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THEDIALOGUE

FEATURED Q&A

What's Behind the Sharp Drop in FDI to Latin America?

Luiz Fernando Pezão (L), the mayor of Rio de Janeiro, spoke with Chinese Premier Li Keqiang on Wednesday about the Asian giant's interest in building subway car factories in Rio, potentially the type of foreign investment Brazil has been lacking of late. // Photo: Agência Brasil.

Q Foreign direct investment in Latin America fell sharply last year as corporate investors turned their attention to other regions, according to a recent analysis by fDi Markets, which found that capital investment in the region fell 39 percent, while the number of greenfield FDI projects declined 16 percent in 2014. Some analysts have observed that while most administrations in the region say they are trying to attract foreign investment, government policies don't always reflect that. What was behind the steep decline in FDI in Latin America last year, and will the trend continue this year? What are governments in other parts of the world doing to attract foreign investment that Latin American countries are not? What sort of policy changes would make countries attract more investment?

A **Andrew Gunther, managing director at Darby Overseas Investments:** "Foreign direct investment into Latin America in 2014 was a function of both the region's economic performance and of exogenous factors in the global economy. The decline in Chinese economic growth and consequently in prices for commodities such as copper, iron ore, soy beans and oil (in the second half of the year) translates directly into lower investment in countries such as Peru, Chile and Brazil, which are major commodity exporters. Lower commodity prices also contribute to reducing economic growth in the region which in turn leaves foreign investors with fewer reasons to expand factories needed to supply industrial and consumer goods. Mexico, the largest recipient of FDI in Latin America, actually experienced higher

Continued on page 3

TODAY'S NEWS

POLITICAL

Guatemala Central Bank President Under Arrest

The head of Guatemala's central bank was arrested Wednesday in a corruption probe that continues to unravel the highest levels of President Otto Pérez Molina's administration.

Page 2

ECONOMIC

Vázquez to Discuss Mercosur With Rousseff in Brazil

Uruguay's president, Tabaré Vázquez, is scheduled to meet with his counterpart, Dilma Rousseff, in Brazil today to discuss revitalizing the Mercosur trade bloc.

Page 2

POLITICAL

Cuba, U.S. Close to Restoring Diplomatic Ties

As negotiators from Cuba and the United States prepare to meet today in Washington for their latest round of talks, the two countries are closer than ever to restoring diplomatic ties, State Department officials say.

Page 2

State Dept. experts answer questions about Cuba policy on reddit's Web site May 12. // Photo: U.S. Government.

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POLITICAL NEWS

Guatemala Central Bank President Under Arrest

The head of Guatemala's central bank, Julio Roberto Suárez, was arrested Wednesday in a corruption probe that continues to unravel the highest levels of President Otto Pérez Molina's administration, Agence France-Presse reported. Others were also placed under arrest, notably the head of Guatemala's social security administration (IGSS), Juan de Dios Rodríguez. The officials are accused of fraud in a $14.5 million contract for dialysis services for patients covered by IGSS health insurance. "No one is above the law," presidential spokesman Jorge Antonio Ortega told reporters Wednesday, adding that central bank Vice President Sergio Recinos will serve as interim president, Bloomberg News reported. "This is the result of a process to fight corruption. We have to try to clean up the system," Ortega said. Several members of the IGSS board of directors and two executives at pharmaceutical firm PISA, which had been awarded the dialysis contract, were also arrested. Massive rallies last weekend in 13 cities across Guatemala to protest against corruption featured calls for President Pérez Molina to resign. His vice president, Roxana Baldetti, stepped down on May 8 after authorities arrested the country's tax chief for customs tax fraud and issued a warrant for the arrest of Baldetti's top aide, who is believed to have fled the country. Energy and Mining Minister Erick Archila, who was recently questioned by Congress over contracts he issued, also resigned last week, alleging blackmail, according to AFP. Guatemalan business leader Salvador Paiz commented earlier this week in the Advisor that Baldetti's resignation "is unprecedented and highly significant," adding that "the entire Pérez Molina administration is a deer struck by headlights, incapacitated and incapable of addressing the escalating crisis." [Editor's note: See "**Will Corruption Topple Guatemala's Pérez Molina?**" in Wednesday's edition of the Advisor.]

Juan de Dios Rodríguez // File Photo: IGSS.

Cuba, United States Close to Restoring Diplomatic Ties

As negotiators from Cuba and the United States prepare to meet today in Washington for another round of talks aimed at restoring diplomatic ties, the two countries are closer than ever to reaching agreement, an unnamed State Department official told The New York Times in a report today. Progress has been slower than many analysts expected since the two governments announced intentions to establish relations last December. This week, a small Florida bank, Stonegate, confirmed it has agreed to take on Cuba's banking account in the United States. For several years no U.S. bank has been willing to service the country out of concerns over violating Treasury Department restrictions on financial transactions with Cuba. And next week, Cuba is expected to officially come off the American government's list of nations that sponsor international terrorism. Another sticking point has been the terms under which U.S. officials will be allowed to travel around Cuba after relations are renewed, Reuters reported Wednesday. Assistant Secretary of State Roberta Jacobson

A small Florida bank, Stonegate, confirmed it has agreed to take on Cuba's U.S. bank account.

NEWS BRIEFS

Chinese Premier Arrives in Colombia, Second Stop on Regional Tour

After spending two days in Brazil, Chinese Premier Li Keqiang is scheduled to arrive in Colombia today to meet with President Juan Manuel Santos at the presidential palace, El Tiempo reported. China is Colombia's second-largest trading partner, after the United States, but the value of trade with the Asian giant fell 72 percent in the first quarter, compared to the same period last year, largely due to a drop in the prices of raw materials. Colombian officials hope to diversify trade with China to include a wider variety of products.

Acciona Windpower to Install Over 800 MW in North America This Year

Acciona Windpower, a unit of Spanish energy company Acciona Group, said Wednesday that it plans to install 805 megawatts of wind turbines in North America this year, including 465 MW in the United States, 239 MW in Mexico and 102 MW in Canada. North America accounts for 59.5 percent of the total wind capacity that the company will put into service in 2015, followed by Brazil, which accounts for 21.5 percent.

Uruguayan President to Discuss Mercosur in Brazil Visit

Uruguay's president, Tabaré Vázquez, is scheduled to meet with his counterpart, Dilma Rousseff, in Brazil today to discuss revitalizing the Mercosur trade bloc, El País reported. Uruguay is especially concerned over the inclusion of agricultural goods in the decade-long negotiations with the European Union on a trade accord with Mercosur. Vázquez also wants more flexibility from Brazil in order to negotiate Uruguay's own trade agreements outside the Mercosur bloc.

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said Washington was determined to minimize restrictions, but a new U.S. embassy in Havana is likely to operate with controls on staff travel similar to those on American diplomats in other countries with authoritarian governments such as China and Vietnam. Jacobson will also insist on the security of deliveries through diplomatic pouch.

ECONOMIC NEWS

Venezuela's PDVSA Looking to Import Lighter Crude Oil

Venezuelan state oil company PDVSA is looking to import more sweet crude to mix with its heavy oil to produce refined products, but it will not consider the United States as a source, Bloomberg News reported Wednesday, citing unnamed sources familiar with the plan. Representatives of PDVSA traveled to Houston in late April seeking long-term structured supply deals for lighter crude from West Africa or the North Sea, but the company is not interested in condensates from the United States, the sources said. PDVSA has long-term plans to build six upgraders that would allow it to process the heavy crude produced in the Orinoco Belt, but in the short term is looking to import lighter blends to mix with its domestic production. Last year, Venezuela imported the Algerian Sahara crude blend to mix with its oil while a heavy-crude upgrader was undergoing maintenance, but the company sees the Sahara Blend as too expensive. Lower oil prices have cut into PDVSA's ability to finance the multi-billion dollar upgrades, and Venezuela has been seeking support from the Organization of Petroleum Exporting Countries to bolster prices. Last week, Venezuelan President Nicolás Maduro sought a deal between OPEC and non-OPEC oil-producing nations to bring prices back up to $100 a barrel from their current price of $60, Reuters reported. After meeting with the emir of Qatar last week, Maduro said plans are to stabilize the market in the second half of this year. OPEC meets next on June 5 in Vienna.

FEATURED Q&A / Continued from page 1

FDI in 2014. However even Mexico struggled with a sluggish economic growth rate of only around 2 percent as the government worked to finalize investor-friendly reforms. Brazil fared worse, managing just 0.1 percent economic growth in 2014. Investors contemplating new FDI in Brazil faced a panorama of electoral uncertainty, fears of water and electricity rationing, clear signs of an upcoming recession in 2015 and rising inflation, all of which gave them pause.

> **"Lower employment costs measured in U.S. dollars will help to push the profitability of the manufacturing sector upward."**
>
> **— Alberto Bernal-León**

During 2014, U.S. economic growth began to recover prompting intense speculation about the end of the Fed's quantitative easing program and an eventual hike in U.S. interest rates. Many market participants believe that rising U.S. interest rate environments have historically been challenging for emerging markets including Latin America, which may have prompted investors to hesitate. That said, there is much the countries in the region can do to increase flows of FDI. Many already have stable macro environments that attract foreign investment. However, in some countries there is still more to do to promote more efficient and fair court systems, reduce bureaucracy and enact other reforms."

Alberto J. Bernal-León, head of research and partner at Bulltick Capital Markets in Miami: "The main reason why FDI fell in 2014 was exogenous to the region. The collapse seen in commodity prices is largely to blame for the very poor performance that FDI showed last year, and lingering low commodity prices are likely to continue to affect the performance of FDI this year, even if markets see a mean reversion of prices going into the year-end. Our analysis shows that there is a material correlation between the performance of international commodity prices and the size of company-specific CAPEX budgets. Therefore, it is only logical to forecast that new investment in capacity will probably be delayed, perhaps all the way to 2017 or 2018. The positive news behind the adjustment that the region has seen in the commodity-related CAPEX is that the continued trend in flows will probably allow for some foreign exchange-dependent sectors to regain some needed competitiveness. Specifically, our analysis clearly shows that lower employment costs measured in U.S. dollars will help to push upwards the profitability of the manufacturing sector. Assuming that the bettering of the competitiveness of the region is sustained, meaning that the gains are not eroded by endogenous regional decisions to raise taxes on the productive sector or by parallel increases in inflation, then the well-being of the manufacturing sector should increase materially."

Armando Senra, head of the Latin America & Iberia region at BlackRock: "Latin American countries saw a decline in FDI over the past year as both economic slowdown and political uncertainty led international investors to favor other regions in their search for attractive investment opportunities. Looking forward, not all Latin American economies are in the same position. In many, such as Mexico, reform agendas in place have the potential to drastically increase FDI flows. Ongoing efforts to boost the competitiveness of domestic industries and to open up the economies to facilitate international flows will increase the attractiveness of these countries for investors. Undoubtedly, structural changes do not happen overnight; it takes patience

Continued on page 4

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FEATURED Q&A / Continued from page 3

and determination to successfully achieve them, but continued improvements in regulations, macroeconomic stability and fiscal responsibility will send investors the right signals. Latin America is in a prime position to benefit from deepened relations with North America; renewed efforts to improve institutional quality and investor protection are key to taking full advantage of existing links to further attract private capital. Another area of opportunity stands in developing stronger relationships with Asia. Enhancing the investment links between the two sides of the Pacific is a mutually beneficial solution. Latin American countries will find in Asian partners the financial capacity and technical knowledge to tend to its essential infrastructure development needs. On the other side, Latin America offers many advantages as a destination for FDI flows, including an abundance of natural resources, but more importantly, a growing middle class that increasingly demands goods and services, as well as a platform to access other international markets."

Jorge Lara Urbaneja, partner at Arciniegas, Lara, Briceño & Plana in Bogotá: "There was a time when major companies, local or foreign, were formed to exploit product lines in local markets. This is no longer possible because projects nowadays are conceived at larger scale, to compete regionally or globally in an international market that is in a permanent state of dynamic change. So when deciding where to make a productive investment, there is close scrutiny of which country or region has the most convenient rules and regulations for the particular project. In spite of this global trend, Latin American governments very seldom put in place policies or incentives that address investors' concerns. Latin American governments are so engaged in confronting immediate social problems that they do not consider improving local and foreign investment conditions as part of the solution. Rather than implementing investment-friendly policies, many Latin American countries impose high tax rates and unbearable fiscal structures, outdated foreign-exchange controls, rigid labor and permissive union regulations and over-regulate foreign trade. This explains the investment decline in 2014. But, investment projects that leave or elude Latin America do not vanish. While some countries in Latin America have a negative outlook and blame it on the drop in oil and commodities prices, European countries that just a few years ago seemed to have a bleak future are now back in the positive figures based on solid economic incentives. India is promoting an aggressive deregulatory and open market economy. And even in Latin America, leftist presidents are now promoting large private agricultural and industrial initiatives."

> **"India is promoting an aggreessive deregulatory and open market economy."**
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> **— Jorge Lara Urbaneja**

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Energy Advisor

The answers to questions that informed executives are asking ... every week.

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