

LATAM Market Update

- **Mexico: *Red Compartida* going after telecom relevant operators. Is AMLO starting to feel cornered? Inflation raised above expectation but slowed at annual rate. Private consumption as single source of aggregate demand**
- **Peru: Another day, another president**

MEXICO: RED COMPARTIDA GOING AFTER TELECOM RELEVANT OPERATORS. IS AMLO STARTING TO FEEL CORNERED? INFLATION RAISED ABOVE EXPECTATION BUT SLOWED AT ANNUAL RATE. PRIVATE CONSUMPTION AS SINGLE SOURCE OF AGGREGATE DEMAND

The so called *Red Compartida* telecom project—historically the greatest so far in Mexico—switched on last Wednesday attempting to cover 32% of the country with a first stage total investment of around 8.1 billion pesos. The new connectivity network will provide telecom throughout a state-of-the-art technology along remote regions reaching over time 92.2% of México. The first milestone operation embraces 36 million users and 5.6 million locations under 10k inhabitants. Assuming complementary stages carry on, the new business model operated by *Altán Redes* would allow Mexico to gain a third place position in the world list of countries outstandingly connected and the greatest population coverage of digital services. Would this enhance Telecom Reforms?

Focusing on political issues, Mexican Business Coordinating Council (CCE) led by Juan Pablo Castañón, called upon Manuel López Obrador (also known as AMLO) to feed dialogue and uphold each contract and project regarding construction of the New International Airport of CDMX (NAICM), stressing the need for discussions in order to identify potential technical improvements, and the unlikelihood of stopping such an awesome project without a burden of reputational loss to Mexican State. In this respect, AMLO responded claiming domestic and foreign investments should not fear when facing potential market punishment arising from contract audits or even cancelation of contracts. Is private sector cornering AMLO?

On the pure economic side, consumer prices during the first half of March increased 0.29%, again above consensus expectation (0.25%). Notably energy prices boosted inflation with a 0.55% rise overcoming the tendency on services that jumped 0.31%. Nevertheless, core inflation gained 0.24% bi-weekly, slowing annual rate to 5.17% from a previous figure of 5.23% (+5.29% a year before).

Without relevant surprises, during 2017-4Q Aggregate Demand and Supply expanded 3.0% real y/y basis (+3.3% during 2016-4Q), while compared to previous quarter both increased 1.18% in real terms (+0.10% in 2017-3Q). By key components, total consumption gained 2.0% y/y boosted by private sector demand increase (+2.5% y/y), although government side shrank 0.2% under same basis. On the external side, exports evolved positively at 2.5% y/y rate, yet were exceeded by imports with 7.1%. Supply side corresponds complementary to a 1.5% y/y real growth rate (+3.3% in 2016-4Q).

—Luis Armando Jaramillo Mosqueira

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PERU: ANOTHER DAY, ANOTHER PRESIDENT

President Kuczynski resigned from office yesterday, as it had become clear that Congress had enough votes to impeach him. PPK stated in his resignation speech that there would be an orderly transfer of power to Vice-President Martín Vizcarra, who has signaled that he will accept the Constitutional mandate. As dramatic as a presidential resignation is, markets have reacted well to the event. The PEN has strengthened, the soberano curve has improved with offshore funds coming in, and equity markets have moved normally. This is proof that Vizcarra is in good standing with market investors. In general, Vizcarra is perceived well by both the business community and the market. His past performance as Governor of Moquegua is broadly viewed as professional and successful. In fact, this was the reason he was asked to join the PPK ticket as Vice-President. He does not pose a risk to pro-market policies.

The business community is also hoping (as are we all) that things will improve between the Executive and Congress with a new Vizcarra government. Although in 2017 Vizcarra was forced to resign as Minister of Transportation by this Congress, some congressional members of the opposition majority Fuerza Popular, (FP) have stated a willingness to improve relations with a Vizcarra government. Since FP seemed to have a personal issue (rather than an ideological or party issue) with Kuczynski, which it does not have with Vizcarra, this seems possible. We perceive a willingness to give the benefit of the doubt to a new Vizcarra government.

There are risks, however. One question is who will Vizcarra work with. One cabinet member has said that the entire cabinet has resigned, which is likely. It is possible that Vizcarra may ask some cabinet members to stay on, but at least some of the more important ones, including Bruno Giuffra (Transportation) and Carlos Bruce (Housing) will need to leave, as they have been accused of trading government favors for votes. As has Mercedes Aráoz, the Second Vice-President, and, until today, head of the cabinet (two independent posts). Yesterday, the president of Congress, Luis Galarreta, announced that Congress would begin proceedings to expel five of its members, accusing them of being involved in trading favors for votes. Both Bruce and Aráoz (yes, she is also a Congresswoman) are included in this list.

There is some likelihood that Aráoz will resign as VP. This is of importance since any future resignation/impeachment of Vizcarra would mean that new elections would need to be called, which is a scenario that a majority of Congress is likely to want to avoid, even though some members of Congress have begun talking about the need to hold early elections.

A cabinet shakeup is likely to affect GDP growth to some extent. Government investment is meant to be the main driver of growth in 2018. Political turbulence probably has already caused a pause in government fiscal stimulus in March. A broad change in the cabinet will extend the pause, affecting domestic demand. There's no telling by how much until it becomes clearer how quickly a new cabinet will be put together and can settle down.

This is mostly a timing issue, as there seems to be little risk that Vizcarra will include leftist, populist, or otherwise market-unfriendly cabinet members. What he may include, however, is members of, or people close to, opposition parties, in particular FP. He would need to exercise care and judgement, however. One of the risks that a Vizcarra government faces is that part of public opinion may not see him as a legitimate government, due to the cumulus of political events leading to PPK's resignation. Vizcarra will need to gain legitimacy over time. To be viewed as submitting to FP, either voluntarily or under political duress, will not help his cause.

For the economy, the main risk is a slow down in public investment. This is likely to be temporary, but long enough to affect growth to some extent. In a best case scenario, that might be the extent of it. This best case scenario requires, however, a workable relationship with Congress.

Although populist or unorthodox economic policies are not likely to emerge from the government, given Vizcarra's profile, the same is not true of Congress, where proper economic management doesn't appear to be a strength. Congress has already given laws that are questionable or expensive in economic terms, and may continue to do so. The PPK regime did not have the strength to oppose them, and there is a real risk that a Vizcarra regime will not either. On the other hand, although most analysts have acknowledged that a Vizcarra government would not have the power to implement important reforms, this assumes that opposition in Congress would not be open to any reforms, which may be an exaggeration.

Although the main point of political contention has hopefully been resolved, political uncertainty will not subside altogether. Not everything depends on the relationship between Vizcarra's government and Congress. Opposition Fuerza Popular has had confrontations with other important State institutions, including the Constitutional Tribunal, the highest court in Peru, and the Attorney General's office. Furthermore, all parties have strong internal issues, of which the confrontation between Kenji Fujimori and Keiko Fujimori is just the most outstanding. The importance of these issues for the economy is not as evident, however, at least in the short-term.

Meanwhile, Fitch Ratings maintained its BBB+ rating for Peru sovereign bonds, with a stable outlook. This is all the more significant, given the political turbulence. But it does underline one aspect to keep in mind, which is that politics in Peru have not altered the country's economic stability and strong macro balances.

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