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FEATURED Q&A

Can Puerto Rico Recover From its Economic Shocks?



Already dealing with the economic blows of hurricanes, earthquakes and a debt crisis, Puerto Rico Governor Wanda Vázquez's government now faces the economic fallout of Covid-19. // File Photo: Commonwealth of Puerto Rico.

Q Puerto Rico's government said last week that it had submitted a revised fiscal plan to a federal control board and asked it to delay austerity measures for at least two years as the island braces for billions of dollars in losses as a result of the Covid-19 crisis, coupled with the costs of recent earthquakes and the aftermath of Hurricanes Irma and Maria. How much have the coronavirus pandemic and recent natural disasters hit Puerto Rico's economic outlook? What does the revised fiscal plan entail, and what effects would delaying austerity measures have? How well is Governor Wanda Vázquez's administration managing the economy and Puerto Rico's debt obligations?

A José J. Villamil, chairman of the board of Estudios Técnicos in San Juan: "The most recent update of Covid-19's impact on the economy was of some \$4.8 billion in direct impacts and \$11 billion in total impacts for calendar year 2020, net of expected federal funds. The result would be a decrease in GNP of at least 6 percent in fiscal year 2021. These are rough numbers that will change in the coming weeks. A telling statistic is the number of unemployment claims, which number some 240,000 since late March. Our estimate is for a loss of more than 300,000 jobs out of a total labor force of around one million, many of which will not be recovered. These aggregate impacts don't tell the whole story. Covid-19 will probably mean the disappearance of thousands of small- and medium-sized firms, particularly in the retail sector, that don't have the capital and the assured supply chains that larger ones do. The end result will be a smaller but also much more

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Brazil's BNDES Unveils Airline Rescue Package

Brazilian state development bank BNDES proposed an airline rescue package worth \$680 million, far smaller than had been expected.

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FBI Probing Companies in Mexico, Europe in Sanctions Case

The U.S. Federal Bureau of Investigation is probing several Mexican and European companies allegedly linked to trading oil from Venezuela, which is subject to U.S. sanctions.

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POLITICAL

Mexico to Start Lifting Quarantine Orders Next Week

Mexico's government will start lifting quarantine orders in hundreds of counties beginning Monday. The country has "begun a new stage" in the fight against Covid-19, said President Andrés Manuel López Obrador.

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López Obrador // File Photo: Mexican Government.

POLITICAL NEWS

Mexico to Begin Lifting Quarantine Orders Next Week

Mexico's government announced Wednesday that it will start lifting quarantine orders in hundreds of counties beginning next Monday and will start reopening the rest of the country on June 1, The Washington Post reported. "We've begun a new stage," President Andrés Manuel López Obrador told reporters Wednesday. However, he said Mexico was about to start a "new normal" that would mandate safety measures in order to prevent major outbreaks of Covid-19. The government is planning to allow 269 municipalities spread across 15 states to resume most normal activities. The municipalities are ones that have no confirmed cases of coronavirus and whose neighboring counties also have no residents confirmed to have contracted the virus. The municipalities account for slightly more than 10 percent of all of the country's municipalities. The government plans to allow a phased reopening of businesses, schools and public gathering places that will be assigned a level at which they may function, The Washington Post reported. Additionally, the government has deemed construction, mining and auto manufacturing to be "essential" sectors that may reopen nationwide next week. It is unclear when manufacturing in sectors other than the automobile industry would be allowed to restart, the Financial Times reported. In March, the country's level of industrial production declined 5 percent as compared to the same month last year. Many economists expect Mexico's economy, the second largest in Latin America after Brazil's, to contract by between 7 percent and 12 percent this year. Mexico has more than 40,000 confirmed cases of Covid-19 and more than 4,200 reported deaths related to it. However, due to a lack of adequate testing, experts have said the true numbers of cases and deaths are likely to be far higher. López Obrador's government announced the plan a day after the country's social security institute reported

that the country lost 555,247 jobs in April, the largest monthly decline on record, the Financial Times reported. Some state governors in Mexico expressed concern that the government is allowing activities to resume too quickly, The Washington Post reported. "Everything is going to collapse, all the measures we have taken to keep people at home," said Governor Miguel Barbosa of Puebla, where automakers Volkswagen and Audi have factories.

ECONOMIC NEWS

Brazil's BNDES Unveils Airline Rescue Package

Brazilian state development bank BNDES on Wednesday proposed a rescue package worth 4 billion reais (\$680 million) for the country's airlines, less than half of the amount originally anticipated, Reuters reported, citing sources with knowledge of the matter. The plan's value,

The package is less than half the amount originally anticipated.

which initially consisted of a credit line of 10 billion reais, has been reduced over time as private lenders hesitated over extending bigger loans and because the airlines were reluctant to accept larger share dilution, the sources said. Under the current plan, airlines Gol Linhas Aéreas Inteligentes and Azul are due to receive 2 billion reais each. It is unclear if the development bank will reach a deal with LATAM Airlines, to which it has also offered as much as 2 billion reais. BNDES will provide as much as 60 percent of the loans, while private banks will contribute about 10 percent, with the remainder expected to come from capital markets investors, the sources said, adding that the plan is still subject to change. The scheme also provides five-year bonds, with a one-year grace period. Airlines have been forced to ground most of their flights due to the

NEWS BRIEFS

At Least 70 Dead in Mexico From Tainted Alcohol

Since late April, at least 70 people have died in Mexico after drinking tainted alcohol, The New York Times reported Wednesday. The death toll includes at least 20 residents of a poor town in the mountains of Puebla state who consumed a popular moonshine. The deaths could be related to officials' imposition of dry laws and other measures intended to fight the spread of coronavirus, Mexican officials said.

Golding Alleges Fraud in Guyana Vote Recount

The head of the Organization of American States' observation team in Guyana's vote recount, former Jamaican Prime Minister Bruce Golding, on Wednesday alleged electoral fraud, saying the results of four ballot boxes had been altered in favor of the ruling APNU+AFC coalition, Trinidad & Tobago Newsday reported. "I have never seen a more transparent effort to alter the results of an election," he said in a Facebook Live video. Guyana this week is undergoing a ballot recount of the election held more than two months ago, which has been marred by accusations of fraud.

Guatemalan Judge Rejects Pérez Molina's Request for House Arrest

A Guatemalan judge has rejected jailed former President Otto Pérez Molina's appeal to be released to house arrest over fears of contracting the novel coronavirus, Agence France-Presse reported today. Pérez Molina has been in custody since 2017, awaiting trial over a massive bribery scandal. Judge Miguel Ángel Gálvez rejected the petition, saying the former president is jailed at an army hospital, where there is no overcrowding. Pérez Molina said he had made the request because his age and heart conditions made him more vulnerable to Covid-19.

coronavirus pandemic. Earlier this month, Latin America's second-largest airline, Colombia's Avianca, filed for bankruptcy, The Wall Street Journal reported.

BUSINESS NEWS

FBI Probing Mexican, European Companies in Sanctions Case

The FBI is investigating several Mexican and European companies allegedly linked to trading Venezuelan oil as it gathers information for a U.S. Treasury Department inquiry into possible sanctions violations, Reuters reported Wednesday, citing four people familiar with the matter. U.S. Secretary of State Mike Pompeo and special envoy to Venezuela Elliott Abrams said last month that the State and Treasury departments were looking into whether several companies were conducting business with Venezuelan state oil firm PDVSA since January 2019, in violation of U.S. sanctions. The administration of U.S. President Donald Trump early last year slapped sanctions on PDVSA in a bid to squeeze an important source of revenue for Venezuelan President Nicolás Maduro, whom it deems illegitimate. According to Reuters, U.S. officials in private say failing to oust Maduro has been a source of frustration for Trump, whose administration has tightened the implementation of sanctions in recent months. The three Mexican companies reportedly under investigation are Libre Abordo, Schlager Business Group and Grupo Jomadi Logistics & Cargo, three of the people who provided information to the FBI told Reuters. The wire service did not find any record of Venezuelan oil purchases by these companies prior to sanctions. Some sources said the probe could potentially lead to action in the coming weeks, while others familiar with the matter said that any action could be delayed or canceled if the Mexican companies halted trade with Venezuela. Libre Abordo and Schlager denied violating sanctions. Reuters' emails sent to Jomadi's website bounced back.

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concentrated economy, making job creation much more difficult. Covid-19 will accelerate the already present trend in this direction. Another consequence of the pandemic will be greater social inequality. Puerto Rico already had the highest inequality metric, the Gini Index, among all states, and one of the highest in the hemisphere. Covid-19 will make the problem much worse. The recently submitted fiscal plan treats some of the above issues, but, as with previous ones, its ambitions outdistance the government's capacity to make it all happen. It does call for a lull in the austerity measures because of coronavirus, but it is not at all clear how this will be achieved and what impact it will have on the economy."

A Rafael Cox Alomar, professor of law at the David A. Clarke School of Law in Washington: "Puerto Rico's ailing economy has been slammed by the perfect storm. The coronavirus pandemic is only the most recent catastrophe in a long continuum of catastrophes: the commonwealth's colossal bankruptcy, Congress' unilateral imposition of PROMESA, the deadly passing of Hurricanes Irma and Maria, massive corruption scandals leading to the governor's resignation, unprecedented earthquakes and the scourge of the coronavirus. Puerto Rico's gross domestic product, by some estimates, could undergo a severe contraction ranging between 3.3 percent and 10.1 percent in fiscal year 2021. In revenue alone, Puerto Rico might end up losing more than to \$2 billion in tax revenue. The government's fiscal plan is illusory at best; devoid of structural reforms and, in all certainty, will be rejected by the PROMESA Oversight Board. It is all too apparent that Governor Vázquez's administration is mismanaging the economy and the government. While the governor and her team have shown themselves disorganized and utterly incompetent in distributing financial assistance to those most in need, it has been caught red-handed awarding tens

of millions of dollars in irregular procurement contracts for Covid-19 testing kits to political cronies with no experience in the medical industry (as the chairman of the Senate Finance Committee, Senator Chuck Grassley, reminded her in a letter dated April 20). The governor is clearly playing politics in anticipation of a tough primary battle in her own New Progressive Party. Meanwhile, the people of Puerto Rico are caught up in the crossfire."

A Brad Setser, Steven A. Tananbaum senior fellow for international economics at the Council on Foreign Relations: "Puerto Rico's economy wasn't showing any obvious momentum before Covid-19 launched the broader U.S. economy into a deep recession. Puerto Rico's economic activity indicator—and its key subcomponents, including the number of employed—was basically flat at the end of 2019. The shock from Covid-19 has been enormous. The governor's fiscal plans noted that unemployment filings have been a bit higher in Puerto Rico than in the United States as a whole. Given that tourism is one of Puerto Rico's main sources of employment, there is also good reason to expect that the downturn will be protracted. Revenues from personal income tax and the sales tax are obviously down sharply. The budget forecasts a roughly \$2 billion fall in revenue from these sources along with the corporate income tax. It is too early to tell if that forecast is too optimistic, as there is obviously enormous uncertainty. Preserving access to health care and other essential services—and making sure that Puerto Ricans have access to the safety net—has to be the priority this year. The unemployment insurance fund is likely to need a top up, for example. This equally isn't the time to be laying off government employees—as there aren't currently jobs to be found in the private sector. The budget as proposed wouldn't generate a primary surplus to pay bondholders in either 2021 or 2022. Puerto

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Rico now does have a substantial fiscal reserve, and that reserve can be used to help cover budget shortfalls. Puerto Rico is also slated to receive \$12 billion from the CARES Act, though the timing of the flow of federal funds is always hard to predict with certainty. At some point the board will have to make a judgment as to whether the existing fiscal reserve is large enough to move forward with the current plan of adjustment and also provide Puerto Rico with a sufficient buffer against the risk of a protracted economic downturn.”

A **Cate Long, founder of the Puerto Rico Clearinghouse:** “Puerto Rico’s government stopped reporting tax collections in March, but, based on available data, it is running about 10 percent below projections (\$789 million). Congress has appropriated \$12 billion to the island, including weekly federal unemployment payments of \$600 in addition to average local unemployment payments of \$157 per week. With the federal gross up, many private sector workers will be making more while unemployed than while working, given the low wage base on the island. Governor Wanda Vázquez assumed office in August and has not yet put forth a budget that reflects her fiscal priorities. She must submit her proposed budget to the Oversight Board in June. Puerto Rico’s government and

the board proposed 35 fiscal plans between 2016 and 2019. Like all previous versions, the current one underestimates revenues and continues to increase spending without paying debts. The Puerto Rico government has an employee absenteeism rate of approximately 40 percent and has cut taxes

“**Puerto Rico stopped paying debt service in 2015 and has accumulated more than \$17 billion in cash.**”

— Cate Long

multiple times since they entered bankruptcy. Between Hurricane Maria, earthquakes and Covid-19, Congress is providing more than \$90 billion to a \$90 billion economy, so there has been massive federal support. Puerto Rico stopped paying debt service in 2015 and has accumulated more than \$17 billion in cash. The government has not published audited financials since 2016. Basically, the commonwealth wants to obscure its financial condition and not pay its debts. It has adequate cash and capacity to do.”

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

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The Political Crisis in Brazil

A Latin America Advisor interview with Gabrielle Trebat, managing director for Brazil & the Southern Cone at McLarty Associates.

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