LATIN AMERICA IN 2019

10 Megatrends Driving Change

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Latin America is turning the corner.

After several years of stagnation, economies are growing and business investment is increasing. But headwinds remain and the recovery is uneven. A series of national elections across the region in 2018 can transform political institutions and offer an opportunity for improved governance. Young people across the region are increasingly entrepreneurial. Citizens are more empowered through mobile and social media to drive change. Technology is disrupting traditional business sectors.

Political leaders and companies who ready themselves for these changes can benefit from the region's evolving landscape. Here are ten megatrends—both risks and opportunities—helping define Latin America's economic, political and social narrative in 2019 and beyond. The supporting data and proof points have been compiled from a variety of respected institutional and media sources to illustrate these trends.

Throughout this report, Latin America comprises South America, Mexico, Central America and the Caribbean. All figures are in U.S. dollars.

1

Growth, income, productivity and innovation must all accelerate.

Latin America has been losing ground in the global economy: the region's share of global GDP has fallen from 8.6 percent in 2009 to 7.7 percent in 2017, even as emerging markets in general have boosted their share of global economic output from 33 percent to more than 50 percent.

After contracting in 2015 and 2016, the International Monetary Fund (IMF) forecasts growth across Latin America to increase modestly from 1.3 percent in 2017 to 1.6 percent in 2018, and further to 2.6 percent in 2019. Peru, Chile and Colombia should lead growth in both 2018 and 2019, while Argentina and Venezuela will be growth laggards.

Higher global commodity prices are providing support for energy, mining and agricultural commodity exporters across the region.

While growth may be strengthening, there are significant risks for several economies in 2019. This includes: [1] financial conditions and needed policy adjustments in Argentina; [2] the lingering effects of strikes and political uncertainty in Brazil; [2] the uncertain impact of U.S. monetary policy on interest rates, debt servicing and currencies; [4] protectionist trade tensions and uncertainty surrounding the NAFTA outcome, [5] the policy agenda of new governments in Mexico, Colombia and Brazil; and [6] the deteriorating economic and humanitarian outlook for Venezuela.

Productivity drives GDP, income and wage growth. But Latin America ranks behind every world region in productivity. Between 2000 and 2015, annual productivity growth averaged just 0.6 percent. Because of falling fertility rates, without improved productivity GDP growth rates could decline by 40 to 50 percent over the next 15 years in most economies.

Innovation must accelerate. China published 50 times more patents per capita than Latin America. Some U.S. universities publish more patents annually than all of Latin America.

Latin America is rich in natural resources, accounting for 14 percent of the world's arable land, 15 percent of oil reserves, 21 percent of forests, 28 percent of fresh water, 54 percent of copper production, and 66 percent of lithium reserves.

2

Demographic trends and migration crisis present economic and social challenges.

By 2030, Latin America's population is forecast to reach 711 million, an increase of 13.1 percent from 2015. Population growth is slowing as a result of falling birth rates and rising death rates.

If current demographic trends continue, Brazil and Mexico—the 8th and 16th largest economies in the world today—would become the 5th and 6th largest by 2050, jumping ahead of countries such as Germany, Japan and the United Kingdom.

The median age in Latin America is 27 years. Latin American youth rank the highest in the world in both necessity-driven entrepreneurship and entrepreneurial perception and intention. More students are graduating from universities. Twenty years ago, most students sought to join large companies and move up through the corporate ranks; now, at least half are willing to create companies.

Latin America's youth population (15-24 years) is 106 million, or 20 percent of the total population. The unemployment rate for the 15-29 age group is three times as high as for the population between 30-64 years of age. Over one-third of workers in this age group are employed in the informal sector, a figure higher among women. Deaths by violent acts and homicides in the 15-24 age group accounted for 43 percent of the total mortality in this demographic.

Latin America faces a migration crisis, requiring a combination of regional and national responses. Colombia has more than 7 million internally-displaced persons (IDPs), the largest number in the world. Venezuela's prolonged crisis has resulted in over 1.5 million citizens fleeing the country; about 1 million Venezuelans have relocated to Colombian border towns, creating economic and social stress. A combination of development projects (dams, mining concessions, federal highways), natural disasters and organized violence has displaced more than 7 million Brazilians since 2000. The Northern Triangle countries (El Salvador, Guatemala and Honduras) are experiencing severe displacement crisis, with citizens seeking protection in Mexico and the United States, where deportations are on the rise.

3

No region of the world is urbanizing more rapidly, but infrastructure finance is lacking.

There are 55 cities with a population of 1 million or more. By 2025, 6 cities will have populations larger than 10 million (São Paulo, Rio de Janeiro, Mexico City, Buenos Aires, Bogota and Lima).

Latin America's cities have struggled to absorb the millions of new arrivals from the countryside. As a result, about 25 percent of the region's urban population—more than 160 million people—live in slums. Most of the urban poor lack formal title and access to basic services.

Latin American cities are struggling to meet infrastructure challenges. Sluggish growth, low investment and corruption scandals have impacted the housing, water treatment, public transport, renewable energy, construction and telecommunications sectors.

Latin America needs to increase infrastructure spending from 3 to 5 percent of GDP—about $180 billion a year—to bridge the gap. Innovative and new sources of capital, such as public-private partnerships, sovereign wealth fund and equity investments, will be necessary to finance urban infrastructure.

4

Middle-class consumers are growing, but income inequities need to be addressed.

Latin America has a $3.5 trillion consumer market, with per capita annual private consumption higher than in China or Russia.

More than 50 million people have worked their way up the social and income ladder over the past decade (earning between $10 to $50 daily) to become middle class. Almost one third of Latin American families are now considered middle class.

Latin America has made impressive progress in reducing poverty since the turn of the century, but it still remains the most unequal region in the world. In 2014, the richest 10 percent of Latin Americans had amassed 71 percent of the region's wealth. If this trend continues, by 2025 the richest 1 percent will have accumulated more wealth than the remaining 99 percent.

E-commerce in Latin America represents only 3 percent of formal retail sales but is growing at double digit rates of 15 to 20 percent. As an emerging region with an underwhelming brick and mortar retail footprint, e-commerce has great potential if payment, logistics and security barriers can be overcome.

Similar to global brands, Latin American regional and domestic brands are exposed to a level of scrutiny never seen before. Consumers are more aware of what is available globally, and social media affords them a voice to express their expectations. For companies that have dominated their domestic markets, there is a greater risk to brand value if companies do not meet customer expectations.

5

Citizens are more empowered and engaged to urge for improved governance.

Through increased political activism, public protests and a strengthening of civil society, citizens are taking steps to address deeply rooted problems, including economic inequality, social injustice, corruption, racism, gender issues and environmental degradation. Latin Americans are developing home-grown movements, not merely copying activism from the United States or Europe.

Latin Americans are showing increasing signs of political discontent and demanding that their governments and businesses tackle corruption more aggressively. Widespread adoption and use of social media is enabling new forms of political engagement. Digitally-active citizens are asking for better services, greater transparency and more meaningful participation.

According to Transparency International's 2018 global index, the public's perception of corruption has worsened in 14 of the 30 countries in Latin America and the Caribbean where its study was carried out, while it has improved in 11 countries, and remained stable in five countries.

Some commonly recognized economic costs related to corruption include: [1] lower provision of public goods, which hurts the poor disproportionately; [2] misallocation of talent and capital through distorted economic incentives; [3] higher levels of distrust in government and public institutions; [4] higher economic uncertainty, and [5] lower private sector and foreign investment.

6

The digital landscape is growing, with rippling impacts on growth and progress.

In 2016, the mobile industry generated about $260 billion of economic value, equivalent to 5 percent of the region's GDP, and is set to grow to $320 billion by 2020, or 6.5 percent of GDP. The mobile ecosystem employed approximately 1.7 million workers and contributed $34 billion in public funding, excluding spectrum auctions. Mobile operators have invested $68 billion to expand 4G networks and add capacity through 2020.

Latin America is home to more than 450 million mobile subscribers. The move to higher-speed networks is accelerating, fueling increased adoption of smartphones and demand for data services. By 2020, mobile subscribers will increase to 511 million—a 76 percent penetration rate.

Smartphone usage is increasing. By 2020, Latin America will have a smartphone adoption rate of 71 percent, higher than the global average of 66 percent. This translates into 170 million more smartphone users by the end of the decade.

4G adaption is accelerating and becoming mainstream. By 2020, Latin America will close the gap with the rest of the world (42 vs 44 percent). Looking ahead, 5G deployments will begin in Latin America in 2020, with 5G covering nearly half of the population by 2025.

Among emerging markets, three Latin American countries—Brazil, Argentina and Mexico—are ranked in the global top ten in internet access by mobile devices.

Social media is more intertwined in the daily lives of Latin American consumers than digital consumers elsewhere. By 2021, the number of social network users in Latin America is expected to reach 324.4 million, up from 237.7 million in 2016.

Mobile banking is driving financial inclusion. More than half of Latin America's population is unbanked or underserved by formal financial services. Regulators across the region are enabling frameworks for mobile money or adopting platforms. In addition, cloud computing, teleheath, the wearable sensor market and robotics are forecast to experience strong growth between now and 2025.

A significant digital gap exists in Latin America. By 2020, more than 250 million people across the region will remain digitally excluded, largely in rural areas, low income classes and women.

7

Despite progress, women face barriers to full and equal participation in economy and society.

Latin America's female employment rate was 50 percent in 2015, lower than the OECD average of 67.4 percent. The share of women across Latin America without personal income has decreased from 47 percent in 1997 to 32 percent in 2015, suggesting an improvement in financial autonomy. Moreover, women are challenging gender-based discrimination in social institutions, notably in land, property and financial rights, as well as in legal reforms to eliminate gender-based violence.

Governments are not doing enough to level the playing field for women. There is a need to invest in early childhood education and care; change norms around gender distribution of paid and unpaid work; promote gender awareness and training, education through media, and offer incentives to delay teenage marriage and pregnancies—which is also critical to keeping adolescent girls in school.

Women in Latin America have made significant progress over the last three decades, increasing labor force participation and receiving more university degrees than male counterparts. However, women face persistent barriers to full and equal participation in society and the economy, including pay inequality and pervasive gender stereotypes.

The UN's Sustainable Development Goals (SDGs) are being integrated into national and regional planning systems, including on taxation, budgets and public investment. At least 20 governments in Latin America are aligning their medium or long-term development strategies with the SDGs.

8

Greater effort is needed to meet the Sustainable Development Goals.

Demographic trends associated with population ageing and urbanization are presenting challenges in meeting SDG goals around hunger and nutrition, education, healthcare and social protection, particularly for children, adolescents, young people, indigenous communities and women.

Unfavorable economic conditions in recent years have stalled progress on key social indicators, including a reduction in poverty and meeting food and nutritional needs.

Progress is dependent on increasing investment to create as many as 70 million new jobs between now and 2030 just for the newcomers to Latin America's labor market. In addition, there are an estimated 134 million workers in the informal sector living in highly vulnerable conditions.

Latin America continues to underperform in education: around one in three youth do not finish high school.

9

Climate change will disproportionally impact development and environmental assets.

Latin America accounts for less than 10 percent of global emissions. However, the region is especially vulnerable to the effects of climate change because of its geographic location, socioeconomic factors, the potential impact on agriculture, extreme weather events, rising sea levels and the highly climate-sensitive nature of its natural assets, such as its forests and biodiversity. Over the last 15 years, the region has lost 96 million hectares of forestlands.

Latin America's per capita CO2 emissions level is close to the global average, but represents about one-third of the average per capita emissions level of Europe and the United States.

The composition of the region's greenhouse gas emissions is different from the global pattern. About 46 percent of the region's emissions are created by energy use (vs. 71 percent globally), 23 percent from agriculture (vs. 11 globally), and 19 percent from changes from deforestation and changes in land use (vs. 7 percent globally).

Climate change in Latin America is altering precipitation, soil humidity, run-off patterns and is accelerating glacier melt. All of these factors will influence water availability for human consumption, agriculture and industry. As much as 50 percent of agricultural lands in Latin America will be desertified by 2050.

The region is developing a cleaner energy matrix, although overall emissions are rising as a result of income growth and increased energy consumption in transport networks, particularly in urban areas. Latin America has some 25 percent of the world's hydroelectric potential, a high potential to develop wind power, and abundant geothermal energy resources.

10

There are opportunities to advance regional and global integration.

Latin America has a favorable policy environment to advance global and regional economic integration: nearly 90 percent of intraregional trade is already duty-free. The region's two largest sub-regional trade blocs—the Pacific Alliance and MERCOSUR—account for a combined $4.3-trillion market and 81 percent of the region's GDP. Mexico, Chile and Peru are members of the Trans Pacific Partnership (TPP).

Brazil, Argentina and Mexico account for almost two-thirds of Latin America's GDP, but the three markets contribute just 7 percent to intra-regional trade. Moreover, the three main sub-regions (Central America, South America and the Caribbean) are barely linked to one another.

Greater openness is making Latin America an attractive destination for foreign direct investment (FDI). However, FDI into Latin America and the Caribbean fell in 2017, with a 2 percent decrease in project numbers and a decline in capital investment of 6 percent to $67.3 billion. Mexico was the leading source of inward investment in 2017, ranked by both capital investment and projects—despite the uncertainty of the NAFTA negotiations.

To attract more foreign investment, competitiveness needs to improve. Only one Latin America market—Mexico—ranked in the top 50 in the World Bank's 2018 Doing Business survey. Mexico ranked 49th. Peru (at 58), Colombia (59) and Costa Rica (61) are the only other countries in the top 100 global markets.

Latin America has a patchwork of 33 existing trade agreements. But the region has much to gain from a region-wide deal. Some experts argue a region-wide trade agreement would reduce dependency on the U.S. economy.

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Sources

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