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THEDIALOGUE

FEATURED Q&A

Can Latin America Break the Boom-Bust Cycle?

Emerging countries must redirect their economies toward new growth sources, International Monetary Fund Managing Director Christine Lagarde said last month. // File Photo: IMF.

Q Emerging and developing economies are "confronted with a new reality" as growth rates have fallen, and cyclical and structural forces have undermined the traditional paradigm of growth, International Monetary Fund Managing Director Christine Lagarde said in a Jan. 12 speech in Paris. Further global aversion to risk may lead to even deeper commodity price declines, she added. At the same time, greater debt burdens in developing nations, including in Latin America, are threatening to hinder global economic growth. Do Latin American countries' debt levels threaten to damage the region's shaky economies even more than they have already experienced? Will investors continue pulling out of emerging market assets, and what will that mean for Latin American countries and companies? Which countries are most at risk, and which are well-positioned to weather the storm?

A **Brian C. Dean, partner at ACG Analytics:** "Domestic fundamentals in some of Latin America's largest economies face political trials in 2016. Argentina's capacity to sustain the pace of the reforms launched in December and uncertainty over the fallout from the Petrobras scandals in Brazil will determine prospects in those countries. Venezuela's hyper-polarized political environment will challenge its capacity to avoid default so long as the global oil rout continues. China and commodities underlie the regional malaise, but internal politics and the rule of law will determine the outcomes. That the hegemony of the ideological left in South America is vanquished in Argentina, threatened in Brazil and drawing its final breath in Venezuela

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TODAY'S NEWS

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Venezuela's Opposition Vows to Oust Maduro

Opponents of President Nicolás Maduro's government, including National Assembly head Henry Ramos Allup, vowed to find a way to legally drive Maduro from office.

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ECONOMIC

Cuba to Launch its First Home Broadband Service

Cuba's state telecommunications company said Cubans would be allowed to order home broadband Internet service through connections operated with China's Huawei. However, it is unclear how much the service would cost.

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POLITICAL

Former Salvadoran President Flores Dies at 56

Francisco Flores, who had faced allegations of corruption stemming from his time in office, died Saturday of a cerebral hemorrhage.

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Flores // File Photo: Salvadoran Government

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POLITICAL NEWS

El Salvador's Flores Dies at 56

Francisco Flores, who served as El Salvador's president from 1999 to 2004 and also faced allegations of corruption, died Saturday after suffering a cerebral hemorrhage, the Associated Press reported. Flores, 56, died while in a coma and had recently undergone emergency surgery. His doctors said last week that the former president had a small chance of survival after suffering irreversible neurological damage. Flores had been hospitalized for thrombosis, or blood clots in veins, in October 2014. He was hospitalized again in December due to an internal hemorrhage, the AP reported. Flores had been under house arrest after he turned himself in to authorities in September 2014, BBC News reported. He had been charged with embezzlement and illegal enrichment. Prosecutors accused him of misappropriating a $15 million donation that Taiwan gave to El Salvador to help the victims of earthquakes that hit the Central American country in 2001. He was accused of transferring $5 million to his personal bank account. The other $10 million allegedly went to Arena, his conservative political party. Loyda Robles, a prosecutor in the case against Flores, told the AP that although the former president's death means the end of the criminal case against him, civil litigation related to the case will continue. When he took office, Flores became the third consecutive Salvadoran president from Arena. Several natural disasters struck the country during Flores' presidency. Earthquakes in January and February 2001 killed more than 1,000 people and left some 200,000 homeless, the wire service reported. A drought later destroyed many of El Salvador's coffee crops.

Flores had been charged with embezzlement and illegal enrichment.

Venezuela's Opposition Vows to Oust Maduro

Top opposition leaders, including National Assembly head Henry Ramos Allup, are vowing to cut short President Nicolás Maduro's term, Agence France-Presse reported. "I don't want this to last three more years, going from bad to worse," Ramos told foreign journalists on Friday. "If you can treat an illness before it kills you, then you obviously apply the treatment." Maduro's current term lasts until 2019, but Ramos said he should be driven from office before that. "Someone said we should let the government finish its term so it can stew in its own juice. That would be irresponsible," he said, AFP reported. Ramos said the opposition is planning to find a way, by no later than June, to legally force Maduro out of office. "I don't know if it will happen by the end of this year ... but the way things are going, I don't see him reaching the end of his constitutional term," Ramos added. Ramos' statements came just after the opposition-controlled National Assembly rejected a request from Maduro for emergency economic powers. Last Thursday, another prominent opposition leader, Miranda state Governor Henrique Capriles said the opposition must work to find a way within weeks to oust Maduro, Reuters reported. "We have to find a common position. The clock is ticking ... We can't wait longer than the first quarter," said Capriles, whom Maduro narrowly defeated in the country's 2013 presidential election. Venezuela is suffering from numerous economic problems, including triple-digit inflation, a third year of economic contraction and shortages of

Ramos // File Photo: Venezuelan Government.

NEWS BRIEFS

U.S., Mexican Authorities Arrest 24 Alleged Sinaloa Cartel Members

U.S. and Mexican authorities on Friday conducted a cross-border raid that resulted in the arrest of 24 alleged members of the Sinaloa drug cartel, CNN reported. The raid happened along the border separating Arizona and Sonora states. The operation also resulted in the seizure of "assault-style" weapons and hundreds of pounds of drugs, said a spokeswoman from U.S. Immigration and Customs Enforcement.

Brazil May Remove Limits on Foreign Ownership of Airlines

Brazil's government may remove its limits on foreign ownership of local airlines in order to attract more investment to the struggling sector, Reuters reported today, citing Valor Econômico. President Dilma Rousseff is also considering opening up the capital of Infraero, the state-owned company that controls most of Brazil's airports, the Brazilian newspaper said without citing any sources, according to Reuters. Currently, foreign groups may only have a total of 20 percent ownership of local airlines in Brazil. Officials in Rousseff's office were not available for comment.

Statoil to Begin Operating in Uruguay

Norwegian multinational oil and gas company Statoil said Monday it would operate in Uruguay for the first time after acquiring a 15 percent stake in offshore oil exploration Block 14 from French multinational oil company Total, MarketWatch reported. Statoil said the project's partners, which include ExxonMobil, will begin drilling in the first half of this year. Block 14 is located in the Pelotas basin in the South Atlantic Ocean, approximately 124 miles off the coast of Uruguay.

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presents the region with the opportunity to reassess its relationship to global markets and investors. Growth will remain limited to those that 'play well' with others. Argentina's Marci gets this and has asserted his government's prerogatives by loosening restrictions on exports, floating the peso and articulating broad macroeconomic reforms. Beginning in March, he will need to work with his Congress—an indicator on how well his reversal of Kirchner-era policies will fare. In Brazil, the drama will play out in the Congress, the courts and among political parties. The central bank appears to have reversed its monetary approach to conform to the new finance minister's more dovish posture on inflation. Brazil's flagship state firms will struggle to divest assets, which could auger a government bailout. In the case of Petrobras, this could cost $21 billion, increasing debt to earnings to 'unsustainable levels,' according to Citigroup. With its president in survival mode, the prospect for sustaining austerity policies is low in the short term. The deeper fundamentals embedded in the country's tax and labor codes and regulatory burdens stand no chance of reform until a government with widespread sectoral and public support is elected, without impeachment or a judicial annulment of the 2014 elections, which means 2018 at the earliest. Venezuela's opposition majority in its National Assembly will test its constitutional authority by challenging President Maduro's powers, and even his presidency."

Alfredo Coutiño, director for Latin America at Moody's Analytics: "Latin America is facing a significant challenge this time, with the confluence of a set of unfavorable factors that depict a non-promising scenario. The new reality of low growth, depressing commodity prices, weakening currencies and increasing interest rates will aggravate fiscal imbalances and will accelerate the debt ratios, thus increasing the region's vulnerability to internal and external shocks. Even though the external environment has blown strong headwinds, the region's increasing fiscal imbalances and debt ratios are basically the result of imprudent policy management that did not act in advance of the foreseeable incoming reality. The first mistake was to consider that global disrupting events were 'transitory,' as was the case of the fall in commodity prices and the consequent currency depreciations in emerging markets. Second was the passivity shown by policymakers to act in advance by implementing the measures and adjustments necessary to cope with the incoming and ongoing unfavorable conditions. For example, prudence would have recommended a budget adjustment to deal with the shortfall in commodity revenues. The severe capital flight would have deserved a timely and more efficient use of monetary defenses. The severe currency depreciations and increasing interest rates have now created additional risks for the already swollen public and private debts. Indeed, the region created its own vulnerabilities, but also seems to have forgotten that the wider the imbalances, the higher the exposure to external shocks. Policy discipline—fiscal and monetary—was left aside in the past years of excess global liquidity. Now the region will have to adjust to the more normal reality of liquidity restriction and expensive financing. Countries at higher risk will be those delaying both the necessary fiscal and monetary adjustments and the needed structural changes."

> **"The region's increasing fiscal imbalances and debt ratios are basically the result of imprudent policy management...."**
>
> **— Alfredo Coutiño**

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basic goods such as food and medicine. Maduro has blamed the plunge in oil prices and his political enemies, saying they have waged an "economic war." However, Maduro's opponents have said Venezuela's economic problems mainly result from mismanagement by Maduro and his late predecessor, Hugo Chávez. [Editor's note: See **Q&A** about Venezuela's political situation in the Jan. 12 issue of the Advisor.]

ECONOMIC NEWS

Cuba to Launch its First Home Broadband Service

Cuban state-owned telecommunications company ETECSA announced Sunday it would allow Cubans to order broadband home Internet service through fiber optic connections operated with Chinese telecom operator Huawei, CBS News and the Associated Press reported. ETECSA described the service as a pilot project and the cost for the service would be announced in the future. Most Cubans earn a state salary of $25 a month, and foreign companies in Cuba typically pay hundreds of dollars a month for an Internet connection. Despite the cost issues that may arise, access to a home Internet connection is seen as an important step forward for Cuba, a country where public access to the Internet began only last year with the opening of public WiFi spots. Earlier in January, U.S. President Barack Obama called on Congress to lift the trade embargo between the two countries as part of a thaw in their relations. U.S. airlines have also recently been cleared to fly directly to Cuba and plan to start offering flights later this year.

> **Foreign companies in Cuba typically pay hundreds of dollars a month for an Internet connection.**

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Alberto J. Bernal, chief global and emerging markets strategist at XP Securities: "The situation in Latin America is clearly quite delicate, yet logic would tell us that the markets should probably have priced in most of the bad news. The world's financial stability has continued to remain hostage to the performance of oil prices, and I suspect that such a situation will not change in the short term. Hence, the future performance of Latin American asset prices and the regional economies will remain dependent on the possibility of oil prices finding a bottom, which would therefore lead to U.S. high-yield assets regaining some sponsorship from institutional investors. If oil prices continue to fall (not my base case), the liquidity of the U.S. high-yield market will continue to dry out, and risk aversion will continue to increase. If risk aversion increases, world equity markets will fall, and emerging market currencies will continue to implode. It's my belief that emerging market forex selling, further from the current already very depreciated levels, will no longer help emerging market economies to increase competitiveness, but rather will introduce detrimental debt dynamics, with investors pricing-in that foreign currency-denominated debt levels will skyrocket. I, however, remain sanguine, because I do consider that it is very likely that the markets will read the news on major oil supply contractions in the very short-term—I expect U.S. shale output to fall dramatically in the next couple of months."

Kathryn Rooney Vera, head of Global Macro Strategy and Emerging Market Research at Bulltick Capital Markets: "Emerging markets, particularly within Latin America, are plagued by the new reality of the post-commodity boom. Countries that sufficiently and prudently prepared for any downturn in global economic cycles are set to outperform those that did not. Clearly, the currencies and fixed income markets that are feeling the most heat are those that are commodities-dependent. I expect the Mexican peso and local bond market (MBONO) to perform relatively better versus regional currency peers this year. The Mexican peso has been hit hard because of the exceedingly bearish emerging markets market sentiment, with the peso deployed as a hedge against emerging market risk. The peso is less commodity-dependent and more dependent on the United States; a competitive Mexican peso is good for FDI in manufacturing, good for real wages and good for consumption, alongside low unemployment. Mexico will grow more than most countries in the region this year at 2.8 percent year-on-year amid a strong domestic consumption story. The ongoing volatile global scenario and lower commodity prices continue to beat up Latin America and fixed incomes, with Venezuela likely to restructure its debt this year given its debt profile and oil prices. I do not expect any other sovereign restructurings this year and maintain Venezuela will be contained. While the steep deceleration in the economic growth rate of China and the macroeconomic picture has played a critical role in the aggressive depreciation in local currencies and government coffers (for commodity exporters) and have thereby produced higher debt levels. One of the multiple risks that I see is a continued U.S. dollar appreciation, perhaps on the back of competitive devaluations globally."

> **"Mexico will grow more than most countries in the region this year...."**
>
> **— Kathryn Rooney Vera**

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org.

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