger fiscal and quasi-fiscal stimuli, leading to a deterioration in the country's ratings and confidence.

In the long term, Mexico could benefit from a more consumption-intensive Chinese economy, while insecurity and low productivity are key challenges. China moving toward a more consumption-intensive economy, eroding its competitiveness as a manufacturing exporter, could help Mexico's manufacturing sector. However, productivity may hinder growth in service sectors. Low productivity is associated with a still-high informality rate (55.6%), limited financial depth (domestic credit to the private sector is around 26.8% vs. the OECD average of 79.6%) and weak rule of law (Mexico ranks in the bottom 27th percentile in rule of law, according to Worldwide Governance Indicators). Moreover, the presence of organized crime hampers the investment outlook.

Low Productivity Hinders Potential GDP



Source: INEGI and Itaú

Forecast: Mexico

	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F	2024F	2025F
Economic activity											
Real GDP growth - %	3.3	2.9	2.1	2.1	-0.1	0.9	1.5	1.8	2.0	2.0	2.0
Unemployment Rate (year avg) - %	4.4	3.9	3.4	3.3	3.5	3.6	3.6	3.5	3.4	3.4	3.3
Inflation											
CPI - %	2.1	3.4	6.8	4.8	2.8	3.2	3.3	3.3	3.3	3.3	3.3
Monetary policy											
Monetary Policy Rate - eop - %	3.25	5.75	7.25	8.25	7.25	6.00	5.50	5.50	5.50	5.50	5.50
Exchange rate & external accounts											
MXN / USD - eop	17.2	20.7	19.7	19.7	18.9	19.6	19.8	19.9	19.7	19.6	19.4
Trade Balance - USD Billion	-14.7	-13.1	-11.0	-13.6	5.8	-5.0	-12.0	-8.0	-9.0	-10.0	-11.0
Trade Balance - % of GDP	-1.3	-1.2	-0.9	-1.1	0.5	-0.4	-0.9	-0.6	-0.6	-0.6	-0.7
Exports + Imports - % of GDP	66.3	70.7	71.2	74.9	73.3	73.3	74.3	74.6	74.1	72.1	71.0
Current Account - % of GDP	-2.6	-2.3	-1.7	-1.8	-0.2	-1.2	-1.6	-1.5	-1.6	-1.7	-1.8
Foreign Direct Investment - % of GDP	3.1	3.5	2.8	3.1	2.3	2.0	1.9	1.8	1.8	2.0	2.2
Fiscal accounts											
Nominal Balance - % of GDP	-3.4	-2.5	-1.1	-2.1	-1.6	-2.1	-2.2	-2.4	-2.5	-2.6	-2.7
Net Public Debt - % of GDP	44.0	48.2	46.1	46.1	45.3	46.3	46.6	47.1	47.2	47.3	47.4

Source: INEGI, Banxico and Itaú

Peru

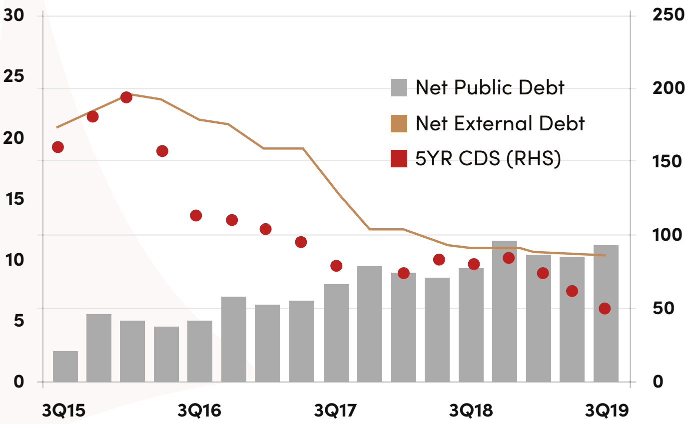
Stabilization policies, opening of the economy to trade and international capital, and weakening of guerrilla groups were the main legacies of the '90s. The main aim of policies was the eradication of hyperinflation, the return of Peru to international markets and a stabilization of the balance of payments. Inflation went from 2,433% at the end of 1989 to 3.73% by the end of 1999. Likewise, a series of structural reforms were oriented to reducing government and eliminating distortions in the economy. The structural reforms included a liberalization of trade, which simplified and lowered tariffs. The administration also focused on weakening subversive groups such as Sendero Luminoso, Movimiento Revolucionario Túpac Amaru and El Commando Paramilitar Rodrigo Franco.

The Asian, Russian and long-term capital management crises were reminders of Peruvian vulnerabilities. After a marked resumption of sustained growth in the Peruvian economy from 1993 to 1997, growing at an average rate of 7%, the economy contracted 0.4% in 1998.

Economic activity was driven by a commodity boom during the first decade of the 21st century. High commodity prices, especially for copper, benefitted Peru, expanding traditional exports and attracting foreign-direct investment (FDI). GDP expanded at an average rate of 5.4% (compared with 3.0% during the '90s). The commodity boom allowed policy makers to greatly improve macro fundamentals, as highlighted by the behavior of gross external debt (29.3% of GDP in 2010, from 48.6% in 2003), gross international reserves (29.6% of GDP, from 17.4% of GDP), and net public debt (11.3% of GDP, from 40.4% of GDP).

After 2011, economic activity in Peru slowed down due to less favourable terms of trade. In addition, the post-commodity-boom period has been marked by corruption scandals that increased the population's distrust of much of the political class. Several former Peruvian presidents and political leaders have been implicated. Still, solid fundamentals shielded the country from the political crisis, as highlighted by the performance of financial markets, where the five-year CDS (credit default swap - a key measure of sovereign credit risk) has traded below 100 bps over the past few years.

Solid Fundamentals Shielded Peru From Political Volatility

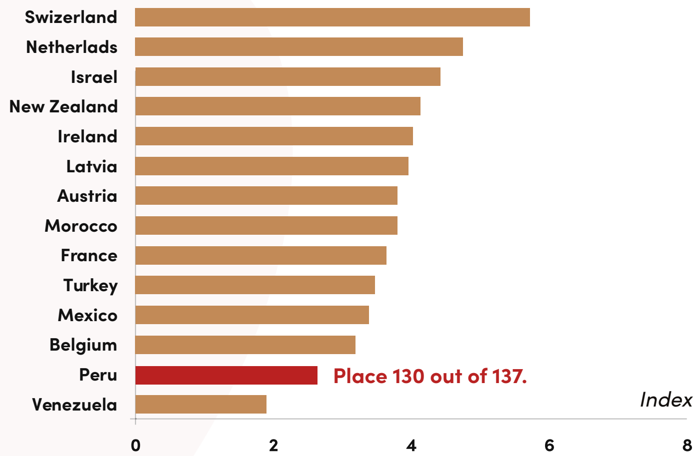


Source: BCRP, Itaú

Besides external risks (mostly linked to China and its trade relations with the U.S.), domestic politics can have an impact on the country's economic outlook. Although so far political volatility hasn't played an important role in the performance of the economy, the possibility of an anti-establishment candidate being elected in the next presidential elections (2021) is a risk for Peru's solid economic fundamentals and pro-market policies. Protests against important mining projects are also important to monitor.

A more flexible labour market and further de-dollarization of the financial system are key challenges for the Peruvian economy in the long term. Current hiring and firing practices incentivize informality; structural reforms associated with reducing firing costs would hamper informality and improve productivity. While the dollarization of the banking system has decreased, it is still significant, as 35.8% of deposits and 25.9% of credit as of December 2019 are in dollars.

Hiring And Firing Practices



Source: World Economic Forum, Itaú

As in Chile, structural shifts in the demand for copper (linked to the electric car industry) and environmental concerns (which are already influencing current economic activity) can also dictate the future of the Peruvian economy.

We expect economic activity to recover gradually to 3.3% in 2020 and 2021, growing close to potential GDP (3.6%) in the three following years. An improvement in local-government-expenditure execution and an expansionary monetary policy will likely support economic activity in the following years

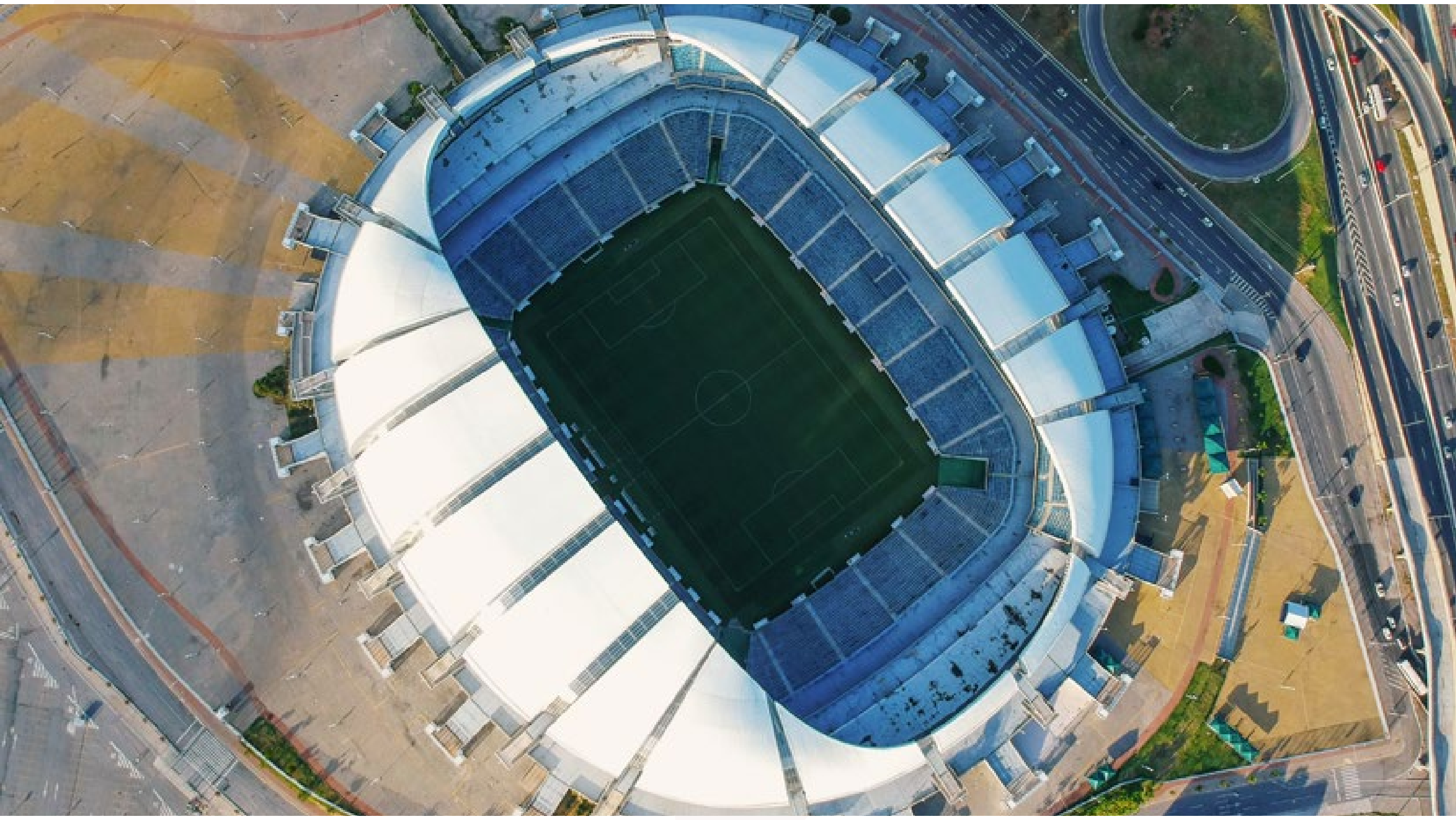
Forecast: Peru

	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F	2024F	2025F
Economic activity											
Real GDP growth - %	3.3	4.1	2.5	4.0	2.2	3.3	3.5	3.6	3.6	3.6	3.6
Unemployment Rate (year avg) - %	6.5	6.7	6.9	6.6	6.6	6.6	6.5	6.4	6.3	6.2	6.1
Inflation											
CPI - %	4.4	3.2	1.4	2.2	1.9	2.0	2.3	2.4	2.5	2.5	2.5
Monetary policy											
Monetary Policy Rate - eop - %	3.75	4.25	3.25	2.75	2.25	2.25	2.25	3.25	4.25	4.25	4.25
Exchange rate & external accounts											
PEN / USD - eop	3.4	3.4	3.2	3.4	3.3	3.4	3.4	3.3	3.3	3.3	3.3
Trade Balance - USD Billion	-2.9	2.0	6.7	7.2	6.6	6.5	6.8	6.7	6.6	7.0	7.0
Trade Balance - % of GDP	-1.5	1.0	3.1	3.2	2.9	2.7	2.7	2.5	2.3	2.3	2.1
Exports + Imports - % of GDP	37.5	37.1	39.2	40.4	38.6	38.0	37.3	36.9	36.9	36.9	36.7
Current Account - % of GDP	-5.0	-2.6	-1.2	-1.6	-1.5	-1.7	-1.8	-1.8	-1.7	-1.8	-1.8
Foreign Direct Investment - % of GDP	4.3	3.5	3.2	2.9	3.9	2.2	2.1	2.3	2.4	2.4	2.5
Fiscal accounts											
Nominal Balance - % of GDP	-1.9	-2.3	-3.0	-2.3	-1.6	-2.0	-1.8	-1.6	-1.3	-1.0	-1.0
Net Public Debt - % of GDP	23.3	23.9	24.9	25.8	26.8	27.4	27.6	26.7	25.6	26.4	26.4

Source: INEGI, Branxico and Itaú

Social Outlook

Alex Grönberger, CEO Latin America, Ipsos



Regional Trends

There is no denying that 2019 was a challenging and complex year for Latin America, one that was characterized by new populist governments, strong social outbursts, a dissolved parliament and continued corruption scandals. The particularity of the social outbreaks in Chile, which have occurred despite the country being considered an economic model for the region, have highlighted structural problems of inequality, corruption, and insecurity, not only in Chile, but further across the region.

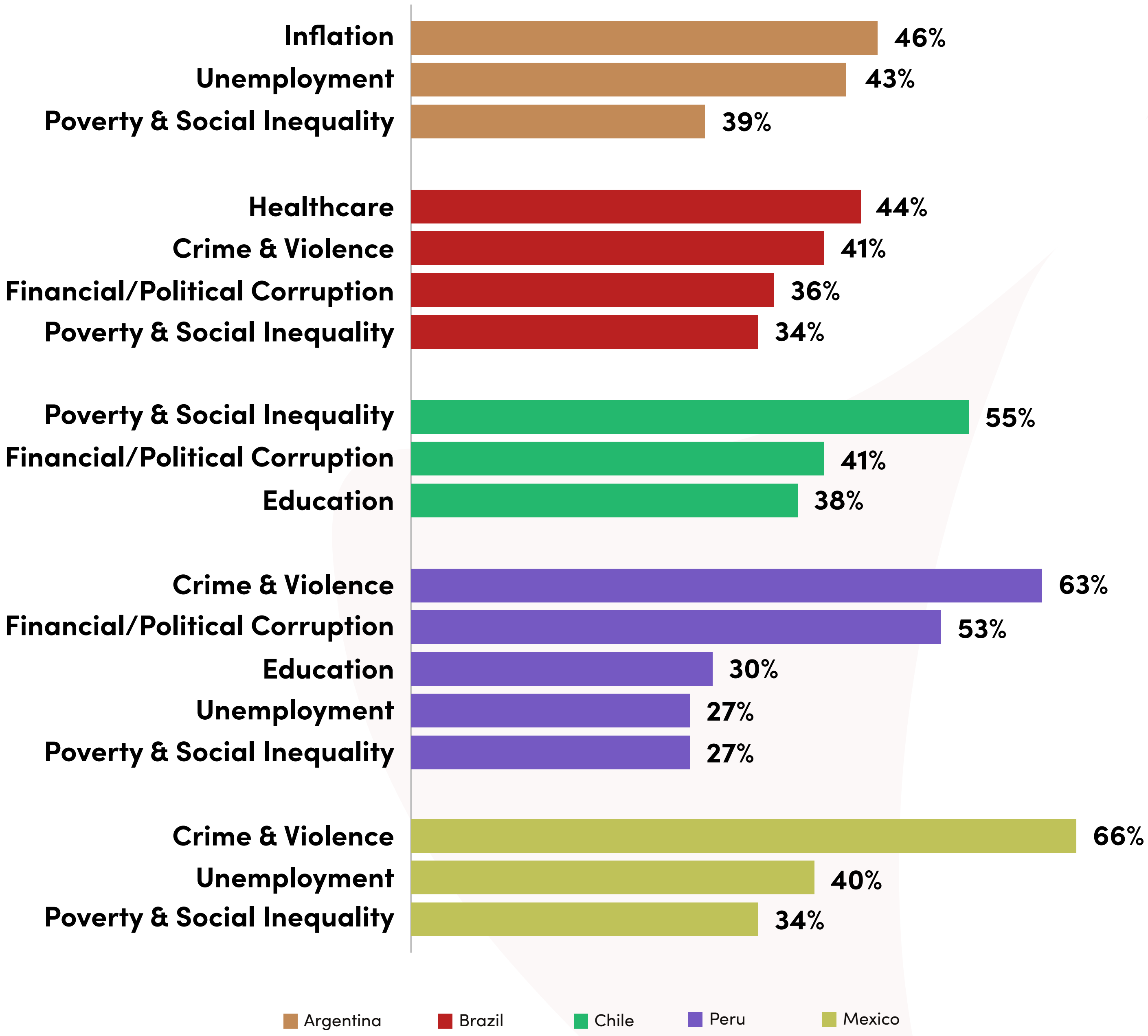
Moreover, we have seen new trends emerging in these countries in recent years, including –inter alia – an increasing lack of trust in authorities, disenchantment with democratic systems, a middle class with greater demands that feel unable to make additional social gains, increasing concern over migration, and polarisation between conservatives and progressives. When combined together, these factors collectively make the business environment more complex and challenging.

In total, there are 42 countries in Latin America & the Caribbean, but only 7 make up the gross of the region's population and economy. Moreover, two countries – Brazil and Mexico - account for more than half the GDP and half the population of the region. When comparing any of the countries in the region there are clear and interesting differences, which begs the question as to whether we should really be talking about Latin America as a whole, or whether we should be talking about each country individually. Nonetheless, when looking at social trends, there are also significant common trends and similarities.

What are Latin Americans most concerned about?

When it comes to what Latin Americans worry about most, there is a widespread perception that poverty and social inequality are among the main concerns in all countries across the region. In Mexico and Brazil, concern over inequality is overshadowed by increasing anxiety regarding crime and violence. In Argentina, in a stagflationary economy inequality features, but is less of a concern than other pressing issues such as inflation and unemployment. However, in Chile poverty and social inequality are at the top of people's list of concerns by a comfortable margin, with the second highest concerns relating to financial and political corruption.

Which three of the following topics do you find the most worrying in your country?



Source: GLOBAL ADVISOR

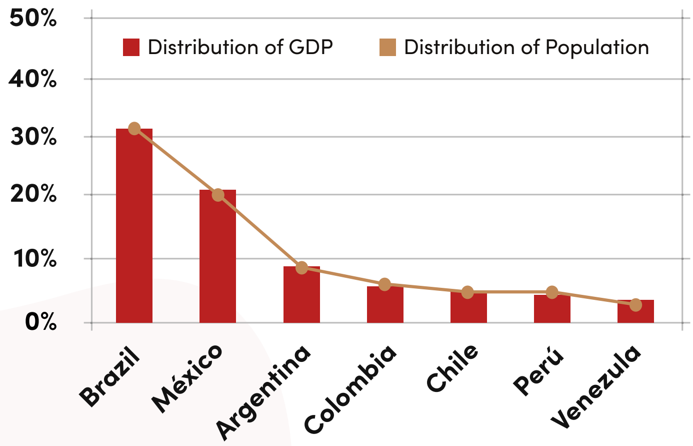
Poverty Reduction

As a region, Latin America has been struggling to combat poverty for many years. However, the windfall from high commodity prices from the beginning of the 2000s resulted in a positive shift that pushed up economic growth and cut the number of people below the poverty line in half.

In general, we have seen two different modes of reducing poverty across the region, each with varying degrees of success. On the Pacific coast, Chile, Peru and Colombia have generally followed a free and open economic model that continues to broadly survive today, albeit with a few hiccups. On the Atlantic side, Brazil, Argentina and of course Venezuela, have all followed populist models characterised by high public spending on social projects, resulting in a faster, but less sustainable reduction in poverty, quickly coming to a halt when commodity prices fell back to normal levels and left the coffers empty for spending on social programmes.

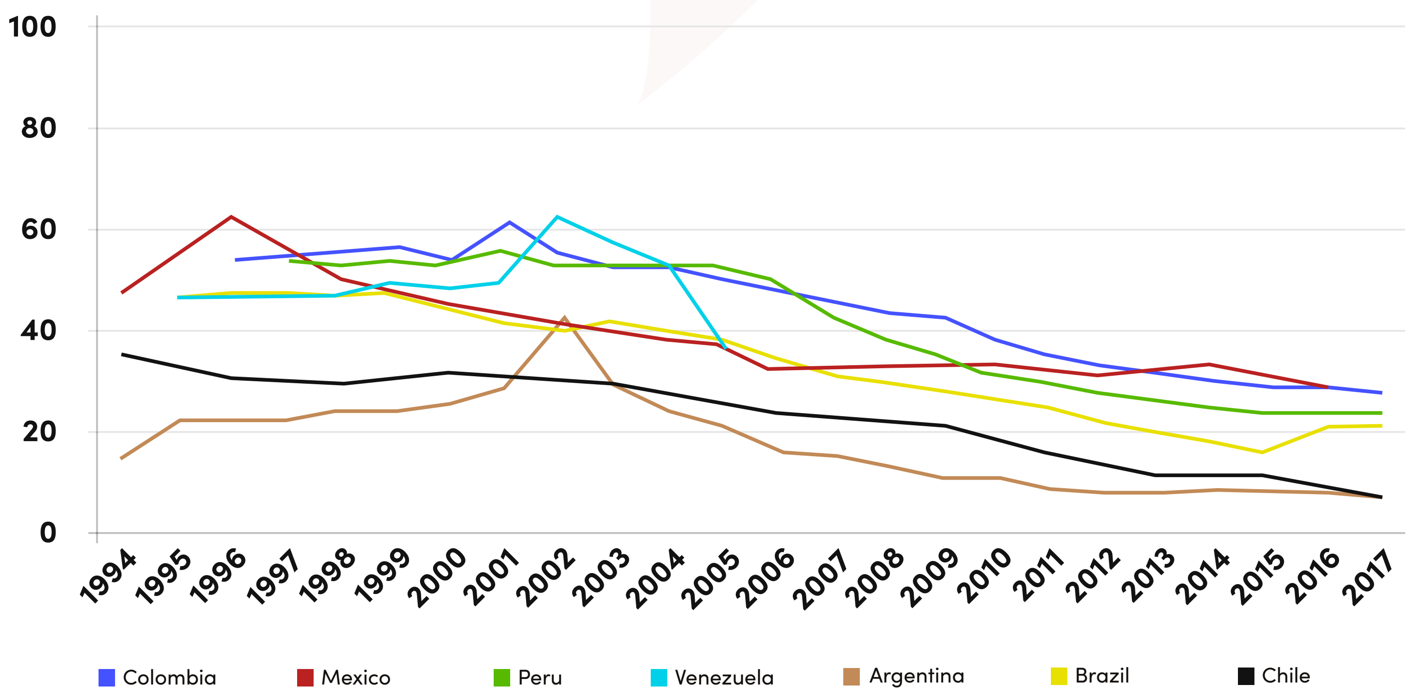
However, despite the pendulum swinging back and forth between populism and more orthodox socio-political and economic models across the region, we can objectively say that the last 20 years should be considered as a success for poverty reduction for Latin America.

Distribution GDP (Current US$) And Distribution of Population in LatAm



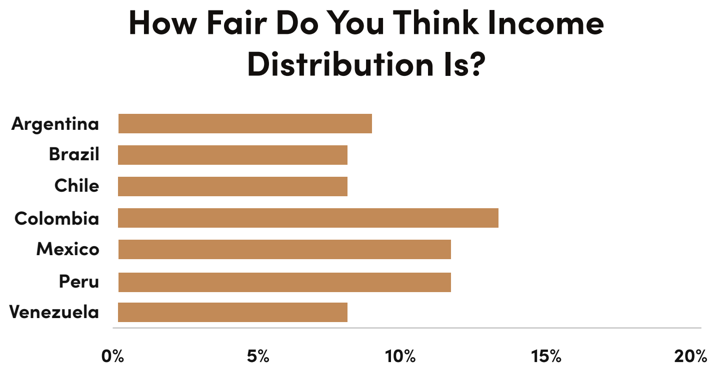
*WORLD BANK 2018/ *Ipsos estimated GDP for Venezuela*

Poverty headcount ratio at $5.50 a day (2011 PPP, % of population)

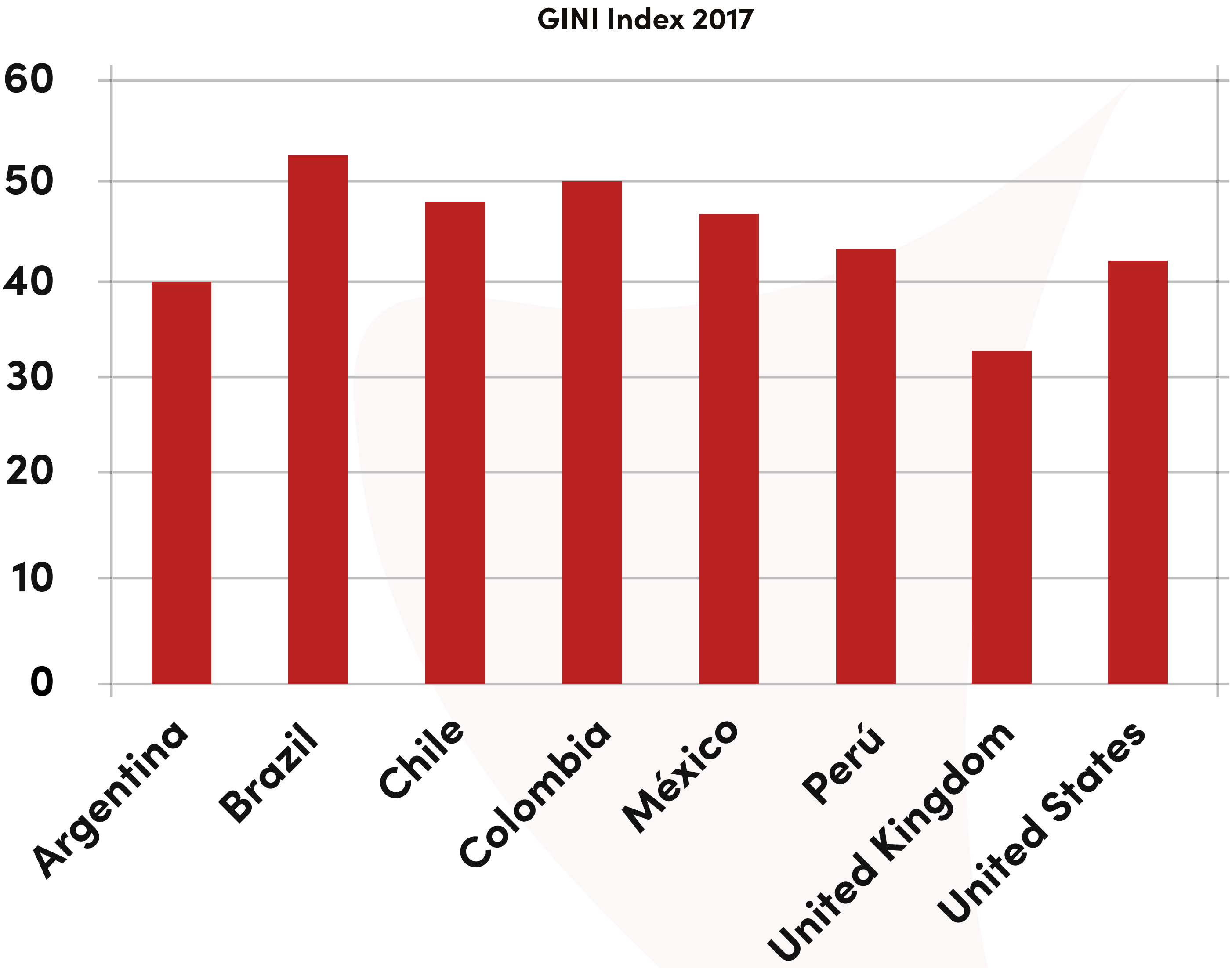


Inequality

Despite economic growth and poverty reduction, Latin America continues to be a region with high levels of inequality with respect to both income and wealth distribution. When looking at the GINI coefficient – where 0% represents perfect equality and 100 represents perfect inequality – Brazil, Colombia, Mexico and Chile score between 47% and 53% in 2017. In particular, in Chile it is worth mentioning that just four families concentrate 47% of the assets of companies listed on the Santiago Stock exchange; these families together made up 9.2% of Chile's GDP in 2004 and 12.5% of GDP in 2008. Argentina and Peru have a slightly better GINI score, closer to that of the United States, at 41% and 43% respectively. By comparison, GINI coefficients for European countries are in the range of 30-33%.



Source: Latinobarómetro 2018



Source: WORLD BANK

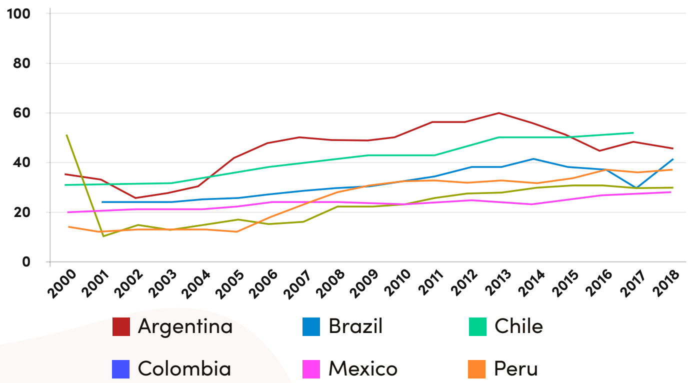
Vulnerable Middle Classes

Leaving aside trends in Argentina and Venezuela, in general we can see that there has been significant growth in the middle classes in recent years.

With social mobility come raised expectations in terms of education, aspirations for individuals and their families, and expectations of public services such as health, education and pensions, plus a determination to hold onto any gains made and avoid falling back into poverty. In Chile, for example, Ipsos has seen that focus group participants tend to be less interested in how their country compares with other nations in the region, and are more interested in comparing themselves against OECD countries.

Moreover, this combination of better education, and increased ambition and expectations, could in turn expose a whole new set of gaps in government services, like education and health, as these new middle-classes attempt to hold on to the gains they have made in recent years.

% Middle class people - (USD 12.4-62, 2011PPP)*



*Source: Inter-American Development Bank / *% of people who earn $12.4 to $62 per day*

Crime and Corruption

Popular condemnation of corruption remains strong, as do demands for crime control and better justice and security.

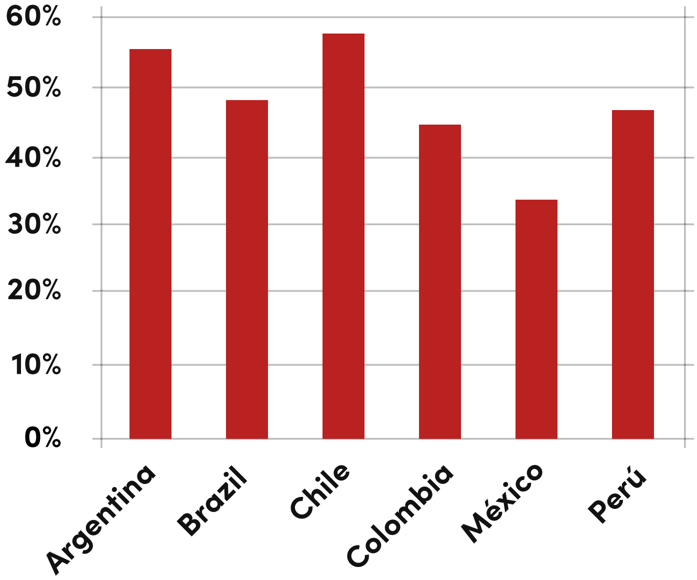
Trust in Democratic Institutions

General support for democratic values also remains generally resilient. However, trust in democratic institutions and those who run them is another matter entirely.

Despite the economic growth and poverty reduction in recent decades across all the countries polled, there is a significant amount of discontent directed towards the state. Almost half of citizens across the region believe that their leaders don't take their needs into consideration, with Chile and Argentina polling particularly badly. (It is worth noting that the poll shown in the graph below was conducted before President Macri of Argentina was ejected from office, and prior to the outbreak of social protests in Chile.)

At the other end of the spectrum, polls in Mexico do not appear to be as harsh as elsewhere in the region. Initial indications suggest that Andrés Manuel López Obrador's election has renewed Mexico's faith in the political system, at least for the short term.

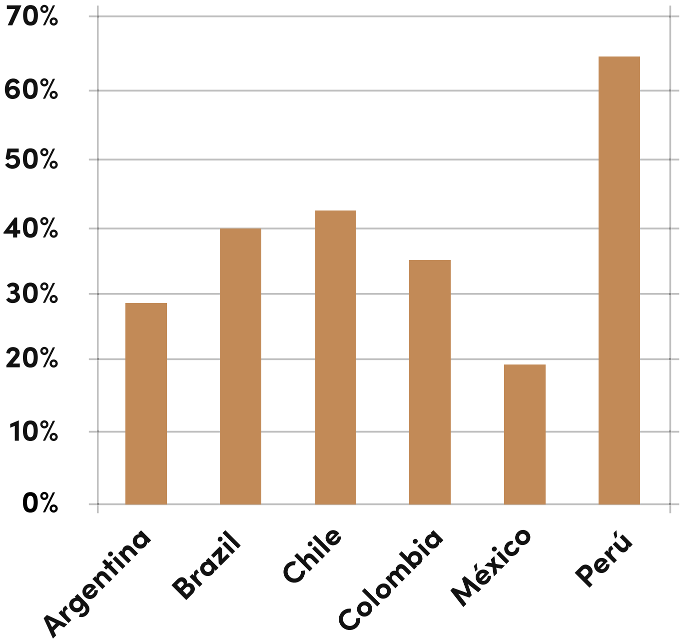
Are those who govern this country not interested in what people like you think?



Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

Significant numbers of Latin American citizens do not trust their democratic institutions. On average, 1 in 3 don't trust their parliaments (a majority in Peru prior to the recent elections)

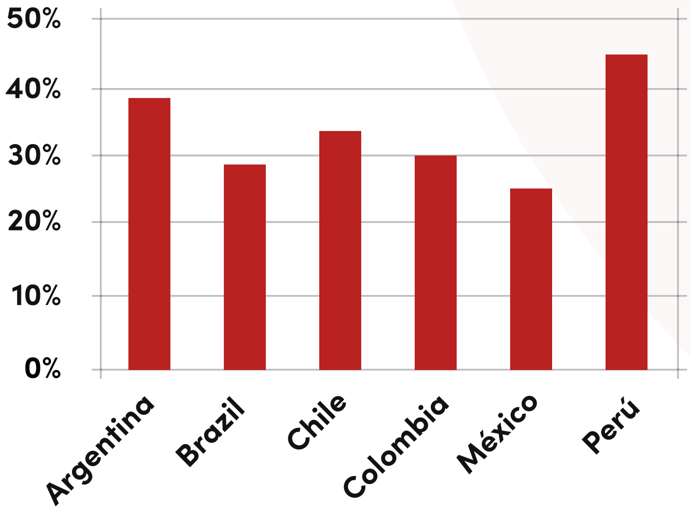
To what extent do you distrust the Parliament?



Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

The jury remains out when it comes to trusting the judiciary to deliver fair trials – with substantial minorities mistrusting the justice system. Moreover, the picture has deteriorated in Brazil, Chile, Colombia, and Peru from previous polls taken in 2012 - especially in Peru where 44% of citizens believe that the courts do not ensure a fair trial, up significantly compared to 2012.

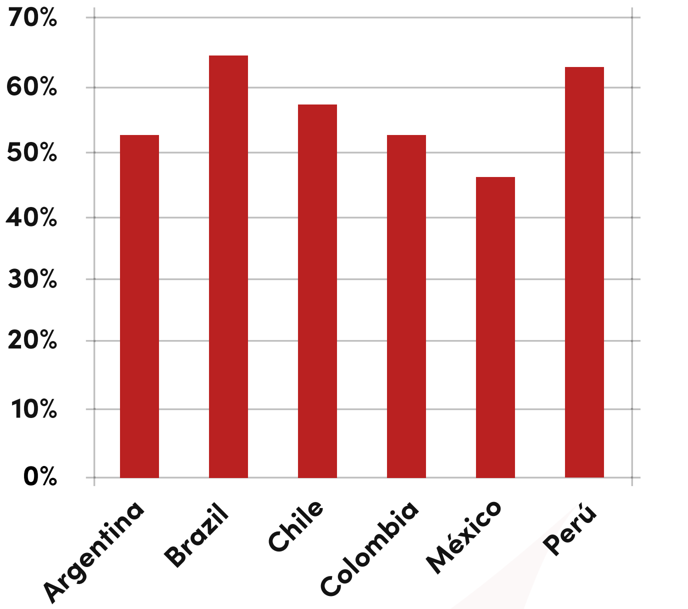
To what extent do you think the courts do not guarantee a fair trial?



Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

When it comes to whether or not people trust their political parties, on average, approximately half of citizens respond negatively, with participants in Brazil and Peru particularly distrustful of their political parties, recording 63% disapproval ratings in both countries.

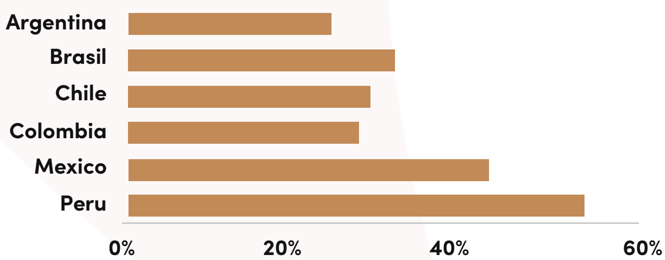
To what extent do you distrust the political parties?



Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

In the light of attempts by elite vested interests to limit or dilute efforts to fight corruption, there are indications that minority support (25-35%) for military interventions might be growing; but the indications are that the armed forces themselves are reluctant to return to politics except in the form of individual Ministers (e.g., in Brazil). During the recent presidential-congressional impasse in Peru, support for a military solution spiked at over 50%, but we anticipate this will have fallen back following the recent elections. In Argentina, where the legacy of military governments is still sensitive, such support is closer to 25%.

When there is a lot of corruption a military take-over of the State would be justified (Justified %)



Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

Polarisation Between Conservatives and Progressives

There is no denying that Latin America is a highly polarised region, with people taking firm stances on social issues. In general, the results of these polls suggest that Latin Americans tend to be more conservative than progressive when it comes to such topics as, for example, immigration, abortion or the legalisation of cannabis, but the key is the passion behind the arguments on both sides.

Attitudes towards Immigration

In most countries, almost half of the people interviewed believed that immigrants take important social services from existing nationals. In some circumstances this has prompted governments to take visible actions against migrant communities. However, one quarter to one third of all respondents were in marked disagreement, and did not believe that immigrants were taking important social services from existing nationals.

Do Immigrants Take Important Social Services Away from Nationals?

Country	Disagree	Neither Agree Nor Disagree	Agree	Don't Know
Peru	29%	20%	50%	1%
Argentina	29%	18%	49%	4%
Mexico	31%	20%	46%	2%
Chile	25%	27%	44%	3%
Brazil	36%	25%	37%	2%

Source: Ipsos Global @dvisor – Populist and nativist sentiment in 2019

Attitudes towards Abortion

Abortion is a polarising issue in many counties around the world, not just in Latin America. However, in the countries polled, whereas c.20% support a woman's right to choose, and only c.10% are opposed to abortion under any circumstances, the majority of those polled fall in the middle ground of supporting abortion in circumstances when a woman has been raped or her life is in danger. In practice, little progress is being made to change current laws.

Please choose which is closer to your point of view

Country	Abortion SHOULD be permitted whenever a woman decides she wants one	Abortion SHOULD be permitted in certain circumstances, such as if a woman has been raped	Abortion should NOT be permitted under any circumstances, except when the life of the mother is in danger	Abortion should NEVER be permitted, no matter what cir-cumstance exists	Don't know/Prefer not to say
Argentina	33%	38%	12%	5%	12%
Brazil	22%	38%	16%	12%	12%
Chile	25%	23%	22%	17%	12%
Colombia	20%	31%	26%	14%	9%
Mexico	21%	41%	17%	12%	9%
Peru	17%	34%	26%	14%	10%

Source: Ipsos Global @dvisor – Abortion – 2019

Attitudes towards Marijuana

Again, attitudes towards the legalisation of marijuana for recreational use are polarised either for or against, with only 15 to 20% not having a stance on the issue. No two countries polled the same on this issue, but on balance opponents of legalisation seem still to have the edge. Either way, this could be an issue that has the potential to take people onto the streets in protest.

Marijuana should be legal in my country for recreational use

Country	Agree	Neither Agree nor Disagree	Disagree
Chile	39%	20%	41%
Mexico	32%	23%	45%
Argentina	30%	19%	51%
Brazil	24%	19%	57%
Colombia	23%	14%	63%
Peru	14%	15%	71%

Source: Ipsos Global @dvisor – Global Views On vices – 2019

Social Media and Protests

People in Latin America are becoming increasingly connected and have much greater access to social media platforms than ever before, allowing them to share their opinions and connect with other like-minded individuals that share the same interests. It also creates a space where citizens can express their discontent and political opinions online. Nowhere was this better evidenced than recently in Chile, where the organisers of the demonstrations and subsequent street violence were able to coordinate their actions using various social media platforms.

However, social media platforms can help to fuel radical positions, as people often seek to connect with other like-minded individuals. When they search for views they will often receive a confirmation bias on their opinions, and the more they do it the more strongly held their position will be. As a consequence, in many debates there is not a search for the truth, but an attempt to discredit and mock others with opposing views.

As can be seen in the corresponding graph, Latin America is a region that is now strongly connected to the world wide web, with social media platforms, notably WhatsApp and Facebook, being very widely used.

Social media and connectivity

Countries	Smartphone ownership	Cellphone in home	Home internet service	WhatsApp users	Facebook users	Twitter users
Argentina	65	92.5	70.9	78.9	67.3	12.9
Brazil	54	94.4	73.7	76.2	59.8	8.5
Chile	72	97	70.3	75.5	62.9	9.2
Colombia	56	92.8	48.2	62.7	59.6	10.5
Mexico	42	82.2	45.7	55.1	47.9	7.6
Perú	41	86.5	37.5	58.6	61.4	7.6

Source: Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

Interestingly, people who spend more time on social media platforms are more likely to be dissatisfied with democracy, the judiciary, or their political representatives, and their opinions, claims and discontent tend to be exacerbated within debates on social media.

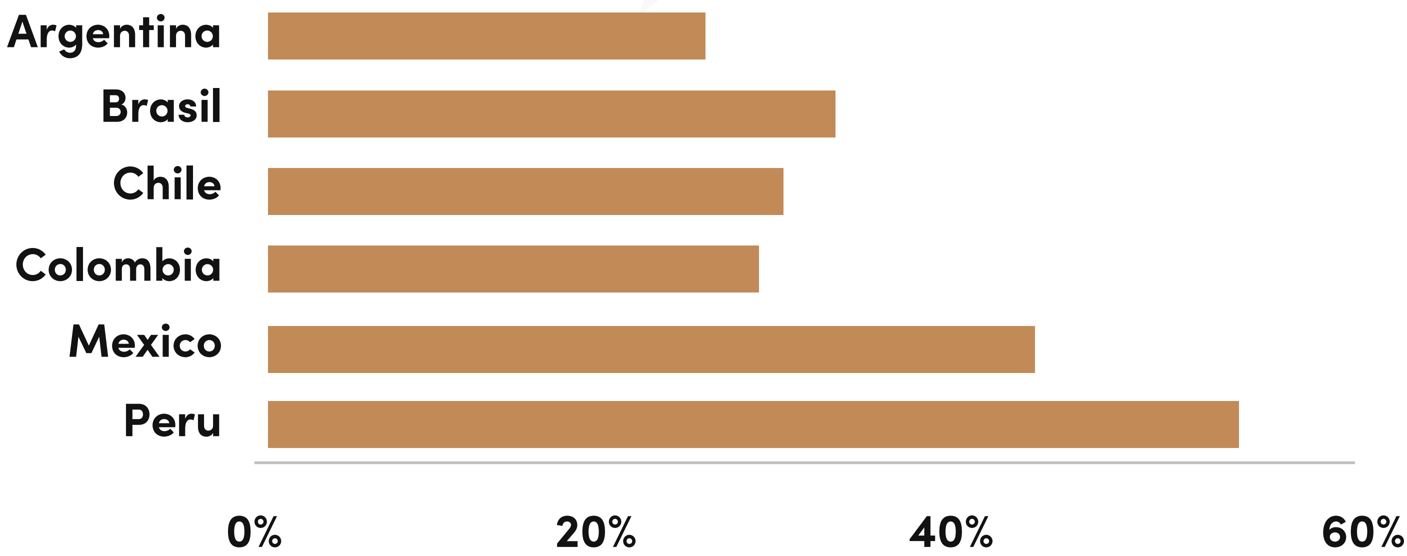
SATISFACTION WITH DEMOCRACY (%)		TRUST IN SUPREME COURT (%)		TRUST IN CONGRESS (%)	
High Social Media	37.7	High Social Media	30.4	High Social Media	26.5
Low Social Media	39.2	Low Social Media	36.8	Low Social Media	33.0
Non - user	43.8	Non - user	38.8	Non - user	35.2

Source: Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

In polling, more than 1 in 10 people said that they had participated in demonstrations. As this was before the social protests in Chile, Ecuador, Bolivia and Colombia towards the end of 2019, current figures might actually be higher.

As mentioned previously, social media has a massive convening ability – obviating the need for organised protest leaders. What LatAm is currently seeing on the protest front might actually be the new norm that these countries – and others – may have to live with.

In the last 12 months, have you participated in a demonstration or protest march? (Yes%)



Source: Pulse of Democracy 2019- Latin American Public Opinion Project (LAPOP)

Security & Corruption Outlook

Control Risks

Oliver Wack, Partner, Control Risks

Regional Trends

Crime

Crime dynamics – including common and organised crime – remain a prominent, if manageable, factor affecting the security of the operating environment across Latin America. There will continue to be stark differences between certain countries (e.g., Mexico vs. Chile) in terms of the pervasiveness and violence associated with organised crime. Nonetheless, from a macro perspective regional governments' arguably largely lacklustre efforts to sustainably curb key drivers of crime – including inequality, porous borders, underfunded public security forces and outdated criminal justice systems – means that criminal organisations will continue to both operate in their own shadowy worlds and intersect with private business in various aspects of their activities and footprint.

Cargo theft, drug trafficking and infiltration of supply chains and extortive crime will all remain part of the operating environment for the foreseeable future. Cybercrime will become both more prevalent and impactful. Business travellers to all major urban areas across the hemisphere will continue to be affected by common crimes, including petty crime.

All of these criminal dynamics are inherently manageable, but will require time, attention and funding by business leaders to mitigate risk.

Corruption

Corruption and its related concerns will continue to pose significant challenges to companies' ability to do business. The region has seen a stark transformation in the corruption landscape over the last five years, informed largely by the growing ability of governments and public prosecutors to identify, formally charge and bring to court corrupt companies and individuals. Factors that have been driving this change include public dissatisfaction with corrupt practices, media and civil society pressures to combat corruption, and businesses' own efforts to enhance compliance.

Country Security & Corruption Outlooks

Argentina

While the security environment in Argentina will remain largely benign compared to regional neighbours, the overall security outlook for the next three to five years is somewhat mixed. Although a significant deterioration of the security environment remains unlikely, common crime indicators have continued to worsen slightly on the back of persistently high levels of poverty and unemployment, as well as lower levels of public investment since 2017. Security will remain more challenging in Santa Fe province and to a lesser extent in Tucumán and Chubut, where crime rates are above the national average. That said, homicide rates (as well as most other security indicators) will continue to be better in comparison to most other Latin American countries including Brazil, Colombia and Mexico.

Businesses will remain exposed to significant levels of organised criminal activity. Cargo theft has become a growing concern for businesses, with most incidents concentrated in the Buenos Aires metropolitan area and targeting a myriad of sectors such as food and beverages, electronics, textile and automotive. Smuggling through the Paraguayan border will also remain a significant source of concern: cigarettes, mobile phones, clothing and household items lead the list of goods most sought after by criminals on the back of the already established black markets for their distribution.

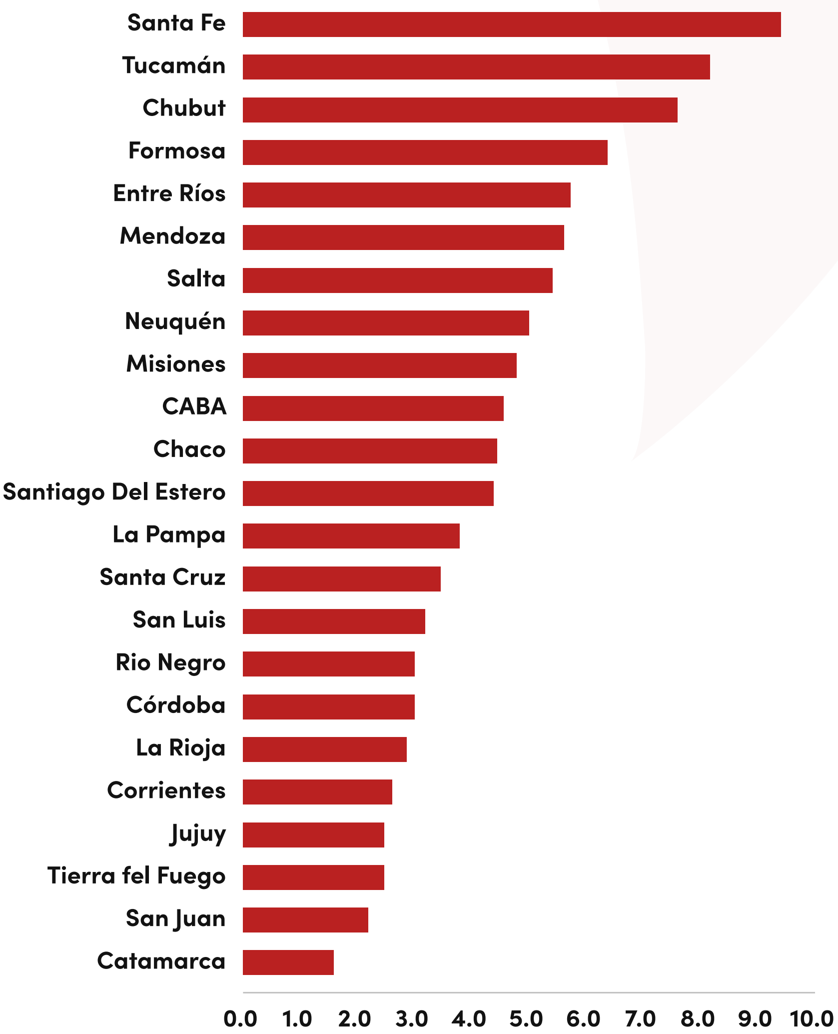
Political allies to members of the government have been appointed to head key enforcement agencies such as the Anti-Corruption Office, the Financial Intelligence Unit and tax agency AFIP. This strongly suggests that President Alberto Fernández and his administration are likely to block corruption investigations into former president and current vice-president Cristina Kirchner and members of her political group. Anti-corruption efforts are far more likely to focus entirely on targeting political rivals. It is likely that initiatives adopted under the previous administration will be partially reversed, such as the 2016 reform that allowed plea bargain agreements in corruption cases.

Enforcement of anti-corruption efforts will remain poor, with most institutions lacking the necessary resources, personnel and expertise to conduct effective investigations. Additionally, communication channels between different enforcement agencies will remain scarce, limiting effective cooperation. While we will continue to see companies struggle with a lack of judicial independence and efficiency, a campaign finance law to ease the tracking of the origin of funds was approved in 2019 and is likely to bring greater transparency to elections.

The new government took office in 10 December 2019 and while most labour leaders maintain a supportive stance towards it, unions will maintain some degree of independence and continue to exert pressure via mobilisations and strikes. Since any improvements regarding inflation will likely be modest in the in the short term, companies will continue to struggle with union pressure to increase wages. The risk of widespread social unrest is still low: people are largely likely to give the new administration the benefit of the doubt during the beginning of its tenure. This scenario could deteriorate, however, on the back of persistently rising poverty levels compounded by severe budgetary limitations.

As elsewhere in the region, less mature cyber security practices mean organisations doing business in Argentina are still likely to face threats from cybercriminals. The online banking, insurance and hospitality sectors continue to be particularly vulnerable to business email compromise, identity theft, phishing, and other mobile-enabled malware attacks.

Homicide Rates In Argentina (Per 100,000 Inhabitants)



Source: Security Ministry

Brazil

Companies operating in Brazil will continue to face security-related challenges to their operations. These challenges remain present despite significant improvements over the past two years, when most crime rates – including homicides - have reduced across the country. Chronically high levels of violent and common crime will still be fuelled by significant income inequalities, the widespread availability of firearms, the influence of drug- and arms-trafficking gangs, and poor and inefficient policing. Crime will continue to be concentrated in the less developed North and Northeast states and affect the business community as a whole. Without fundamental reforms to these deep-rooted drivers of criminal dynamics, the inception and successful implementation of a holistic solution to Brazil's crime problems will not occur within the given timeframe.

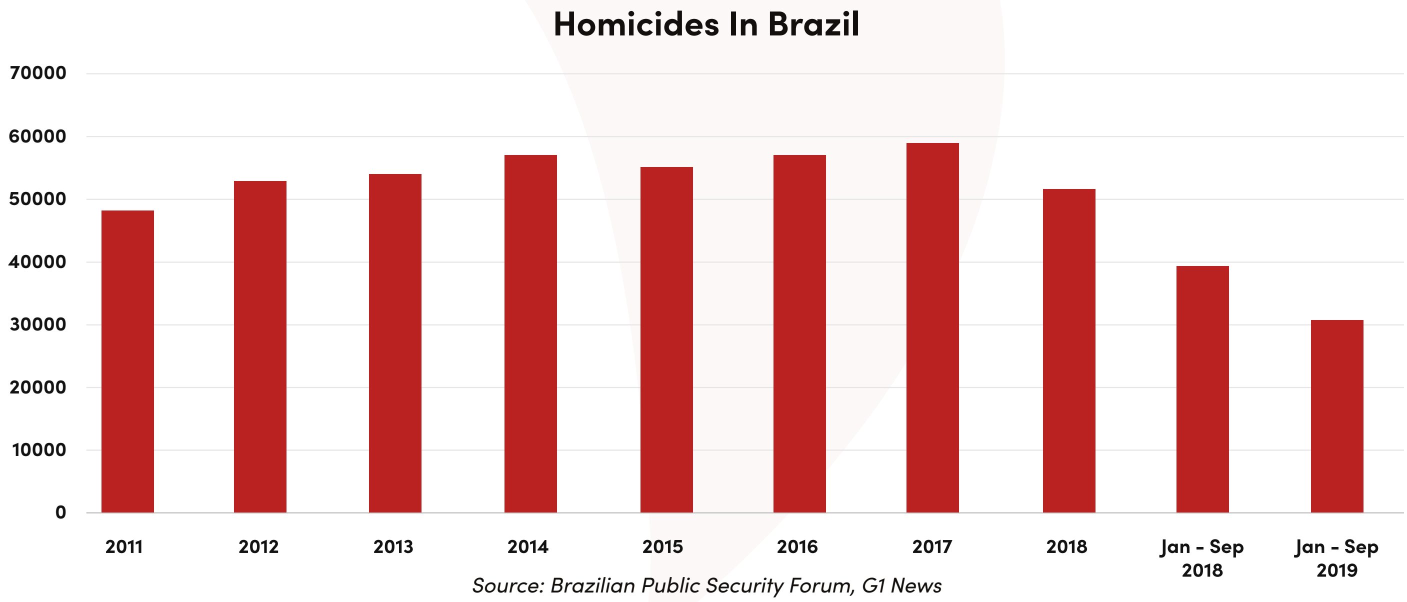
That said, recent national and regional government efforts to integrate different security forces, tackle turf wars and optimise resources and intelligence have likely contributed to the reversal of a decade-old trend of rising crime. The overall homicide rate, for example, has seen a downward trajectory since early 2018, driven in particular by steep declines in the states of Ceará, Espírito Santo, Rio de Janeiro and Pernambuco.

This decline has also been mirrored in the rates for other offences including theft, robbery and vehicle-related crime. We expect security trends to remain on a similar trajectory over the next two-to-three years.

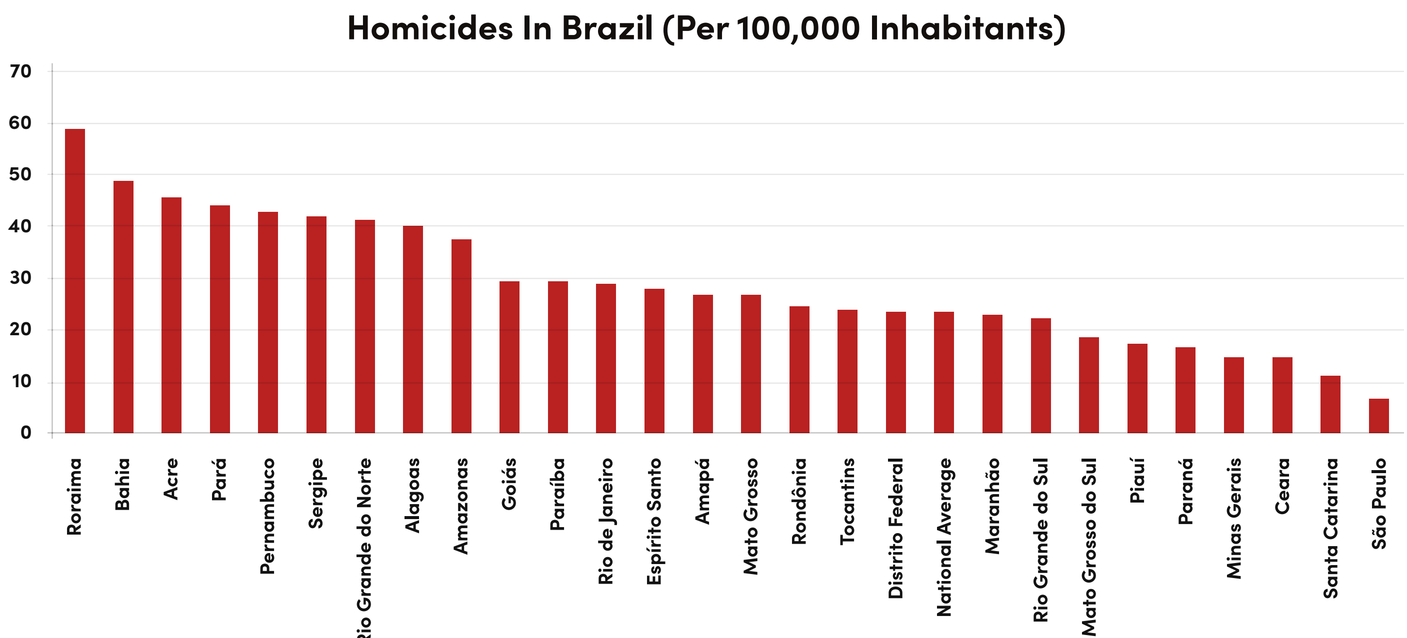
At the same time, despite significant improvements, businesses operating in Brazil will remain exposed to threats related to crime dynamics and the presence of organised criminal groups. Over the past five years, a growing number of drug-trafficking groups have used Brazil as a trans-shipment route to export drugs (mainly cocaine) to Europe, and the number of seizures in local ports has increased substantially. This trend has accompanied efforts over the last decade by criminal groups expanding their scope to include other activities such as cargo theft and smuggling. Cargo theft is still a key threat in the São Paulo and Rio de Janeiro states, particularly for companies trading electronic devices, cigarettes, food and beverages and pharmaceutical goods; we have also noticed a significant uptick in incidents of theft involving vehicles carrying agricultural goods as well as fertilisers (particularly in the Centre-West region) – these goods tend not to be tracked by producers and can easily be sold on the black market. Homicides remain disproportionally concentrated in low-income regions, particularly in the country's North and Northeast states.

The strength of Brazil's anti-corruption institutions will be put to the test in the next three to five years. On the one hand, President Jair Bolsonaro is attempting to curb the independence of key enforcement agencies, getting involved with key appointments and exposing these bodies to political influence. On the other hand, Congress and the judiciary have also implemented measures that restrict investigative powers. The autonomy of Brazil's anti-corruption bodies, however, is the result of decades of institutional improvement – that autonomy is highly unlikely to be fully reversed overnight, not least because it also counts on significant popular support. Additionally, the successful implementation of plea bargain agreements has provided additional instruments for investigators to advance corruption probes. As such, we assess that scrutiny into contracts involving private companies and the public sector will remain high.

Overall, the cybercriminal threat in Brazil is likely to grow in the foreseeable future, particularly due to the high technical skills and operational agility demonstrated by Brazilian criminals, the lack of effective law enforcement, and an economy that makes illicit online activity an attractive alternative for a growing number of people. Given the emergent and open nature of the Brazilian cybercriminal community, some crossover between low-level criminals and cyber activists is likely to continue. This will likely lead activists to adopt cybercriminal tactics, techniques and procedures (TTPs), such as ransomware attacks, as part of their campaigns against companies.



Source: Brazilian Public Security Forum, G1 News



Source: National Public Safety Information System (Sinesp)

Chile

Chile will continue to be a comparatively safe country within Latin America and the outlook is largely positive, with violent and non-violent crime rates remaining well below the broader regional average. The most likely security threat is opportunistic crime – particularly robbery, which remains on an upward trend, though it is largely concentrated around major urban centres. Cargo theft is also a growing concern, particularly on highways connecting Santiago to the coastal cities of San Antonio and Valparaíso (both in Valparaíso region).

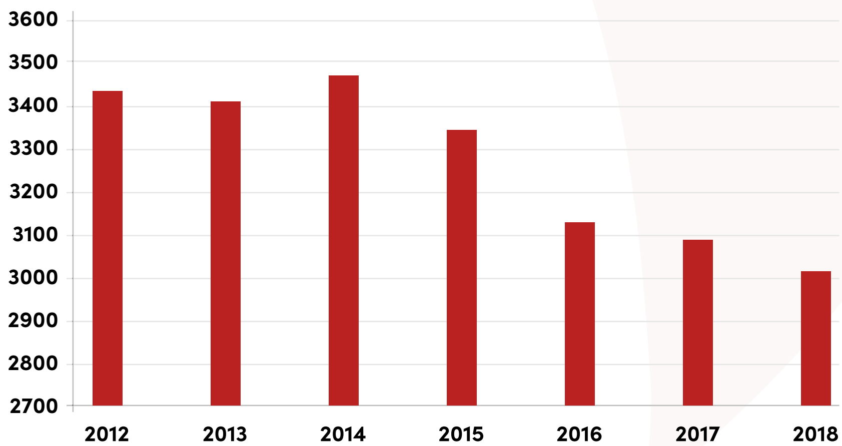
There is growing consensus among political forces for increased social spending – including within the executive branch and the ruling coalition in Congress. Coupled with the upcoming constitutional referendum on 26 April, this is likely to reduce the risk of widespread protest activity re-emerging in the next year. That said, the longer-term outlook will remain challenging since the economy is likely to slow significantly in 2020 and President Piñera will continue to face pressure from opposition parties and social movements. Civil society groups will also attempt to seize on the momentum to continue to pressure for structural changes throughout the constitutional drafting process, which is expected to last until mid-2021. Moderate levels of protest activity therefore remain likely.

The financial, retail, transport and forestry sectors (as well as government buildings) will continue to be the most vulnerable to violent social unrest. Anarchist and eco-terrorist groups are well organised in Chile in comparison to other Latin American countries and have to some degree infiltrated groups such as student collectives, cultural centres and squatting movements. Anarchists typically infiltrate anti-government protests to engage in violent behaviour such as vandalism, looting, and arson attacks. There have been a number of incidents of explosive devices detonating in the capital Santiago over the past five years, including attacks on business executives, and the threat of further attacks remains credible. Metro stations have also been common targets – over 80 of Santiago's 136 metro stations were vandalised during the peak of protest activity in October-November 2019. Bus and metro stations have also been targeted in bomb attacks by anarchist groups over the past decade.

Political uncertainty remains unlikely to impact the robustness of Chile's anti-corruption institutions in the coming years. Although a number of recent corruption scandals have increased awareness of the risk of bribery across the country, the government will continue to implement significant changes to improve transparency levels. Recent initiatives, such as the September 2019 legislation to reform the financing of the armed forces (by abolishing the funding mechanism that transferred 10% of the revenues of the state-owned copper company Codelco directly to the military), are likely to increase oversight over defence expenditure going forward.

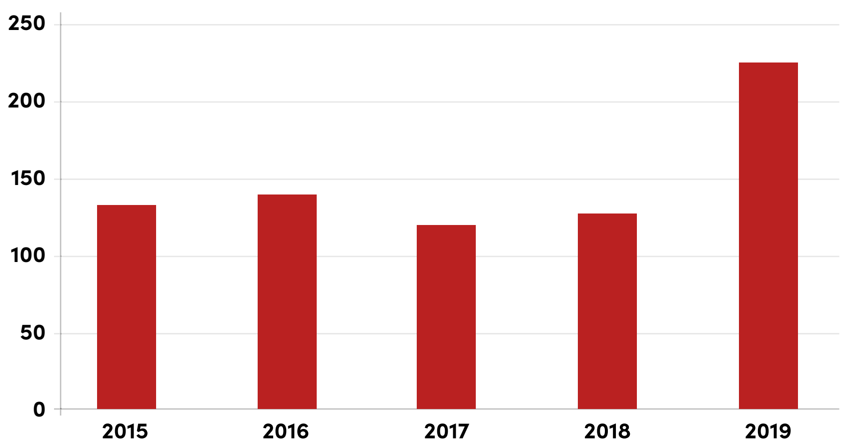
Cyber-related threats in Chile will continue to be largely tied to political activism ("hacktivism") and, to a lesser extent, extortive crime. Activists will continue to rely on unsophisticated tactics, techniques and procedures (TTPs) in their attacks. These TTPs include distributed denial of service (DDoS) attacks to overwhelm websites and disrupt their availability, as well as website defacement attacks. Breaches of unsecured servers through Structured Query Language injection (SQLi) to access backend information that was not meant to be displayed (e.g., personally identifiable information) also remain likely.

High-impact crime rates in Chile per 100,000 inhabitants (including theft, robbery, murder and rape)

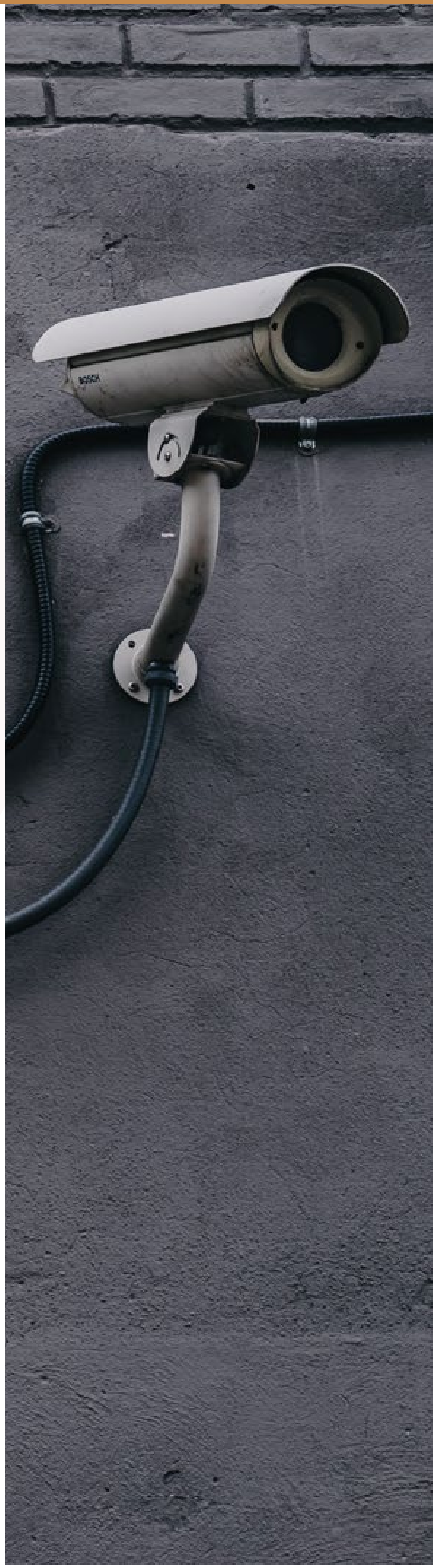


Source: Interior Ministry

Number of social unrest incidents in Chile per year



Source: Control Risks



Colombia

General security conditions have improved as a result of the 2016 peace agreement between the government and the now-demobilised Revolutionary Armed Forces of Colombia (FARC) guerrilla group; this trend will likely continue on its positive trajectory over the next few years. That said, companies operating in remote rural areas of the country (e.g., the energy, extractives and infrastructure sectors) will continue to face challenges linked to the consequences of the armed conflict, including facing conflict from other, smaller guerrilla groups or dissident factions and organised criminal gangs. Companies focused on operations in urban areas (e.g., services, retail, FMCG) while be less exposed to such dynamics and instead see key threats stemming from common crime (and to a lesser extent organised crime) including cybercrime.

The threat posed by large-scale armed actors, which was prevalent in Colombia as late as the 90s and early 2000s has subsided. That said, threats emanating from smaller armed actors, organised criminal groups and common criminals will persist for the Outlook period. The National Liberation Army (ELN) guerrilla group will continue to target police and military units in rural areas as it attempts to pressure President Iván Duque to resume negotiations. Occasional terrorist attacks against select government targets in urban areas remain likely although these will have limited direct implications for business. Duque is unlikely to concede to talks with the ELN however, and military operations against the group will continue. Other organised armed groups (GAOs) such as the Clan del Golfo and the Caparrapos will continue to compete for control of illegal economies, resulting in increased violence in disputed territories.

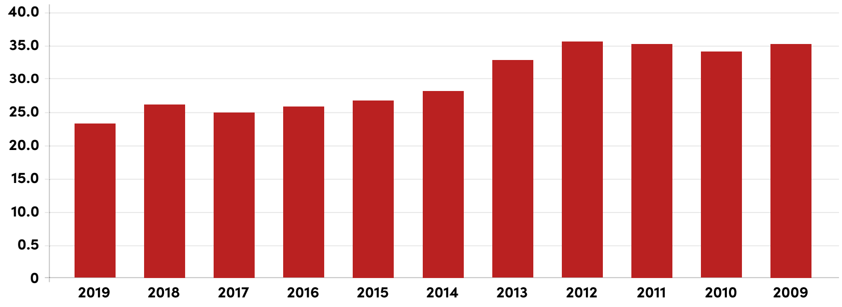
The citizen security situation in Colombia continues to be complex; public safety risks are still present in major cities and some indicators are improving while others have deteriorated in recent years. Homicides and kidnap rates will continue to decrease, following the same trend as over the last decade-and-a-half, partially due to the improved capabilities of local authorities and continued political support at the national, regional and local government level. However, common crime will remain frequent and will often involve violence, which will continue to pose incidental risks to residents and visitors alike.

Social unrest will continue in 2020, particularly in the capital Bogotá, where student movements and labour unions are most likely to concentrate their efforts. Duque will attempt to dilute protests with partial concessions on issues such as labour conditions, pension reform and public university funding, though any major regulatory changes are unlikely to take effect before January 2021. In any event, growing tolerance for political dissent, combined with the president's unpopularity, will increase the likelihood that protests against his government become more common in the next two years. Collateral disruption caused by marches and roadblocks is likely to affect business operations in major urban areas, particularly Bogotá and Cali (Valle del Cauca).

The Duque administration, along with other branches of government, will continue to prioritise anti-corruption efforts over the next several years, but these measures are unlikely to have a significant impact in the short term. Colombia will continue to demonstrate expertise in fighting white-collar crime and benefit from its solid international cooperation channels, but issues of concern will remain around the lack of clear rules and procedures to protect prosecutorial bodies from politicisation, including the President's and Congress' influence in the appointment of top justice officials such as the attorney general and the comptroller general. Progress is also likely to be slow in developing leniency and plea bargain instruments in corruption-related cases.

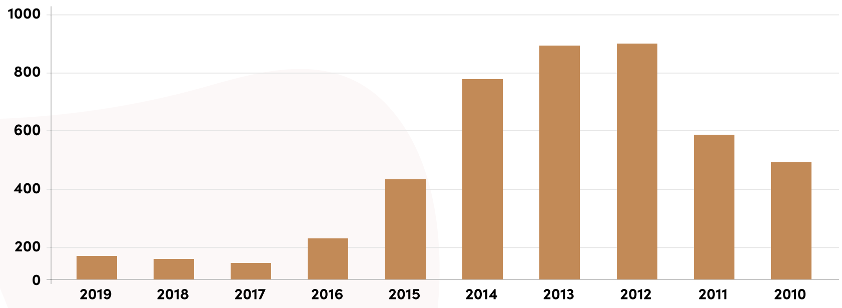
Cybercrime has increased steadily in Colombia over the past five years, as local threat actors become more sophisticated. The online banking, insurance and hospitality sectors continue to be particularly vulnerable, while the most prevalent tactics, techniques and procedures (TTPs) include identity theft (which accounts for nearly a third of total incidents), business email compromise, phishing and smishing scams, and other mobile-enabled malware attacks.

Homicide rates (per 100,000 inhabitants)



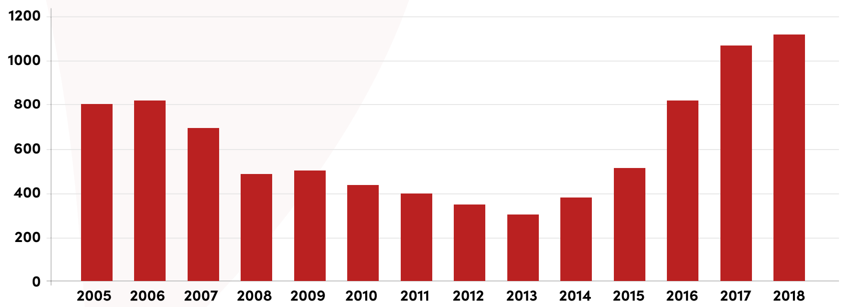
Source: Control Risks

Terrorist Attacks



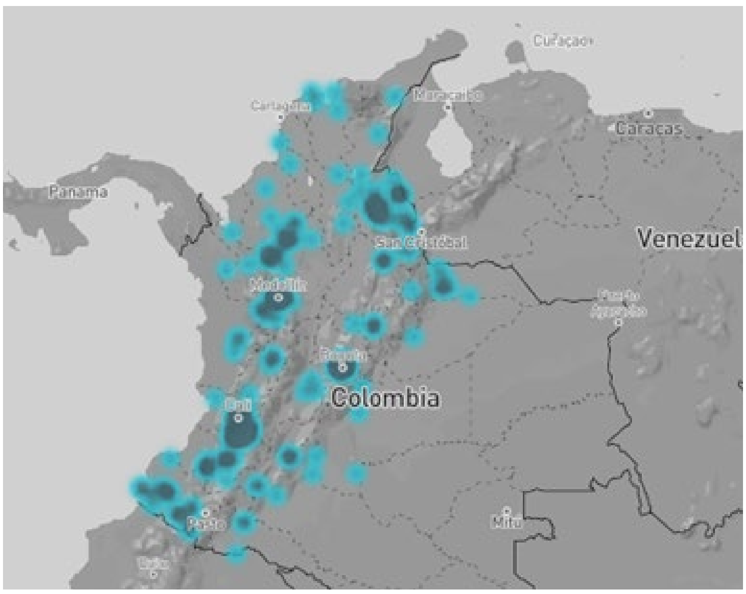
Source: Control Risks

Estimated cocaine production (Tons)

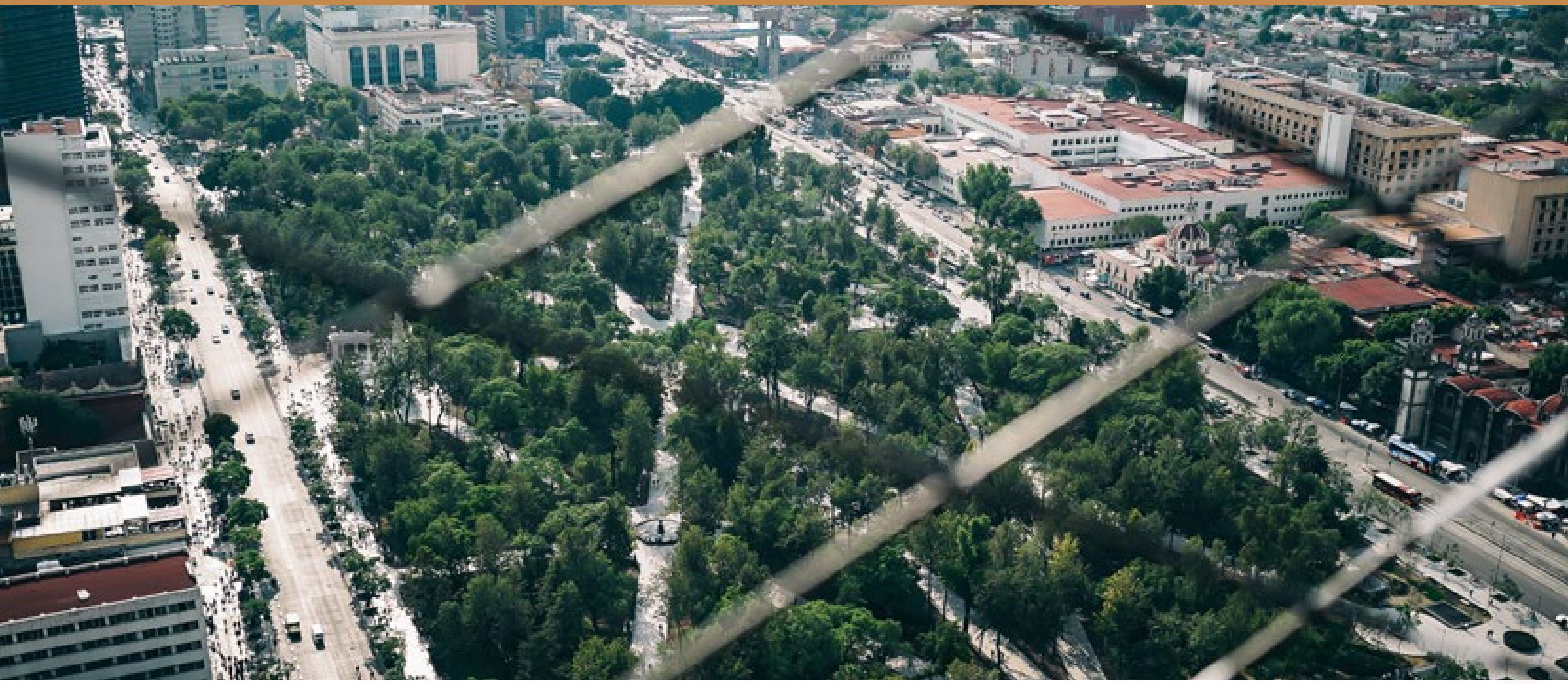


Source: Control Risks

Geographic distribution of terrorist incidents in Colombia (2019)



Source: Control Risks



Mexico

Insecurity continues to be the flagship issue in Mexico and will remain one of the principal challenges to doing business in the country over the next few years. The national security environment has experienced a notable deterioration in recent years, which has been exemplified not only by the ever-increasing homicide rate, but also in a significant rise in the incidence of other crimes. The entrenched and pervasive influence of organised criminal groups (OCGs) and the increasingly complex organised crime landscape remain some of the root causes of insecurity. There are now a multiplicity of OCGs across the country that are engaged in a wide variety of illicit activities – it is an anachronism to talk of "drug cartels" as though the OCGs still deal only in narcotics. Despite the increasingly pressing nature of this situation, AMLO's administration remains unlikely to find the resources or the institutional means to attempt to tackle, let alone eradicate, it.

With this in mind the administration will likely prioritise short-term security gains: for example, the reduction in violence in a particular hotspot through the targeted deployment of the recently established National Guard. This approach does not guarantee success. The failed and widely criticised security operation in October 2019 in Culiacán, Sinaloa state that led to the arrest and subsequent release of Ovidio Guzmán (son of notorious drug lord Joaquín "El Chapo" Guzmán) laid bare chronic deficiencies in law enforcement agencies and a distinct lack of leadership on security matters within the federal government.

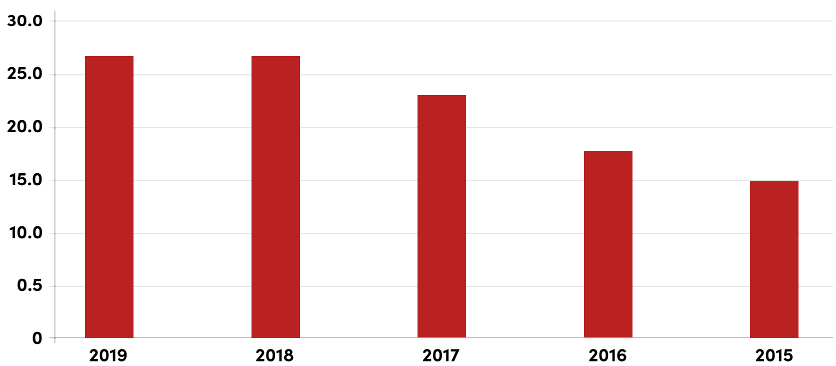
In the context of these events, we do not expect a tangible improvement in the security environment for the remainder of AMLO's six-year term in office.

Similarly, significant improvements to the corruption-risk environment are unlikely. Addressing corruption in the political class was one of AMLO's key campaign pledges. However, these promises have not translated into a practical effort to address the issue now that he is in office; for example, his administration has not increased resources (human or financial) allocated to law enforcement agencies and judicial institutions to the extent that would significantly improve their capacity to investigate and prosecute corruption cases. The National Anticorruption System, which was established in 2015, has also not been fully implemented, and the administration remains hesitant to either push for its implementation or provide an alternative.

The government has also refrained from carrying out a systematic crackdown on corrupt officials from previous federal administrations – even those suspected of the most egregious cases. Many of the government's recent anti-corruption investigations are seen as politicised, leading to accusations by opposition politicians and observers that the crackdown is more focused on undermining AMLO's political rivals than on cracking down on corruption across the government. The Finance Ministry's Financial Investigation Unit (UIF), which works directly under the president and Finance Minister Arturo Herrera, has become increasingly prominent in this context, leading to questions about whether such politically charged investigations constitute a net benefit for the country's overall corruption environment.

Organisations doing business in Mexico are susceptible to cyber-attacks due to the prevalence of poorly configured systems, outdated versions of software, application vulnerabilities and an overall lack of cyber security culture. This, combined with threat actors' perceptions of a lower awareness of cyber threats in Latin America, make Mexico an attractive target for cybercriminal operations. The financial sector in Mexico is particularly attractive to cybercriminals who have recently increased their focus on cyber-physical attacks such as ATM jackpotting. Activists' capabilities in the country are likely to remain limited to distributed denial of service (DDoS) and website defacement campaigns.

Homicide rates (per 100,000 inhabitants)



Source: Mexican National System for Public Security

Peru

The overall security outlook for Peru continues to be largely positive. A significant deterioration of the security environment remains unlikely despite the fact that common crime, including petty theft and armed robbery, will continue to impact public safety (particularly in the capital Lima). Homicide rates will remain lower than in other large Latin American economies, such as Brazil, Mexico and Colombia. Social unrest associated with labour and environmental disputes between communities and companies will remain a common feature of the political landscape. Sustained large-scale mobilisation is unlikely, and periodic protests are likely to concentrate in the areas of influence of large extractive, energy or infrastructure projects. These will have a limited impact on safety and security conditions in major cities.

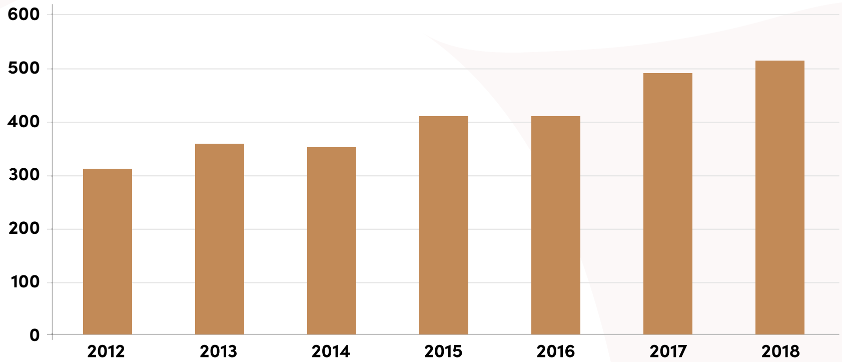
Security risks for foreign companies operating in rural areas tend to be limited to social unrest resulting from conflict with local communities; the threat of violence from armed groups in Peru is significantly lower than in neighbouring Colombia. One exception to this rule is the Shining Path (SL) guerrilla group – a dwindling force located in remote jungle areas – which is unlikely to pose a direct risk to businesses. SL survives by collecting protection fees on gasoline smuggling used for cocaine production in jungle areas, particularly in the Apurimac and Ene river valley (VRAEM). Although drug production undermines the security environment in major producing areas, the illegal narcotics trade has had a relatively limited impact on the security environment at the national level.

President Martín Vizcarra will continue to promote a broad anti-corruption agenda for the remainder of his administration, which remains widely popular. Reform proposals will likely include an end to parliamentary immunity and public financing of electoral campaigns. The government will likely be able to count on support from the interim Congress, elected on 26 January. The legislature will bring together novices and traditional politicians from across the political spectrum who despite their varied backgrounds will share an interest in wanting to be perceived as strong supporters of the anti-corruption agenda.

Despite ample political support for reforms, Peru will continue to struggle with anti-corruption enforcement since the judicial branch and criminal investigation authorities are unlikely to overcome their structural limitations regarding resources, personnel and expertise to conduct effective investigations. High-level investigations into corruption cases of national interest will continue, creating a temporary deterrent to large-scale corruption in major public contracts. That said, risks derived from corruption in mid-level and low-level public contracts will persist, particularly in rural areas, where enforcement capabilities will remain quite limited.

As elsewhere in the region, less mature cyber security practices mean organisations doing business in Peru are still likely to face threats from cybercriminals. The online banking, insurance and hospitality sectors continue to be particularly vulnerable to business email compromise, identity theft, phishing and smishing scams, and other mobile-enabled malware attacks.

Peru Coca Cultivation: Production Potential (Tons)

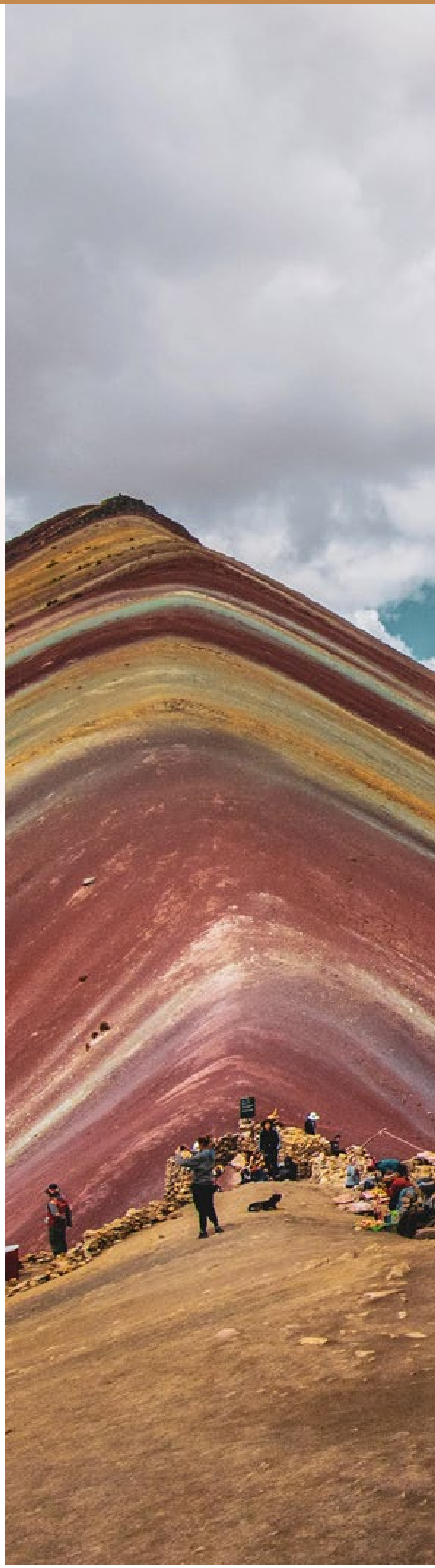


Source: United Nations Office on Drugs and Crime

Peru: Corruption Perception Index and National Ranking

Year	Index	Country Rank - Peru
2019	36	101º
2018	35	105º
2017	37	96º
2016	35	101º
2015	36	88º
2014	38	85º
2013	38	83º
2012	38	83º
2011	34	80º
2010	35	78º
2009	37	75º
2008	30	72º

Source: Transparency International



Summary

Drawing all the threads together from the in-depth analyses and expert insights of the preceding chapters, the following points stand out.

The Political Outlook

As of 2020, three out of the "big six" countries can be said to have populist leaders (Brazil, Argentina and Mexico – 1 of the right, 2 of the left). But the other three face presidential elections in 2021/22 (Chile, Peru and Colombia) in which current holders either cannot be or are unlikely to be re-elected. Bolsonaro's first term is up in 2022, Fernandez's in 2023, and AMLO's in 2024. So, by the end of the five-year period, it is possible that none of the current incumbents will be in power – the most re-electable candidate currently looks like Bolsonaro.

A general lack of voter trust in politicians and political parties suggests that support for centre candidates (centre-left or centre-right) may further erode and additional populist candidates may emerge; whether they are from the left or the right will determine whether they seek to blame (and turn their back on) free markets and globalisation, or whether they continue to be liberal in the international sense. It will also determine the extent to which fiscal and monetary discipline will be applied in-country; although even right-wing governments will tread the austerity path with care in order to avoid social protest explosions.

However, popular support for democratic values, condemnation of corruption, and demands for crime control and better justice and security remain resilient. Although the electorate may resort to outsiders and populists to bring mistrusted elites to heel, in general the appetite for any form of return to military rule appears weak (and even then only as a last resort to control rampant corruption if the main brakes on progress come from vested interests among the elites).

The shadow of the Venezuela crisis hangs over the entire Region and, given the intractability of the situation, it may well form the backdrop for the entire period covered by the Outlook. With Brazil, Chile, Colombia and Peru backing Guaidó and Mexico and Argentina attempting to stay neutral – the Region is unlikely to develop a united plan to resolve the situation.

Dominant external influences on the Region will remain the USA (diminishing) and China (growing). The Region's own influence on the rest of the world, despite further accessions to the OECD, is likely to remain weak as the key players – Brazil and Mexico - are largely inwardly-focused, while Argentina might (again) end up excluded from financial markets. Colombia, Chile and Peru may benefit from their Asia-Pacific associations, but they are unlikely to be in the globalisation driving seat.

The Economic Outlook

The continued economic concentration of the Region on agriculture and extractives meant that, when the latest commodity super-cycle came to an end in 2010, five of the "big six" countries went into recession. Although most (apart from Mexico and Argentina) are now back into positive growth figures, which we expect to continue, recovery is likely to be gradual and vulnerable to the lukewarm global economy; while a growing population means that GDP per head is likely to continue to struggle to grow.

The "big six" LatAm economies have in recent years all been pursuing broadly responsible fiscal and monetary policies. However, the lack of a buoyant commodity market is putting public revenues under pressure and government debt levels are rising – just at a time when public tolerance for austerity is at its lowest.

Governments will make more earnest attempts to increase welfare and improve poor public services in order to put a lid on social protests; though their impact is likely to be blunted by insufficient public resources. The very austerity that is needed to shore up shaky public finances impacts the poorest most; while the high proportion of the economy represented by the informal sector not only adversely impacts public finances but reinforces inequality and insecurity for the disadvantaged.

In order to secure growth not only in absolute terms but also in terms of per capita income, high levels of infrastructure investment will be needed (e.g., transport, education, hospitals, communications, digital economy). Structural productivity-enhancing reforms – of the public sector, pensions, labour markets, education, tax simplification, cutting red tape – will continue but progress will be slowed by the resistance of vested political interests and is vulnerable to governmental changes of direction (e.g., Mexico – airports and oil; Argentina). Corruption-induced higher spending and large informal economies will continue to siphon off public resources.

There is little prospect of another commodities boom coming to the rescue. Governments will therefore need to perform a difficult balancing act between the need for structural adjustments to shore up shaky public finances and allow scope to invest versus growing popular demands for better welfare and public services.

Governments like Mexico who try to go it alone – without calling in private and overseas investment - will struggle a lot more than others.

Environmentally, the Region is acutely exposed to climate change and sustainability issues – not least for the 80% of its citizens that live in cities. Given the importance of its environmental stewardship, the Region has a critical importance for the world. Brazil in particular has a serious choice to make between world leadership on the environment and losing international credibility through careless exploitation of the Amazon; social media (with its pictures of burning forests) are not on its side.

In terms of international trade, the US influence remains important, especially for Mexico and Colombia; but the US is being eclipsed for other countries by China, which is taking the bulk of agricultural and mineral exports and is an increasing source of infrastructure funding – albeit China is not proving an easy partner for the Region. Effectively, one dominant partner has been replaced by another. When the USA and China engage in trade wars, although the Region can benefit tactically (e.g., if China reduces agricultural imports from the US and turns to LatAm), overall it is exposed to falling growth as global trade contracts.

If the proliferation of different free trade associations (Mercosur, Pacific Alliance, CPTPP, USMCA, Prosur) is anything to go by, LatAm stands out as a continuing champion for growth through free trade. But, as in many other geographies, globalisation and free trade have taken the brunt of popular criticism for countries' economic woes. The more likely culprit is the failure to more evenly distribute the benefits of trade-led growth; however, unless inequality is substantively addressed in the coming years, protectionist pressures in the style of the US's 'America First' might become too tempting to resist for LatAm as well.

The Social Outlook

The past twenty years have seen significant reductions in poverty, with all six countries halving the percentage of their populations below the poverty line. However, massive inequality will remain a major issue; Gini coefficients are in the 40-50 range (more in line with Africa than Europe) - and this is not expected to significantly diminish over the Outlook period.

The recent social protests and demonstrations across several countries have featured multiple sources of social discontent - poor public services, pensions, education, crime, political corruption. Protests are expected to continue for the foreseeable future - especially in the Andean countries, although the social-media-fed trend could spread to Mexico, Brazil or Argentina.

The problems of inequality of power and influence will continue - with entrenched elites controlling the levers while others struggle to progress. However, the middle classes that emerged from the last commodity upswing will not slide back into poverty quietly – especially now that they have revised expectations, ambitions for their offspring, and have social media and know how to use it (penetration of social media platforms like WhatsApp is 90%). Unless popular expectations are met in full, or at least until popular discontent can once again be channelled through political parties (which, at the moment, is not a near prospect) recurring social protests will be the norm (and sometimes violent if anarchist, criminal or hooligan elements get involved).

The standard response of last resort to limited national opportunities has historically been migration. The two big sources of migration in recent years – Central America and Venezuela – will continue to dominate the picture. In its tolerance and willingness to absorb migrants, LatAm has recently offered an outstandingly humane example to an increasingly intolerant world; however, the scale of the problem (hundreds of thousands from Central America; 4.5 million to date from Venezuela) is expected to test the capacity of recipient countries (especially Colombia).

The Security & Corruption Outlook

Crime and insecurity in the region are driven by inequality, guns, porous borders, poor policing and outdated justice systems. These factors will continue to facilitate criminal activity for the foreseeable future. The capabilities of law enforcement and justice systems have improved in recent years and that progress is likely to be sustained by public pressure for improvements in human security, but change will continue to be gradual.

Countries fighting against corruption have also made great progress – notably in Brazil and other countries that have faced up to the damage exposed by Lava Jato and similar scandals. Progress, however, remains patchy and, although corrupt politicians and CEOs have been sent to jail, immunity remains widespread – in fact, this is a major reason for parliamentary incumbents to hold on to their posts. The prosecution and justice systems are not immune from political interference.

Cyber is a new area of concern – criminals are diversifying with notable success, given that the region's cyber protection systems are, as yet, not mature.

On both security and corruption, risks across Latin America are inherently manageable for businesses, but will require sufficient attention from management to mitigate them effectively.

Conclusions

Outlook report is of a set of countries which have made enormous progress in terms of democracy and development in recent decades but which still face serious challenges. Perhaps the main one is that of continuing to grow the size of the economic "pie" through continued open international trade and access to free markets, while improving its distribution in order to secure the consent of the governed. Given the highly unequal life chances of high proportions of their populations, that consent cannot be assumed.

However, the scenario suggests that democratic government might become more populist, but it will survive; that economic progress will continue to be made, albeit slowly; and that continuing protests and disruptions will keep pressure on governments to share the benefits of progress more evenly. Governments – with the possible exception of Argentina - will also for the most part be fiscally responsible, but will be wary of erring too far on the side of austerity lest they provoke uncontainable social unrest.

Our overriding conclusion is that most of the risks are on the political and social side. Security presents issues which need to, but can be, managed. The economic prospects, though in a relatively low growth scenario not exciting, suggest these countries are nonetheless places where seasoned, well-informed and well-advised investors can continue to do business. There are, of course, triggers which could shift this scenario – either for better or for worse:

- Upside triggers would include: a fresh commodities boom, China stepping up its LatAm infrastructure investments to a level similar to its Asian investments, a technology boom triggering major productivity gains and boosting growth, or a resolution to the Venezuela crisis.
- Downside triggers would include: severe climate change events or sustainability issues, commodity price weaknesses, a prolonged Chinese recession, a US-China trade war, or generalised and prolonged popular unrest.

Canning House will be monitoring these triggers and, in conjunction with our partners, we will update the LatAm Outlook should any of these start to materialise.

A final word just to put LatAm in context. We are surrounded by significant uncertainty – not solely in LatAm but also in the US, the UK, the EU, Middle East, China – pretty much everywhere you look:

- the models of open trade and free market economies are being challenged especially by those who feel left behind – though it is a moot point as to whether the main drivers of inequality are globalisation or national policies
- populist politicians are challenging centre parties and annihilating them at the ballot box in the US, Hungary, Italy and the UK (not just Brazil and Mexico).
- also under fire is business's dependence on conventional sources of energy – calling into question how emerging markets can grow cleanly, but still grow.

Against this background of shared uncertainty, the objective of launching the Canning House LatAm Outlook with our partners was to develop a realistic frame of reference for policy makers and businesses - helping them to assess the risks and opportunities that lie ahead in the principal countries of Latin America and compare them realistically with other Regions which they might historically have more readily considered.

I hope we have in large measure succeeded; but we welcome your suggestions for areas to broaden or deepen our coverage – whether by country, by sector or by theme.

- Please do complete the questionnaire insert included with this report.
- We will endeavour to reflect your suggestions in the Canning House LatAm Outlook 2021.

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In partnership with:

Itaú

Control Risks

Michael Stott

Ipsos