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## FEATURED Q&A

# What Factors Could Cool Down Peru's Hot Economy?



Peru's construction sector activity has been boosted by the Pan American Games, which Lima is hosting for two weeks starting July 26. // Photo: Andina.

**Q** Peru's economy expanded by 5.27 percent year-on-year in November, the government said last week, a figure that surpassed analysts' expectations. The government has forecast that GDP grew by roughly 4 percent last year. Will Peru's economy continue to expand at higher-than-expected rates this year? How long is the growth likely to last, and which sectors are likely to drive it? What sorts of headwinds could Peru's economy face in the year ahead, and how can the government prepare for them?

**A** Diego Pereira, chief economist for Argentina and the Southern Cone and executive director at J.P. Morgan: "We expect the Peruvian economy to grow above its potential in 2019, albeit China's deceleration poses a relevant risk to our baseline call. The economy proved capable of growing above its potential in 2018 despite the political uncertainty bouts experienced throughout the year, with a marked recovery in private sector investment. Higher commodity prices in the second half of 2017 and in the first half of 2018 helped investment to recover, up 4.7 percent year-on-year following three years in red. We think private investment will grow again this year, close to 6 percent year-on-year, but the risk comes precisely from the external backdrop. In fact, we estimate that terms of trade explain about 50 percent of the business cycle variation. In turn, public sector investment is to decelerate a tad in 2019, with the fiscal consolidation unlikely to prove a relevant headwind to growth in 2019, but rather in 2020. Regarding consumption, with private sector formal employment growing above

Continued on page 3

## TODAY'S NEWS

### POLITICAL

## Venezuela, U.S. Prepare for Standoff

A standoff could be developing at the U.S. Embassy in the Venezuelan capital of Caracas after government officials threatened to shut off electricity and gas to the complex in an effort to force U.S. diplomats to heed orders to leave the country this weekend.

Page 2

### ECONOMIC

## Mexican Inflation Rises More Slowly Than Expected

Gasoline shortages suffered in many parts of the country amid a government crackdown on fuel theft have not yet affected inflation rates overall.

Page 2

### ECONOMIC

## Economic Activity Falls Sharply in Argentina

Treasury Minister Nicolás Dujovne conceded that the biggest drop in GDP in Argentina's already bad year occurred in the second half of 2018. November's contraction marked the largest in a decade.

Page 3



Dujovne // File Photo: Argentine government.

## POLITICAL NEWS

## Venezuela, U.S. Dig in for Potential Standoff

A standoff could be developing at the U.S. Embassy in the Venezuelan capital of Caracas after government officials threatened to shut off electricity and gas to the complex in an effort to force U.S. diplomats to heed orders to leave the country this weekend, Bloomberg News reported today. President Nicolás Maduro severed diplomatic ties with the United States on Wednesday after the administration of President Donald Trump publicly backed National Assembly head Juan Guaidó as the legitimate leader of Venezuela. Hundreds of thousands of Venezuelans took to the streets this week to protest Maduro's government, and at least seven people have been killed. On Thursday, Maduro said he was shuttering Venezuela's embassy in Washington, as well as consular offices in the United States. Secretary



Padrino // Photo: Venezuelan state television.

of State Mike Pompeo responded to Maduro by saying the United States doesn't recognize his authority and therefore won't pull its staff out of Caracas, although non-essential personnel at the U.S. Embassy will leave the country, McClatchy reported Thursday. A daily security alert from the U.S. Embassy warned that protests may continue all week in Caracas and suggested U.S. government personnel to keep their children out of school. The staff who remain there could face hardships or harassment as they travel from their homes in the city to the embassy in the Chula Vista district, analysts say. "They could be picked up and sent out of the country forcefully. I wouldn't rule that out. It could get pretty ugly," Michael Shifter,

president of the Inter-American Dialogue in Washington, told McClatchy. "I don't rule out that there could be some force used to carry out his decision [to expel U.S. diplomats]," Shifter said. Meanwhile, Venezuela's powerful military establishment is publicly backing Maduro. In a news conference Thursday, Defense Minister Vladimir Padrino López called the latest developments "very dangerous" and denounced marches this week across the country as a coup attempt by the Guaidó-led opposition. The conflict has put Venezuela on the top of the global geopolitical agenda. Russian President Vladimir Putin, a financial backer of socialist Venezuela, spoke to Maduro Thursday to voice his continued support and express his concerns about meddling from the United States and the other countries that have backed Guaidó, Bloomberg News reported. "Destructive external interference severely violates basic norms of international law," Putin said, according to the report. Pompeo said Thursday that the U.S. government is prepared to dispatch more than \$20 million in humanitarian aid to Venezuela as soon as "logistically possible," CBS News reported. The U.S. mission to the United Nations said Thursday it requested that the U.N.'s Security Council, which includes Russia and China, both of which have backed Maduro this week, meet in open session at 9:00 a.m. Saturday to address the situation in Venezuela, Agence France-Presse reported. Pompeo is expected to attend. Seeking further support among Venezuelans sympathetic to the government's socialist agenda, Guaidó said he would consider an amnesty for Maduro if he cedes power, BBC News reported.

## ECONOMIC NEWS

## Mexican Consumer Prices Rise at Slower Pace Than Expected

Mexican consumer prices rose during the first half of January at a slower pace than forecast, the national statistics agency said on Thursday, Reuters reported. Inflation rose

## NEWS BRIEFS

## JP Morgan Expands Private Banking Business in Mexico

JPMorgan Chase's private bank is expanding in Mexico and elsewhere in Latin America, the unit's regional chief executive told Reuters on Wednesday. The bank plans to increase the number of its frontline private bankers in Latin America by 15 percent from its current 450 personnel. In addition to Mexico, Argentina and Colombia will also be focus areas for the expansion, the executive, Adam Tejpaul, said in the interview.

## Pope Francis Calls Killing of Women in Latin America a 'Plague'

Pope Francis on Thursday urged Latin American leaders to reject corruption and tackle gang violence, drug trafficking and the killing of women, which has become "a plague" in the continent, the pope said at a meeting with Central American bishops in Panama, Reuters reported. Francis is in Panama City for a five-day trip to celebrate the Catholic Church's World Youth Day.

## Latin America, Caribbean No Longer the Top Source for Migration: Report

Latin America and the Caribbean is no longer the fastest-growing source of international migrants, according to a Pew Research Center study released today. Most global migrants came from the region between 1990 through 2010, but that number has plummeted in recent years mainly because a slowdown of people leaving Mexico, the study said. The global population of Latin American and Caribbean emigrants grew by 7 percent between 2010-17, far below the Middle East and North Africa, which increased 38 percent. [Editor's note: See also [Q&A](#) in the Jan. 3-16 issue of the biweekly Financial Services Advisor.]

0.11 percent in the first half of the month, well below a Reuters forecast for 0.27 percent. Annual inflation stood at 4.52 percent in the year through the first half of January, according to INEGI. The central bank forecasts inflation will be close to its 3 percent target by the first half of 2020. Gasoline shortages suffered in many parts of the country amid a government crackdown on fuel theft have not yet affected inflation rates overall, The Wall Street Journal reported Thursday. "Disruption created by the sudden shortage of an essential good would generally lead to a response in the price; supply shocks often have inflationary consequences," Citibanamex said in a recent report cited by the newspaper, which added that fuel in Mexico is "a peculiar case, as gasoline prices are set using a formula." Several months ago, central bankers had expressed concern over the potential for rising inflation this year. The central bank raised interest rates in November and December on concerns about inflation holding stubbornly above its 3 percent target and exchange-rate volatility weakening the peso, according to the report.

## Argentine Economic Activity Falls Sharply in November: INDEC

Economic activity in Argentina slumped 7.5 percent in November as compared to the same month last year, state statistics agency INDEC said Thursday. The figure, which was 2.3 percent lower than in October 2018, marks the biggest decline in INDEC's Monthly Economic Activity Estimator (EMAE) in nearly a decade. Agence France-Presse described the economic contraction as "the worst shrinkage during the tenure of President Mauricio Macri." Market economists say the repercussions could drag on for months. "The statistical carry-over from 2018 into 2019 will be very negative, and we expect final domestic demand to remain weak for a while," Goldman Sachs analyst Alberto Ramos told clients in a research note. The South American country suffered from unexpectedly difficult headwinds last year. In the second quarter of the year, a "very large real GDP contraction" was driven chiefly by

the negative weather shock over agricultural production, Ramos noted, while the contraction of activity during the second half of 2018 was driven by a sharp tightening of domestic financial conditions. The acceleration of inflation, which cut into purchasing power, and more defensive spending decisions associated with the deterioration of consumer and business confidence also contributed, he added. "The brunt of the contraction during the second half of 2018 was felt by the credit and interest rate

### FEATURED Q&A / Continued from page 1

4 percent, and inflation expected at 2.6 percent by December 2019, we believe real consumption will add about 2.7 percentage points to GDP. In all, we forecast 2019 GDP at 3.9 percent, a tad below 2018's 4.0 percent, but still below the level we deem as potential (3.6 percent). In other words, we expect the output gap to vanish in 2019. The main risk to our baseline scenario comes from a more punitive domestic demand deceleration in China, with the corresponding negative impact through the commodity price channel affecting private investment, linchpin of above-potential growth. We expect a cautious central bank unfolding a gradual normalization of monetary conditions, together with fiscal measures anchoring the future consolidation. That should help private sector investment, while mitigating the domestic demand adjustment in case of negative external shocks."

**A** **María Amparo Cruz Saco, professor at Connecticut College and Universidad del Pacífico in Lima:** "The Peruvian statistics institute, INEI, estimated that the November 2018 year-on-year growth stood at 5.27 percent. This outcome is driven by two lead processes: First, the catch of fish—mostly anchovies, for both direct consumption and manufacturing—grew from 6,361 to 866,913 metric tons, a 13,528 percent growth. This remarkable fish catch explains the 188 percent increase in fishing activity alone, and also the 959 percent increase in the processing of fish that indirectly dominated the 12.2

sensitive sectors," Ramos said. Treasury Minister Nicolás Dujovne conceded Wednesday at the World Economic Forum in Switzerland that the biggest drop in GDP in Argentina's already bad year occurred in the second half of 2018, but he told investors that a brighter outlook lay ahead for Argentina. "The message I want to send is that the shocks that we suffered in 2018 reinforced our government's commitment toward reforms," he said. "So we decided to accelerate the path toward fiscal balance."

percent growth in manufacturing. Second, construction expanded by 13.5 percent due to the implementation of public investment projects, including the reconstruction of infrastructure in the northern region and the Lima 2019 Pan American Games. Economic growth in 2019 may be slightly higher than last year's growth of 3.5 percent. To attain this expansion, renewed growth in private and public investment will pull construction and financial services. In addition, the catch of fish will support manufacturing growth

**“** Employment growth in large, registered establishments is stagnant or, worse, falling.”

— María Amparo Cruz Saco

until meeting the authorized quota of 2.1 million metric tons. Turbulence, however, is likely. First, the labor market is not strong enough. Employment growth in large, registered establishments is stagnant or, worse, falling. Second, in November 2018 year-on-year, the growth of manufacturing of consumption goods was negative (-1.04 percent), and commerce grew at a mere 2.4 percent. Both indicators are used to measure the strength of domestic consumption. Third, mining fell 2.52 percent due to the downward trend of prices, the exhaustion of the life cycle of major mines and several

Continued on page 4



## FEATURED Q&amp;A / Continued from page 3

social conflicts. Finally, foreign inflows of capital that sustain private investment in new mining projects can reverse. Thus, the government would be wise in ensuring the timely and efficient execution of its investment projects. And, in the event of a demand downfall, it should use expansionary policies in a selective and prudent manner.”

**A** **Nicolás Mariscal, member of the Advisor Board and chairman of Grupo Marhnos:** “I believe Peru’s economy is gaining momentum, and it has high possibilities of surpassing expected growth. Despite uncertainty at the global level, Peru is strengthening its domestic market, and it has become a very attractive economy to invest in, especially in sectors such as primary manufacturing, mining and infrastructure. The government has improved its regulatory framework for public-private projects, which provides more

“**The government has improved its regulatory framework for public-private projects.”**

– Nicolás Mariscal

certainty for investors. Likewise, the country has a very large list of potential projects to be tendered between 2010 and 2021, including of hospitals, schools, ports, roads, wastewater treatment plants, systems for drinking water supply and hydrocarbons projects, among others. Additionally, the government is carrying out different efforts, in coordination with the private sector, with the aim of diversifying production. It is betting on sectors such as tourism, agriculture, forestry, mining and energy. In parallel, it is supporting small- and medium-sized enterprises, which I think will create a solid base to drive growth in the longer term. Of course,

the local financial sector is playing an important role. With this focus, the region’s eyes are fixed on this Andean country, which is setting an example of a clear path toward sustainable development.”

**A** **Jaime Reusche, vice president and senior credit officer of the sovereign risk group at Moody’s Investors Services:** “The Peruvian economy had been showing signs of strength since mid-2018, despite the escalation of political noise in the second half of the year. Growth was supported by domestic demand with a favorable performance of many sectors tied to consumption, but it was also underpinned by mining investment. To this we add that the rebound in fiscal revenues afforded a substantial increase in public investment that grew strongly in the last quarter of the year, marking a huge difference from other regional electoral cycles where the change in sub-national authorities used to collapse public investment. This seems to have been the spark that triggered the recovery of non-mining private investment, which will lead to a similar 3.7 percent growth rate for the economy in 2019. The quality of this growth will be higher and more sustainable because it will be supported by private investment. This type of investment, particularly in mining, has a strong multiplier effect on the broader economy because it ignites the construction sector that is labor-intensive and creates employment. Based on these trends, we see favorable signs that this expansionary cycle will continue and should peak in late 2020, depending on what happens with the external demand that at the moment is not generating much momentum for the Peruvian economy, but neither does it seem to be subtracting too much from growth.”

*The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at [fkuleta@thedialogue.org](mailto:fkuleta@thedialogue.org).*

## LATIN AMERICA ADVISOR

is published every business day by the Inter-American Dialogue, Copyright © 2019

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**Latin America Advisor** is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at 1155 15th Street NW, Suite 800 Washington, DC 20005

[www.thedialogue.org](http://www.thedialogue.org)

ISSN 2163-7962

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