

H. Calero  
Consulting Group, Inc.

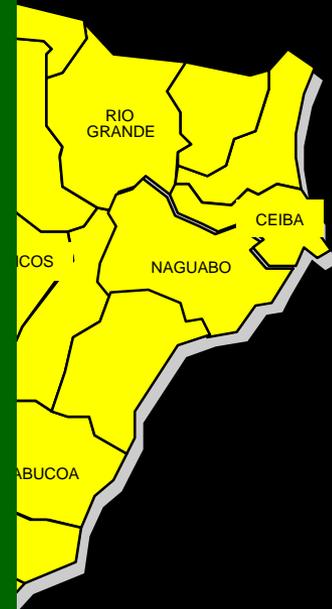
# **In the Eye of the Storm**

**Puerto Rico 2013 - 2015**

# Where is Puerto Rico today

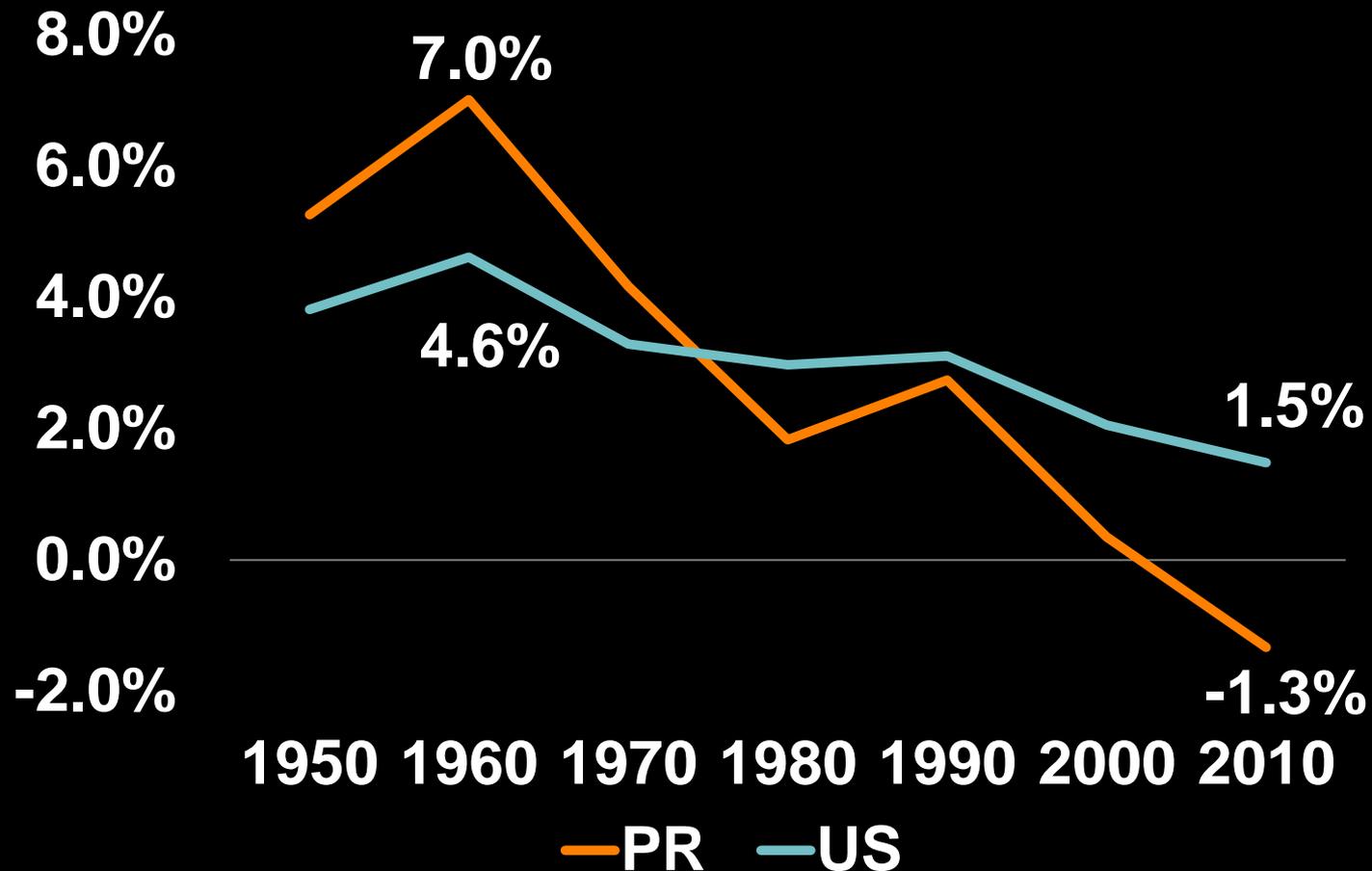


Gross Domestic Product 12	\$101.0b
Gross National Product 12	\$69.5b
Population Census 2010	3.7m
Share of Manufacturing in GDP	46%
Income Per Capita 12	\$16,934
Total Employment 7/13	0.9m
Inflation 7/13	1.9%
Unemployment rate 7/13	14.7%
Participation rate 7/13	41.0%



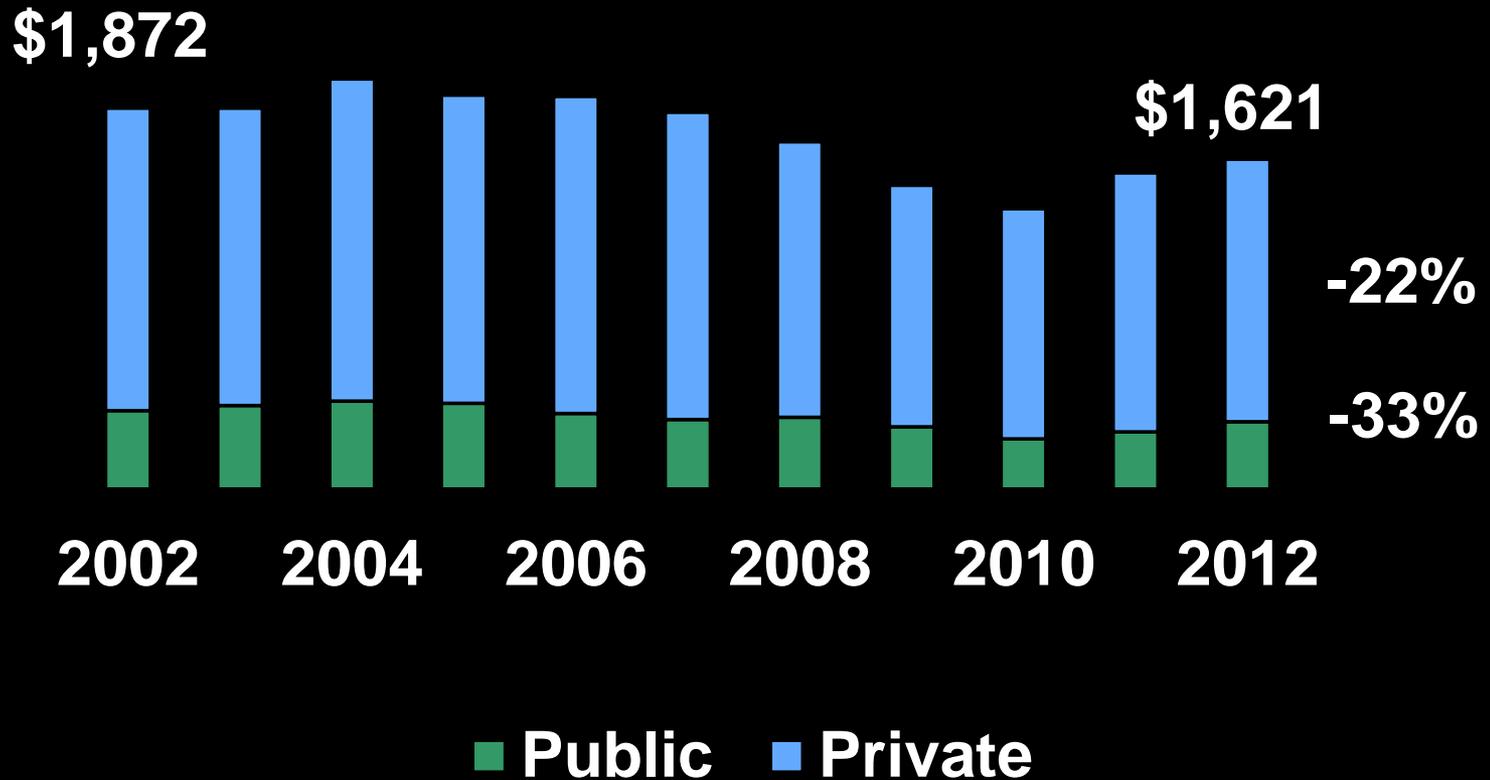
# PR is a regional economy of US

10-year real GNP growth, %

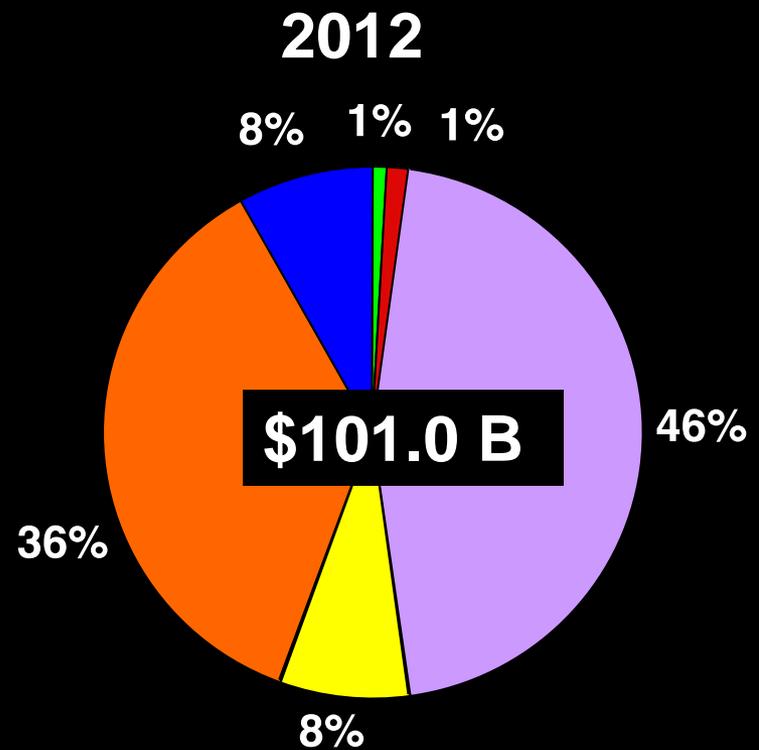
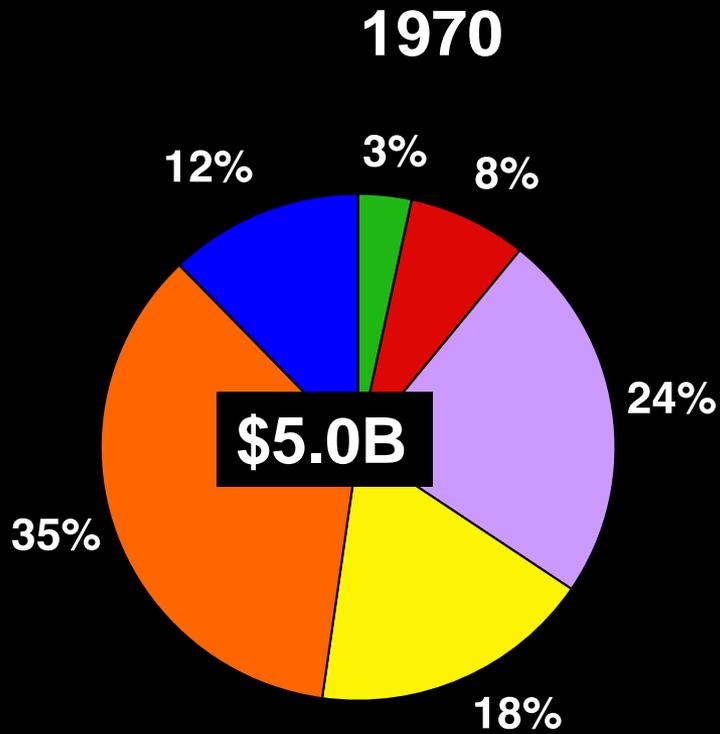


# Investment went down

Public & private investment, real \$ million



# Composition of GDP



**Agric.**

**Constr.**

**Mfg.**

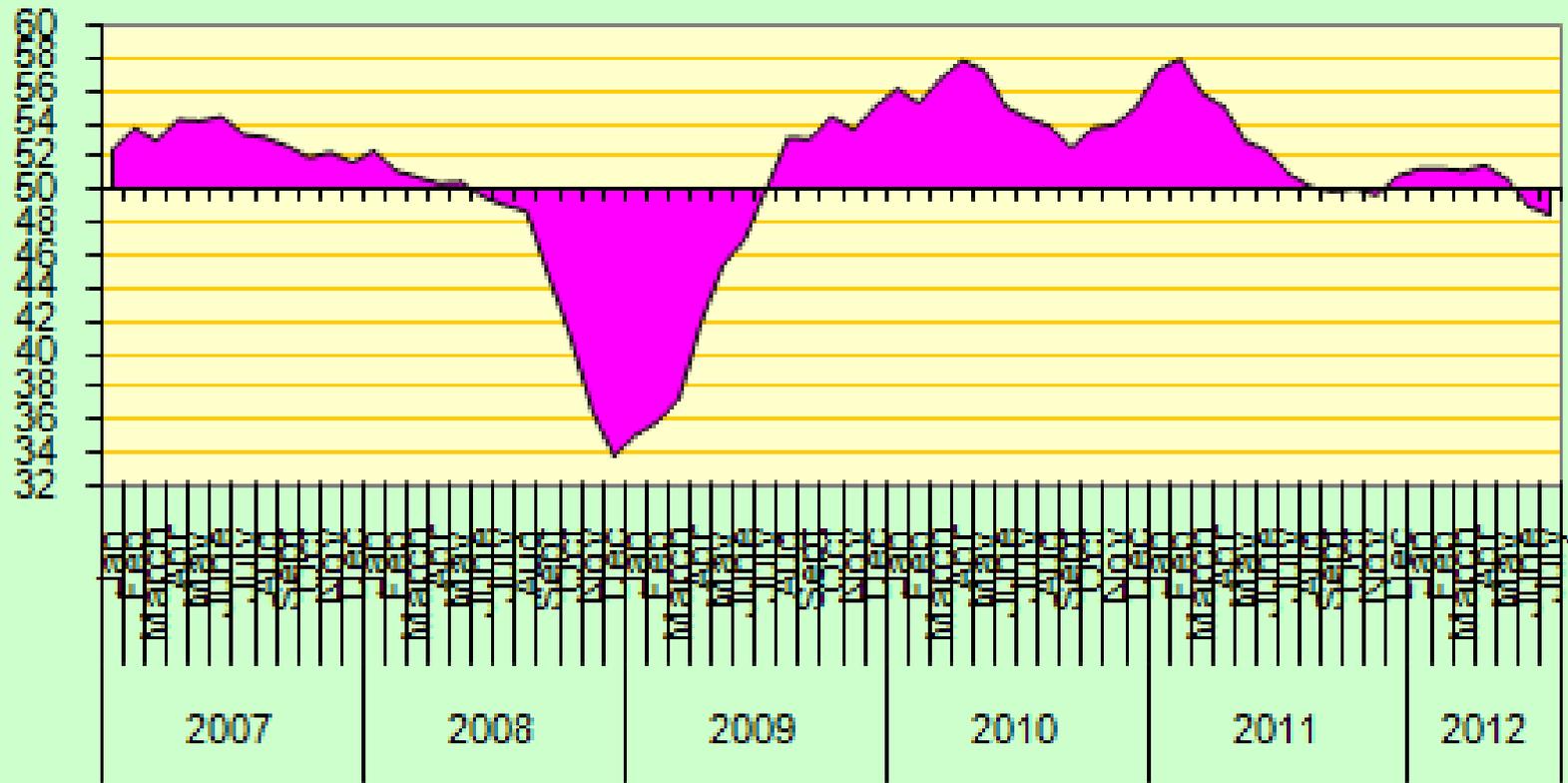
**Trade**

**Services**

**Gov**

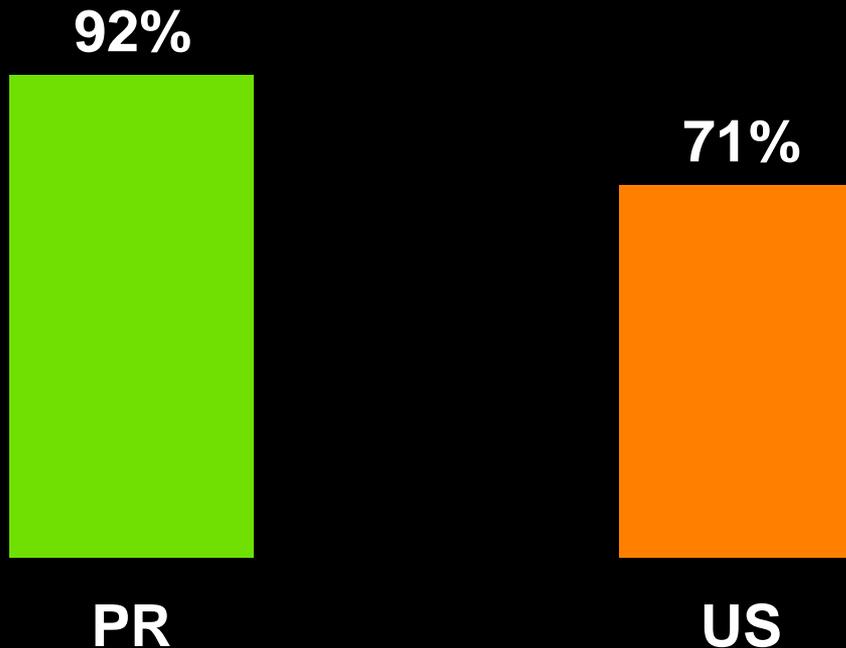
\* Includes Transfers and Federal Grants

# Global Manufacturing PMI



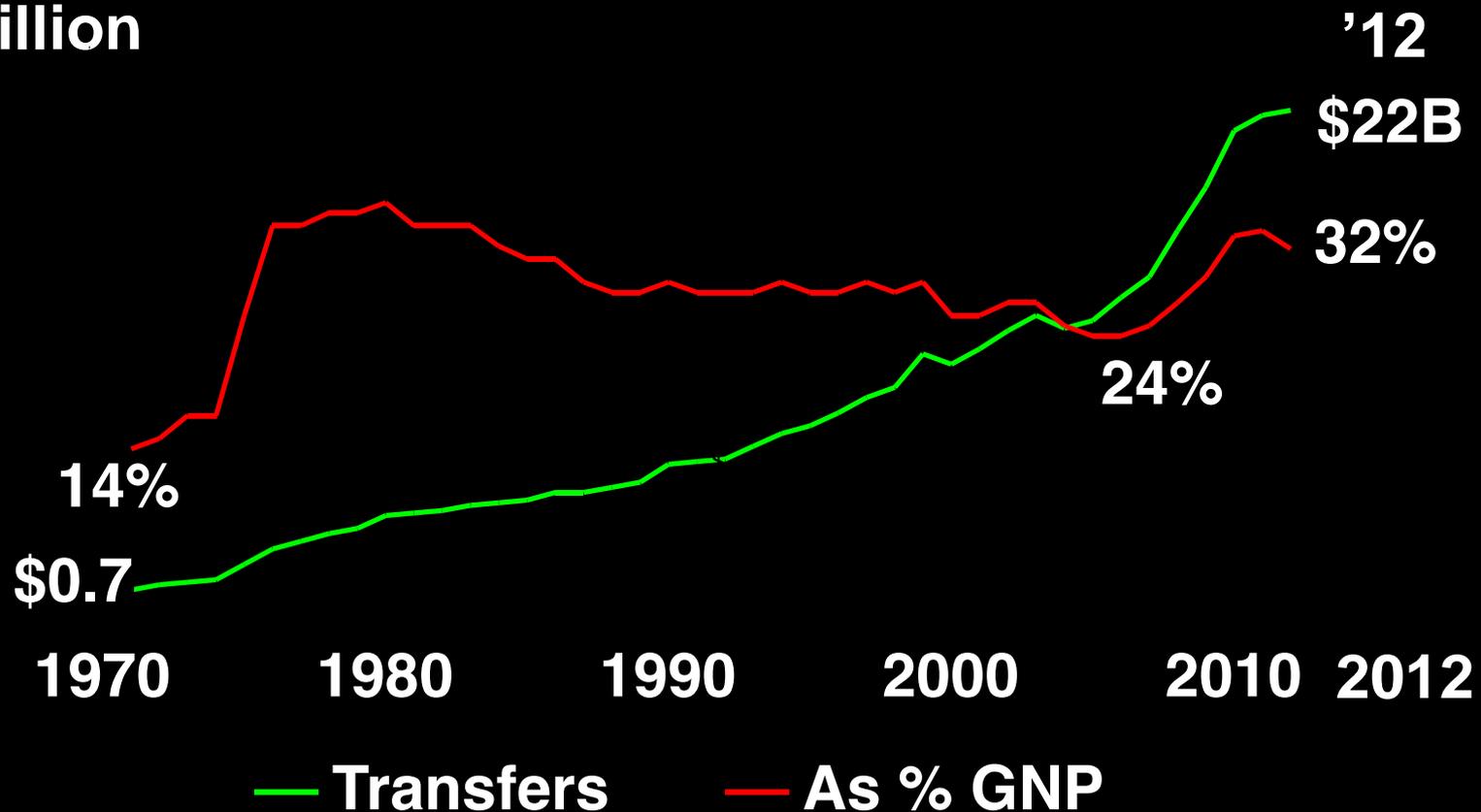
# The economy relies on consumption

Real consumption as % of GDP, 2012



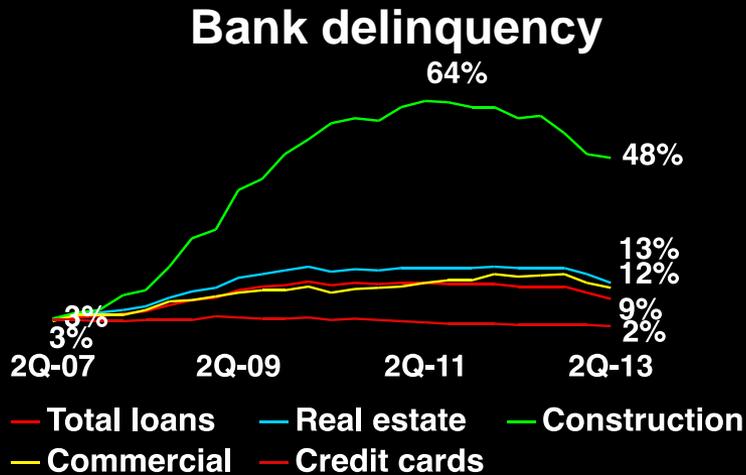
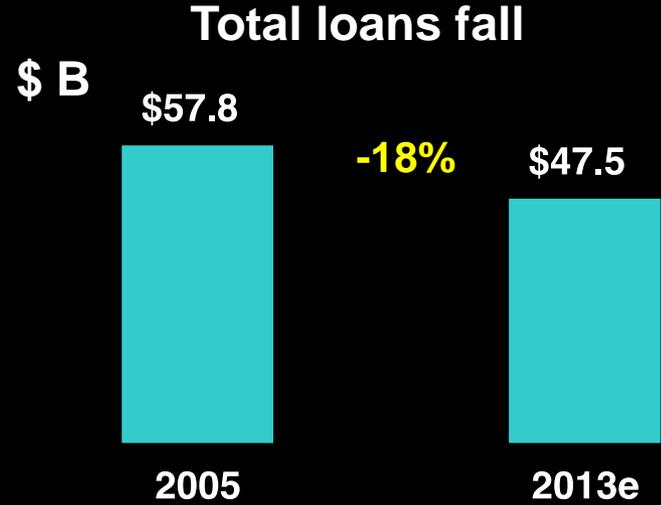
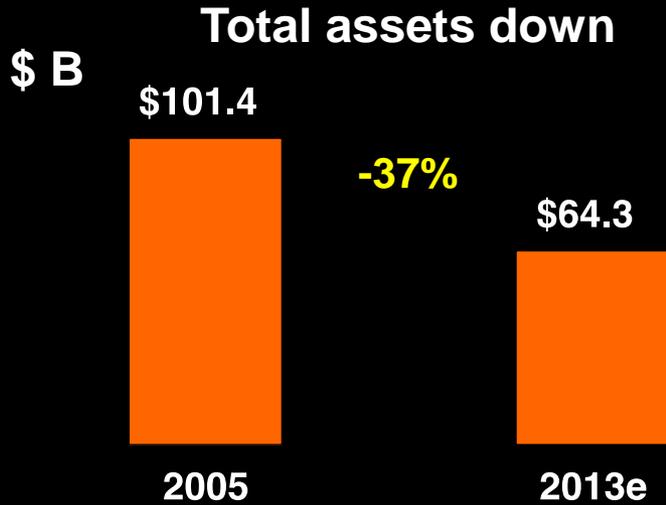
# Living on transfers

\$billion



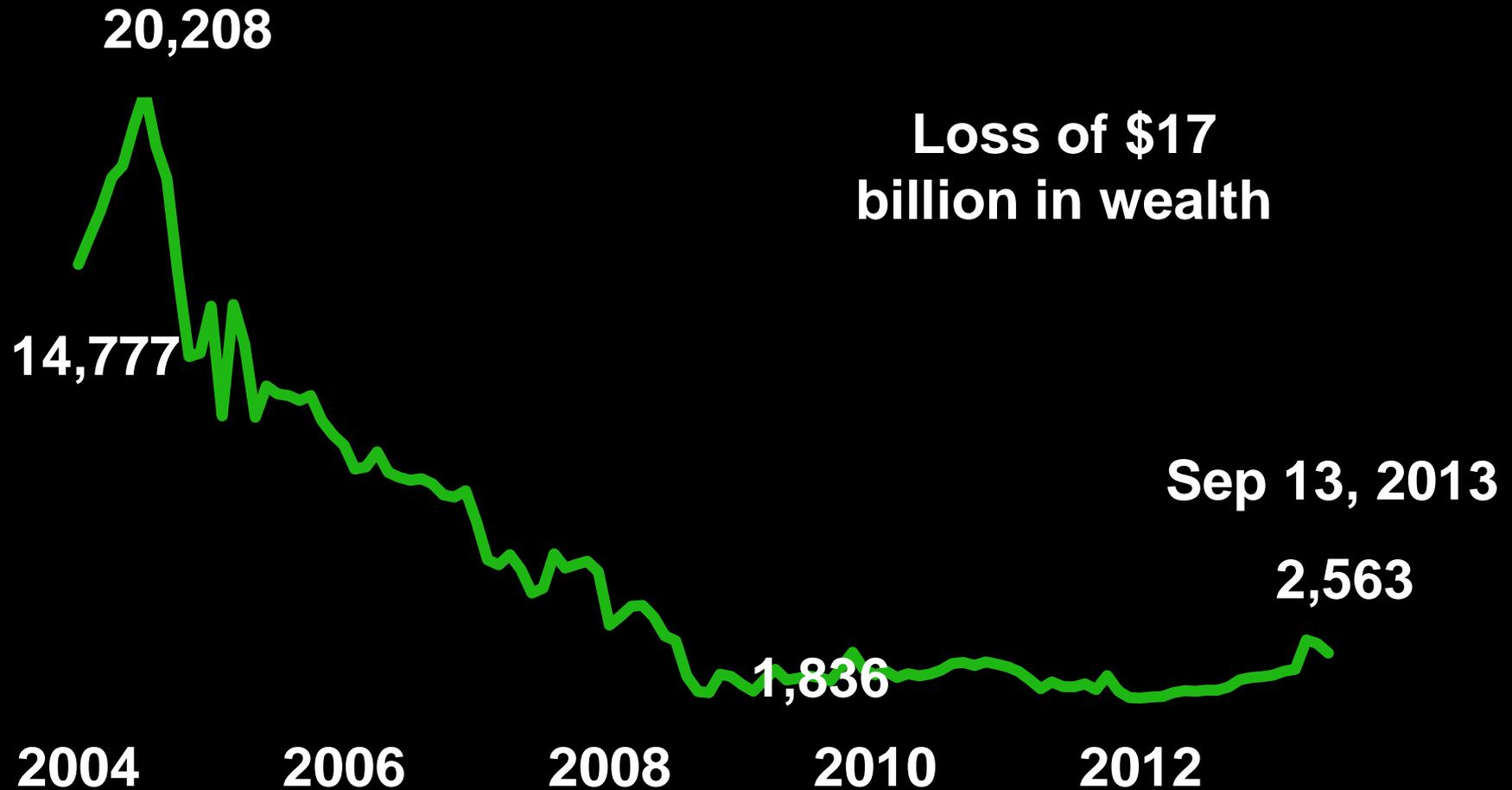
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# Banking performance

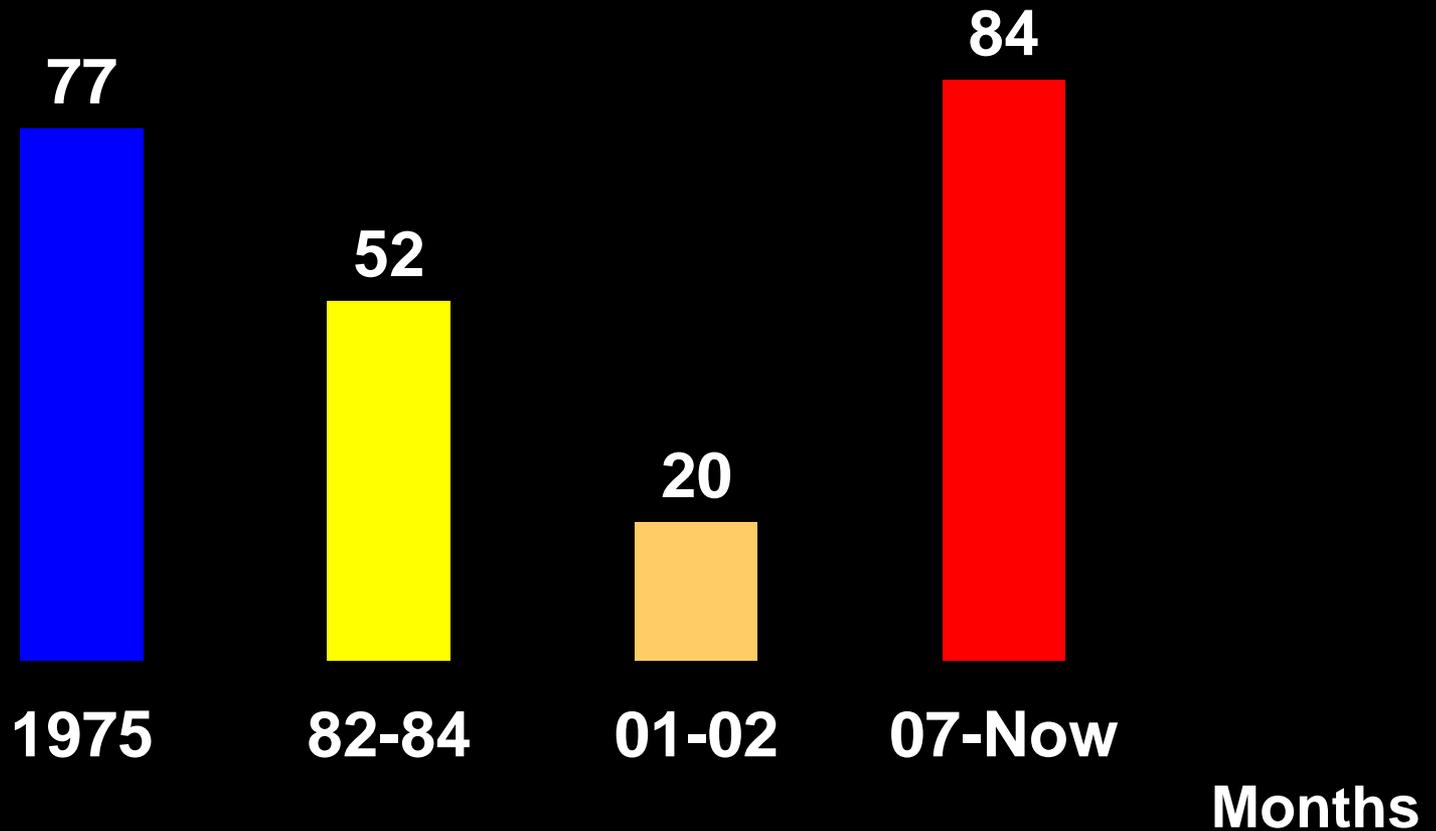


# PRSI continues in recession

Monthly PRSI

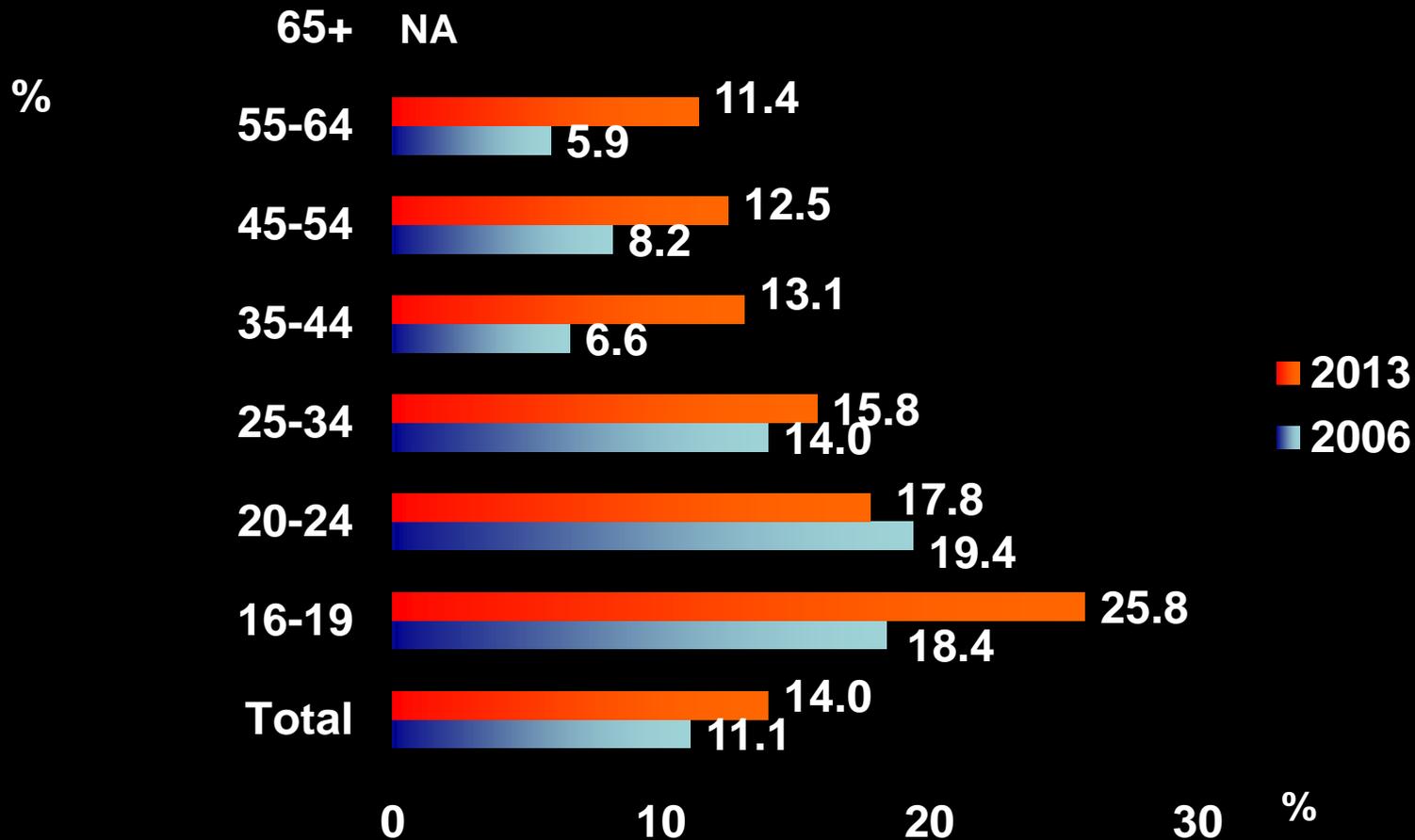


# Duration of employment to return to pre-recession levels



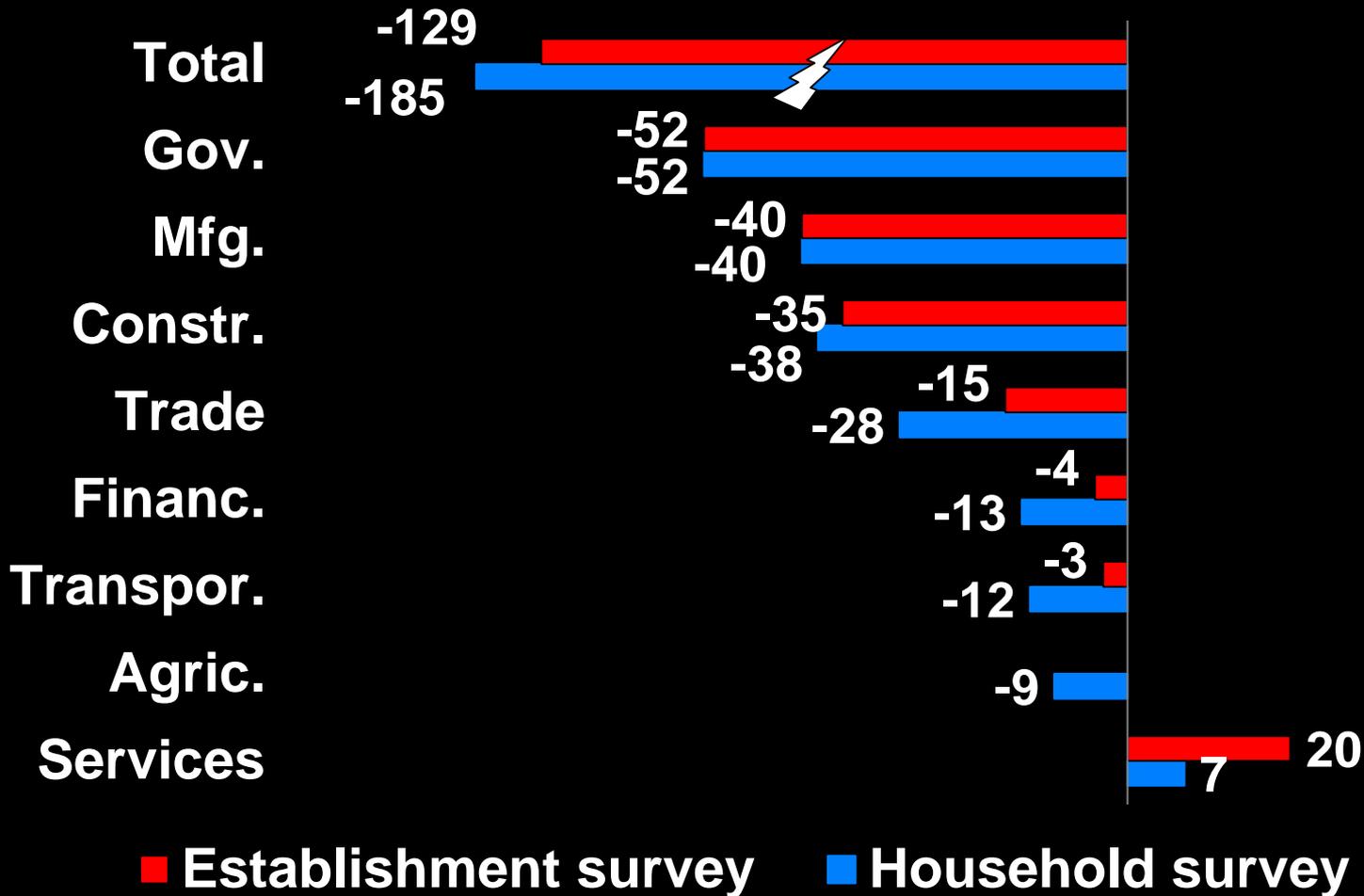
# Higher Unemployment in 2013

Unemployment rate by age group, %



# Most impacted sectors

PR employment by sector, FY '05 v. '13, 000s



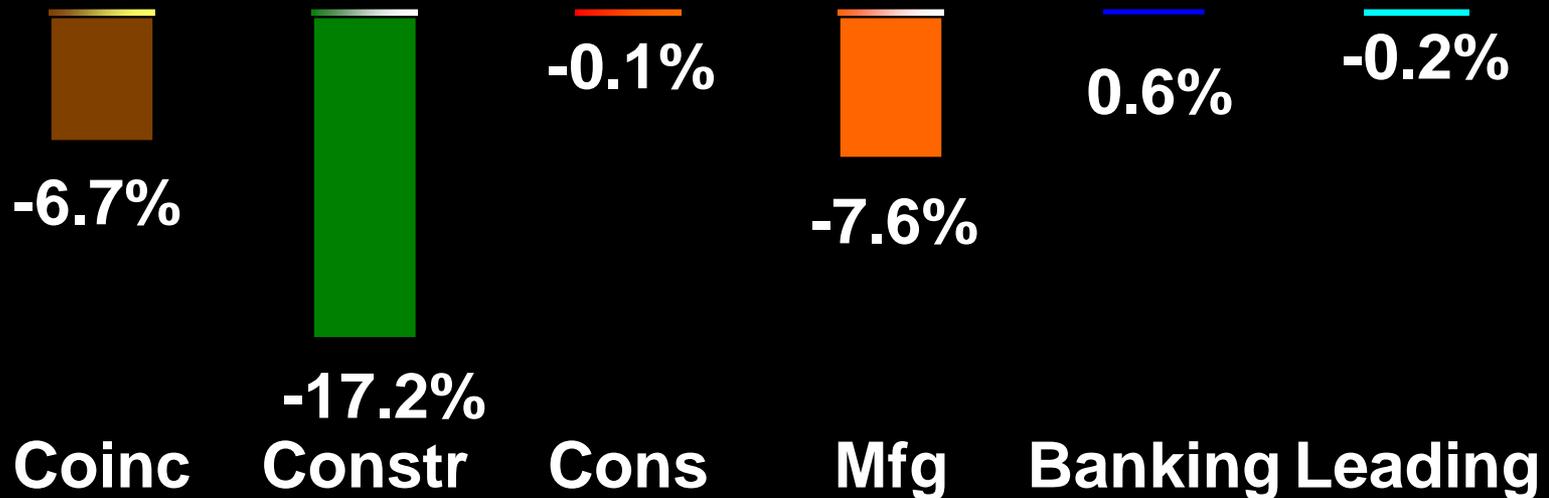
# Expect higher inflation



Revised IPC

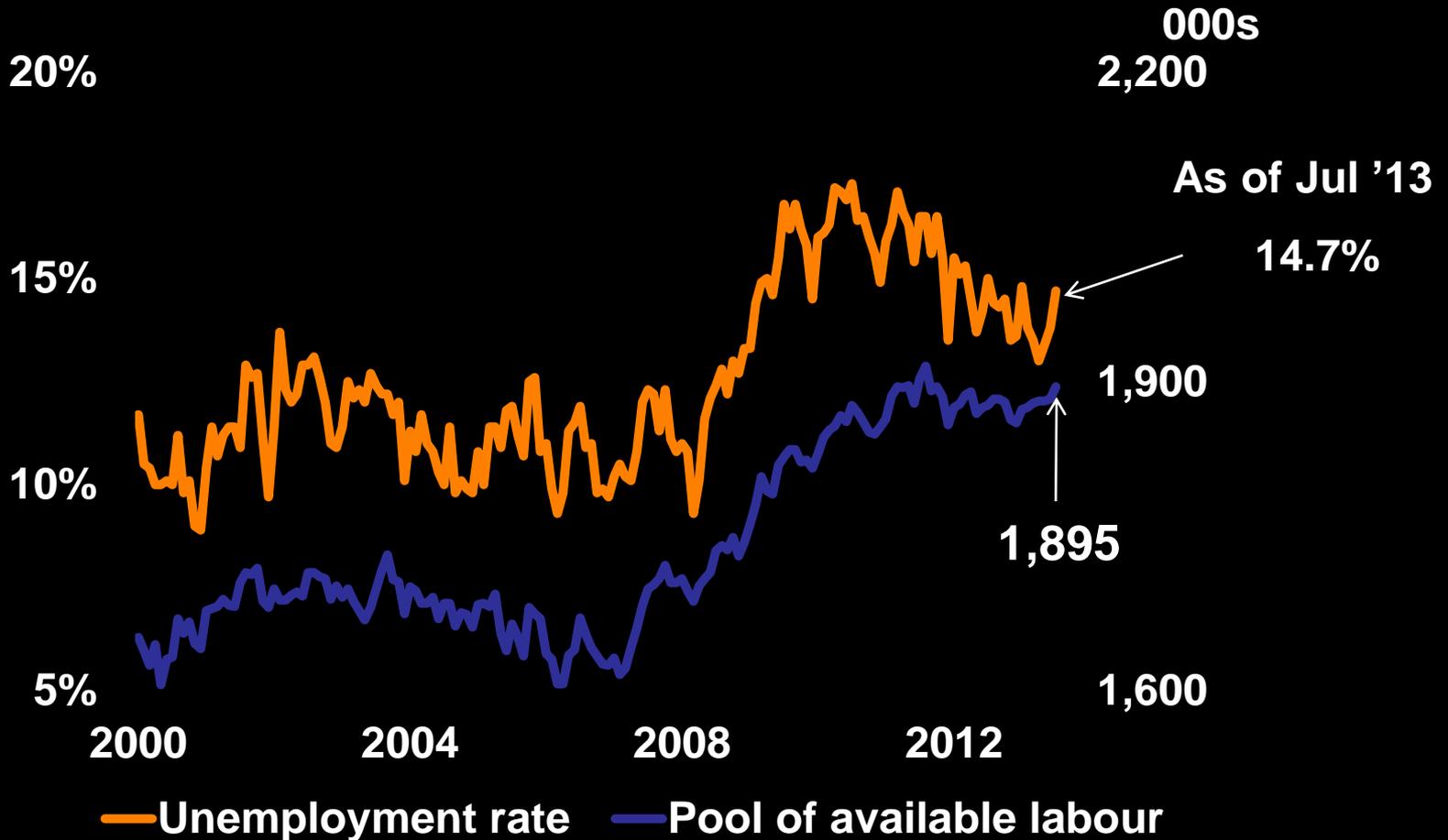
# PR posts mixed results

HCCG quarterly economic Indices, 2Q 2013



# The job challenge

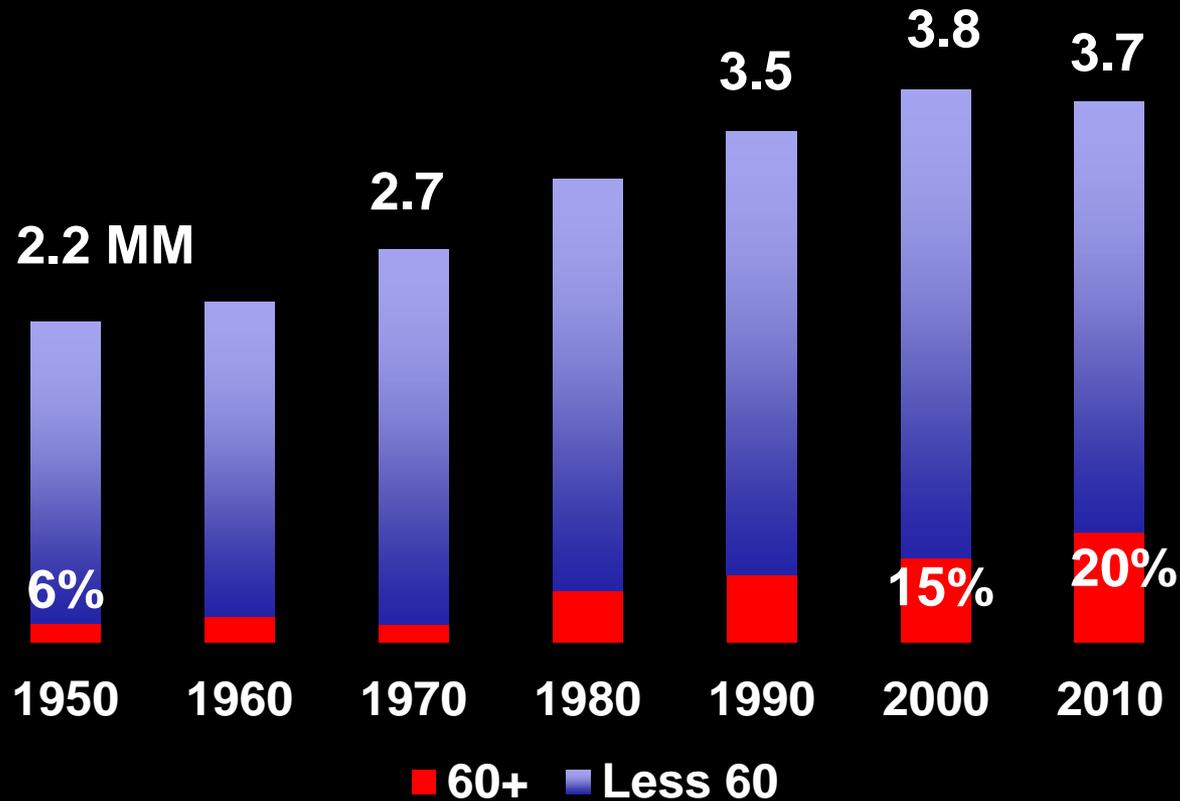
Unemployment still a major problem



Revised change in methodology (2010 Census population)

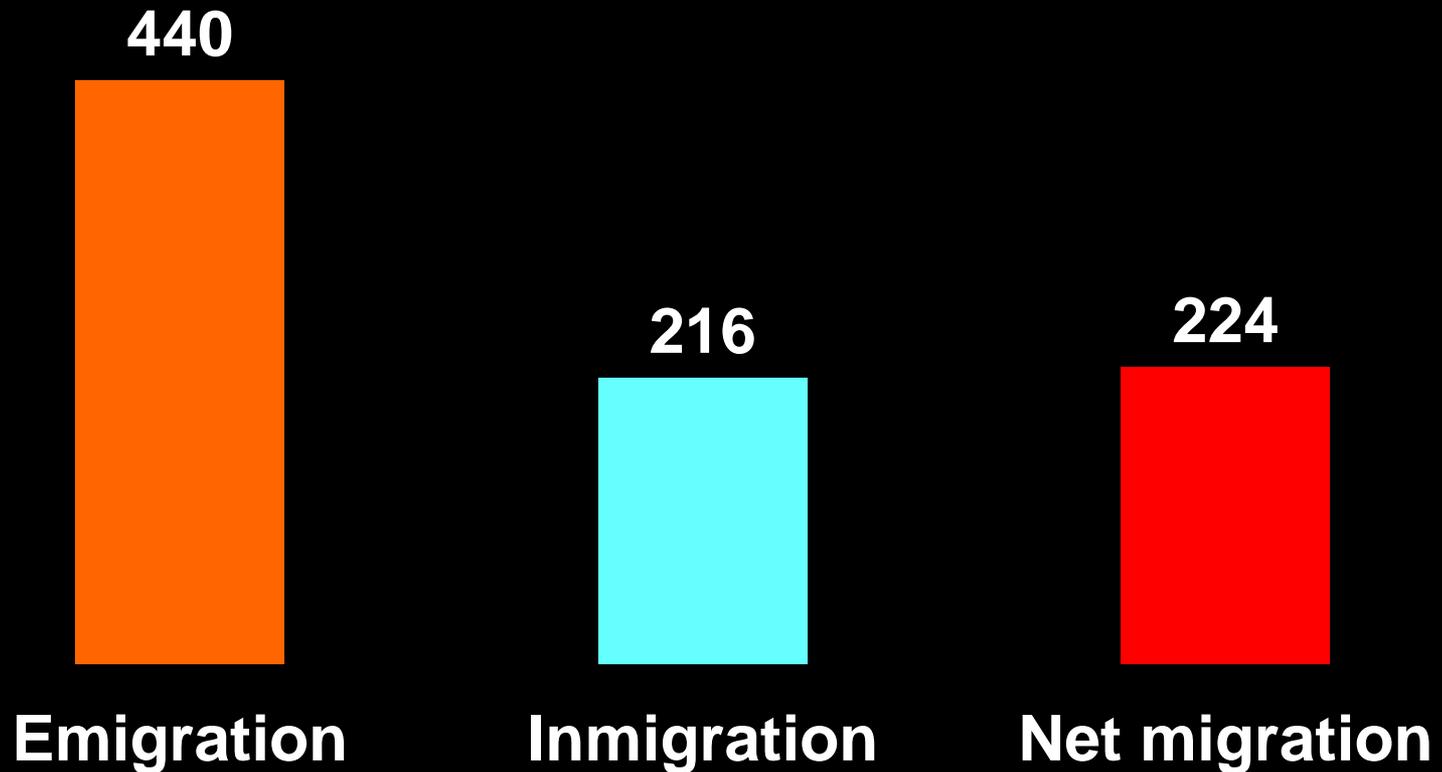
# Demographic challenge

PR population, million



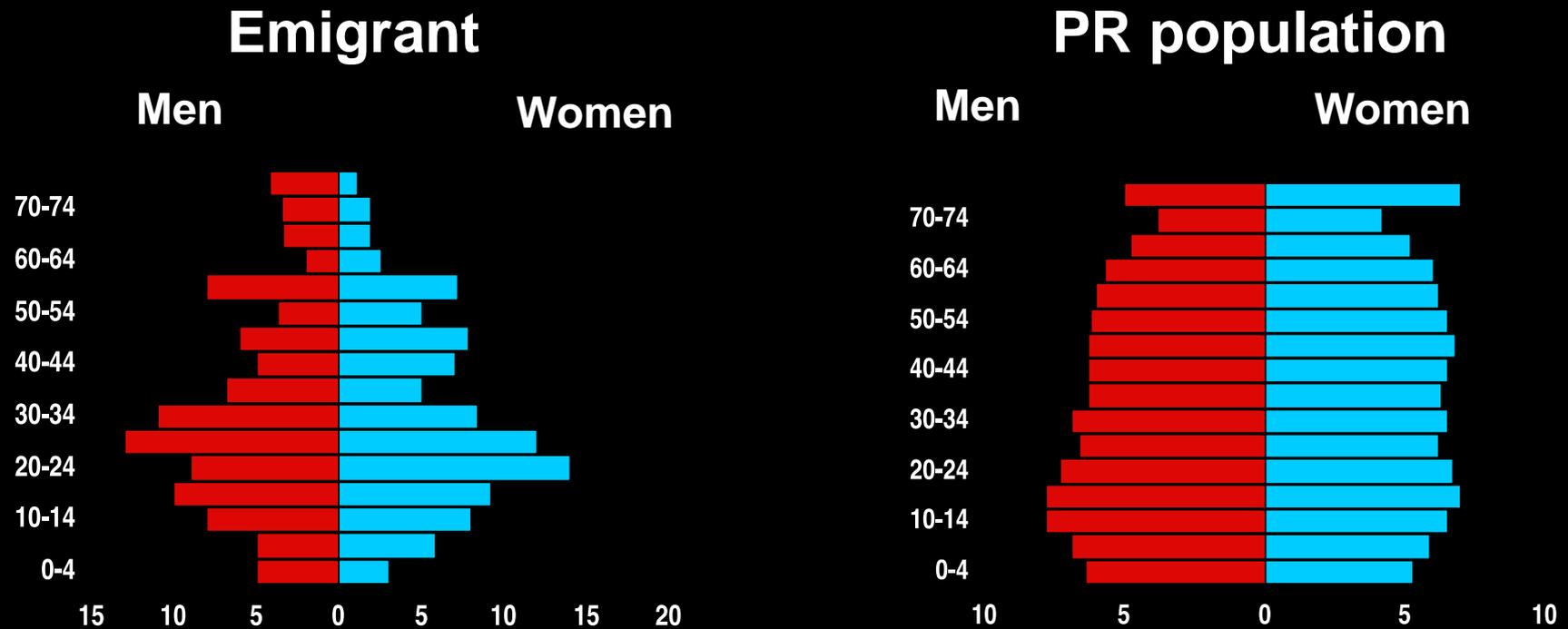
# Migration challenge

2005-2011, 000s



# Young people are leaving PR

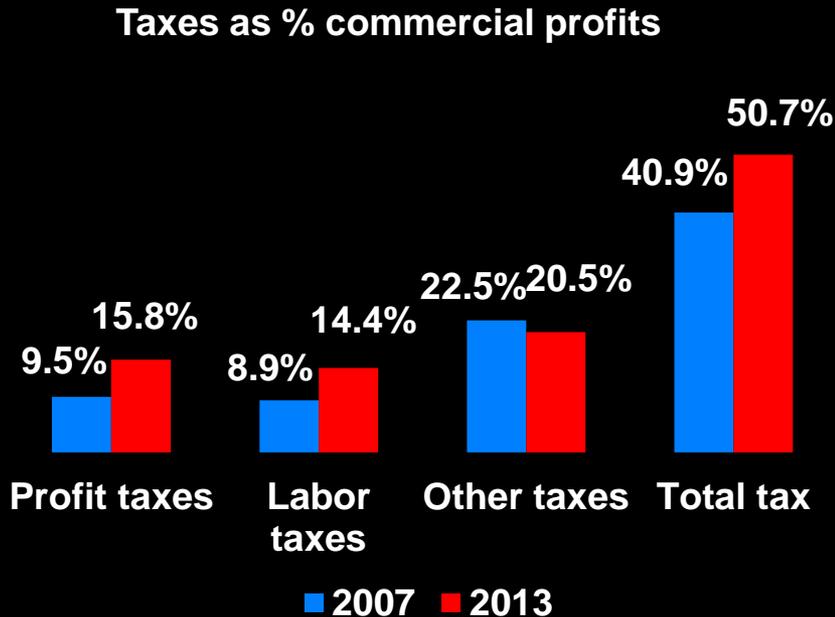
Population by age group 2011, %





# Challenge: Competitiveness

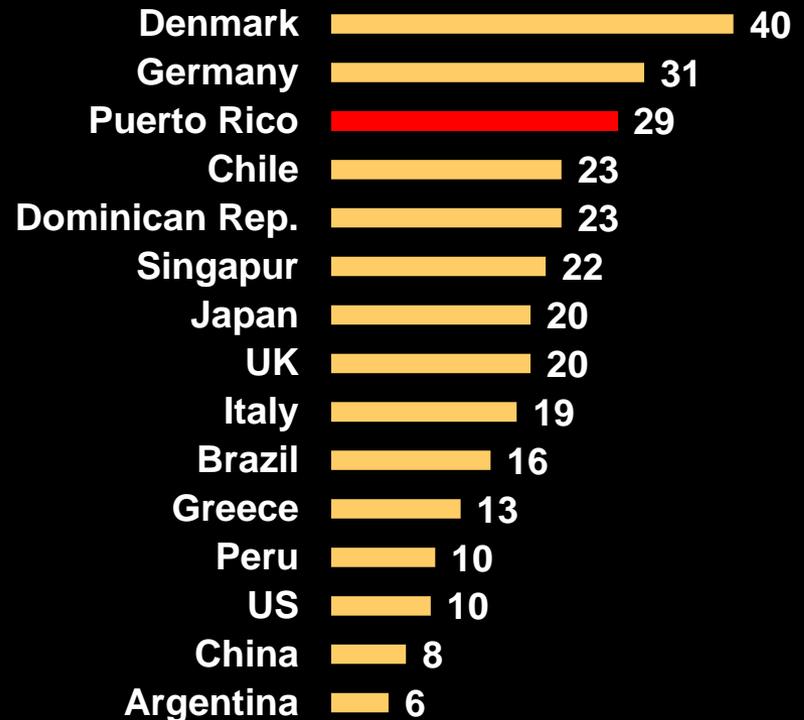
## Higher taxes than 6 years before



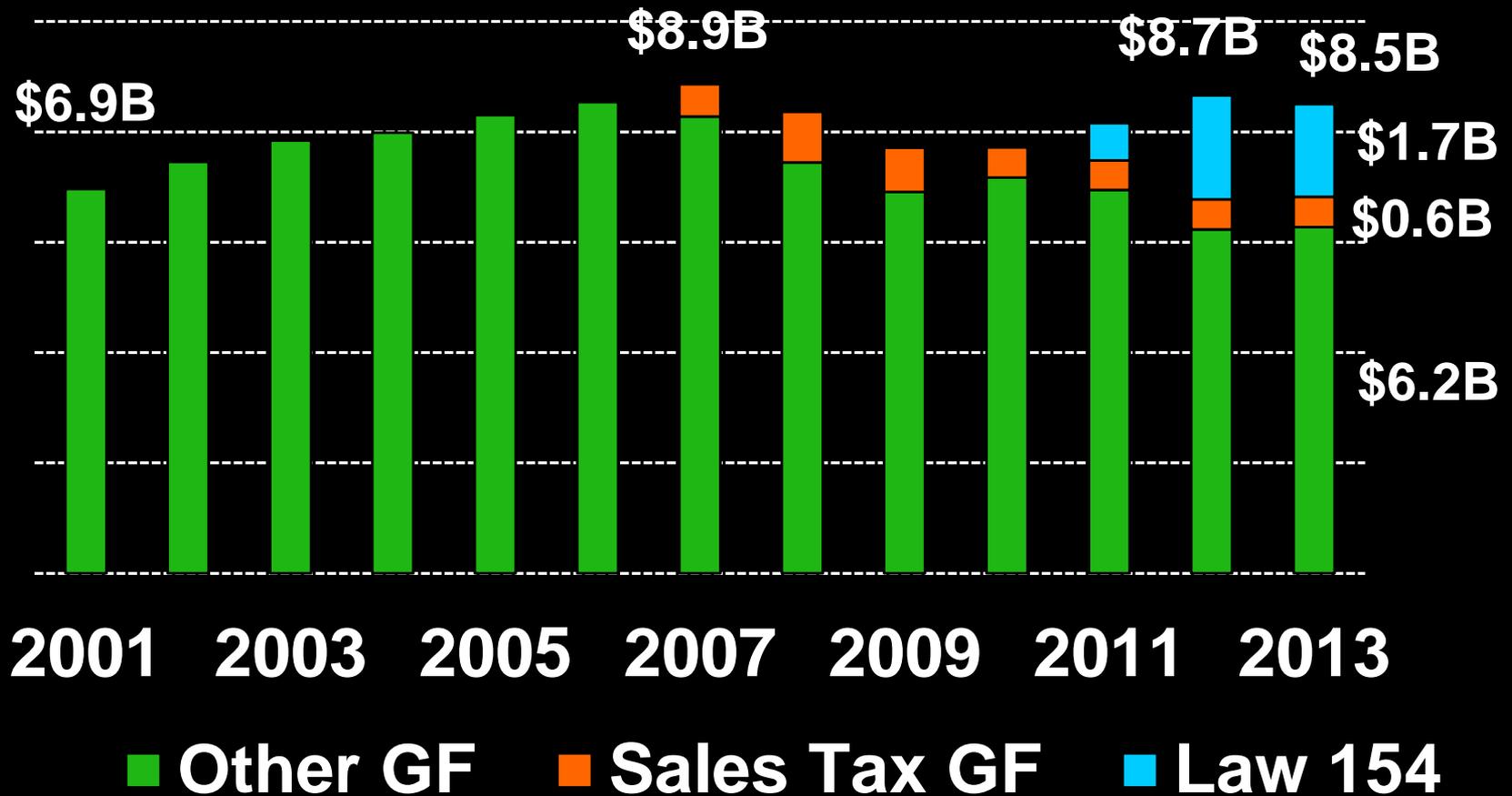
5th obstacle to Doing Business

## Electricity cost

\$ cents per kWh

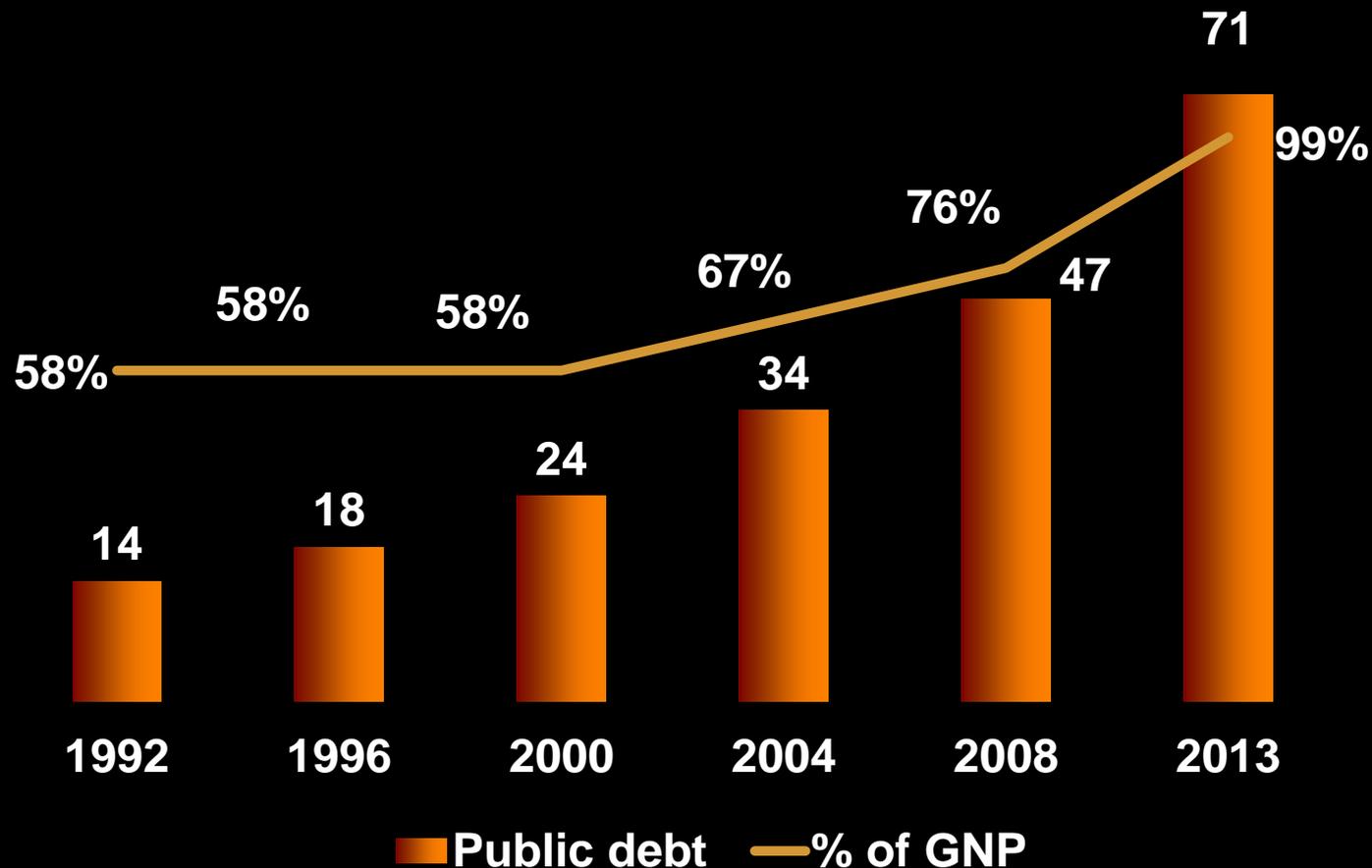


# Fiscal revenues challenge



# The public debt challenge

PR total public debt, \$ billion



# One notch above junk

<b>GO Bonds</b>	<b>Moody's</b>	<b>S&amp;P</b>	<b>Fitch</b>
<b>Prior rating</b>	<b>Baa1</b>	<b>BBB</b>	<b>BBB+</b>
<b>Current rating</b>	<b>Baa3</b>	<b>BBB-</b>	<b>BBB-</b>
<b>Date</b>	<b>Dec-12</b>	<b>Mar-13</b>	<b>Mar-13</b>
<b>Outlook</b>	<b>Negative</b>	<b>Negative</b>	<b>Negative</b>
<b>Junk rating</b>	<b>Ba1</b>	<b>BB+</b>	<b>BB+</b>

# What challenges ahead?

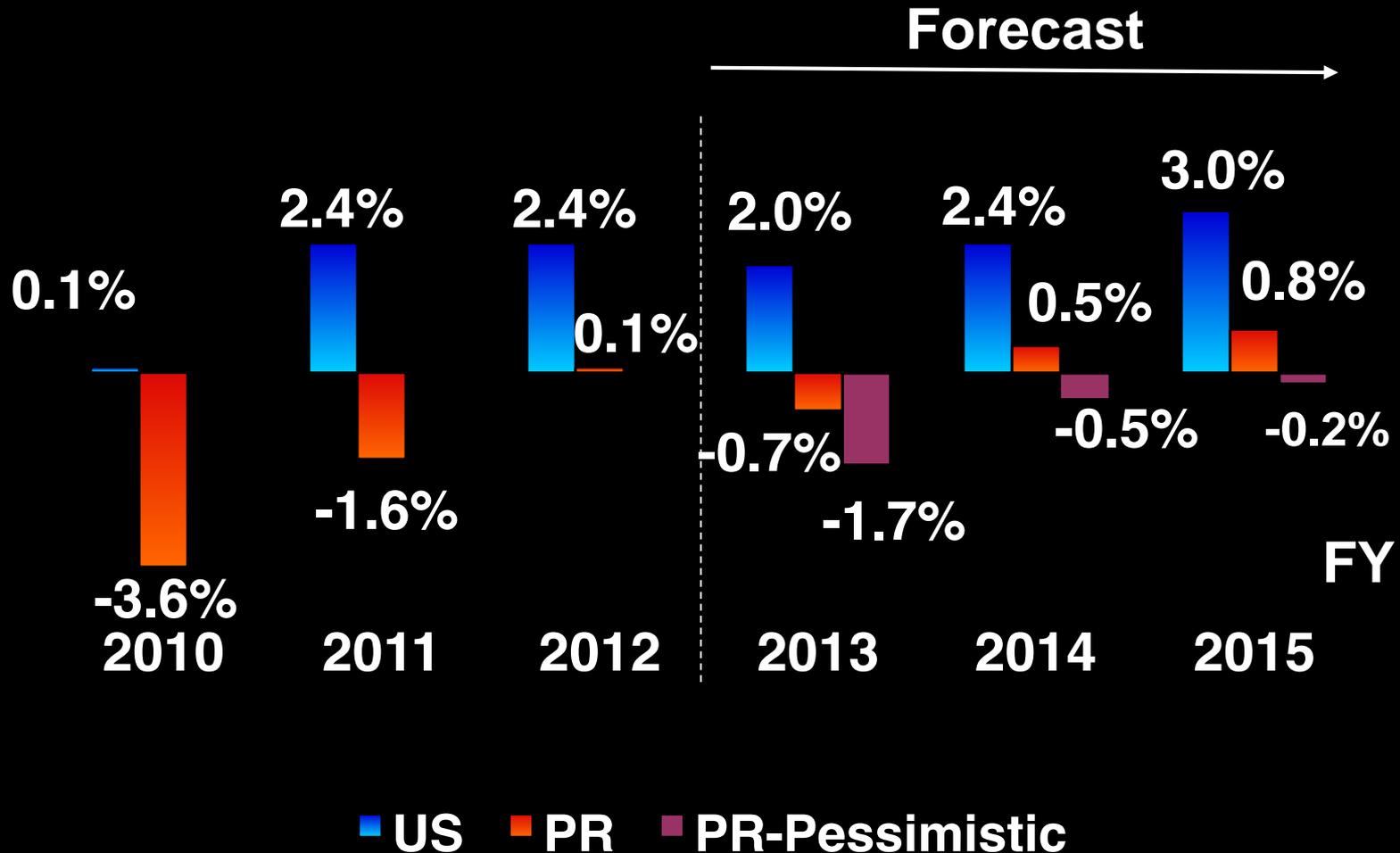
- ✓ PR' s growth depends on manufacturing and investment
- ✓ Public debt must be reduced
- ✓ US fiscal woes threaten PR' s budget
- ✓ Banking is not jumpstarting the economy
- ✓ PR faces many challenges and a very mixed outlook

## **In short:**

- 1. PR is at a crossroad between fiscal discipline and economic growth**
- 2. Investment has not recovered.**
- 3. Credit remains tight.**
- 4. Labor market does not reflect more jobs.**
- 5. Structural change has not taken place.**
- 6. Road to recovery is uphill.**

# Full recovery will take time...

Forecast of US and PR real GNP growth



# Consumption & Income

## Baseline

	History			Projected		
% change, real	2010	2011	2012	2013	2014	2015
Consumption	1.4%	0.7%	3.0%	1.5%	0.5%	0.7%
Dispos. Income	0.2%	1.8%	-0.4%	-0.6%	-1.6%	-0.2%

# Investment

## Baseline

	History			Projected		
% change, real	2010	2011	2012	2013	2014	2015
Construction	-14.1%	2.0%	11.0%	-2.8%	-1.7%	2.0%
Machinery	-2.3%	12.9%	1.0%	4.2%	1.2%	-1.8%
Investment	-7.8%	12.8%	4.4%	-1.1%	0.8%	-2.6%

# Exports

## Baseline

	History			Projected		
% change, real	2010	2011	2012	2013	2014	2015
Exports	-3.9%	1.7%	-4.1%	-1.0%	-1.7%	1.4%

# Unemployment

## Baseline

	History				Projected	
% change, real	2010	2011	2012	2013	2014	2015
Unemployment	16.3%	16.2%	15.2%	14.0%	14.1%	14.0%

# Inflation

## Baseline

	History				Projected	
% change, real	2010	2011	2012	2013	2014	2015
Inflation	2.0%	1.8%	2.6%	0.9%	2.4%	1.9%

# Expected revenues from new taxes

\$ million

Total PR \$1,490 million

New tax on gross sales



Higher corporate income tax rates



Selected B2B

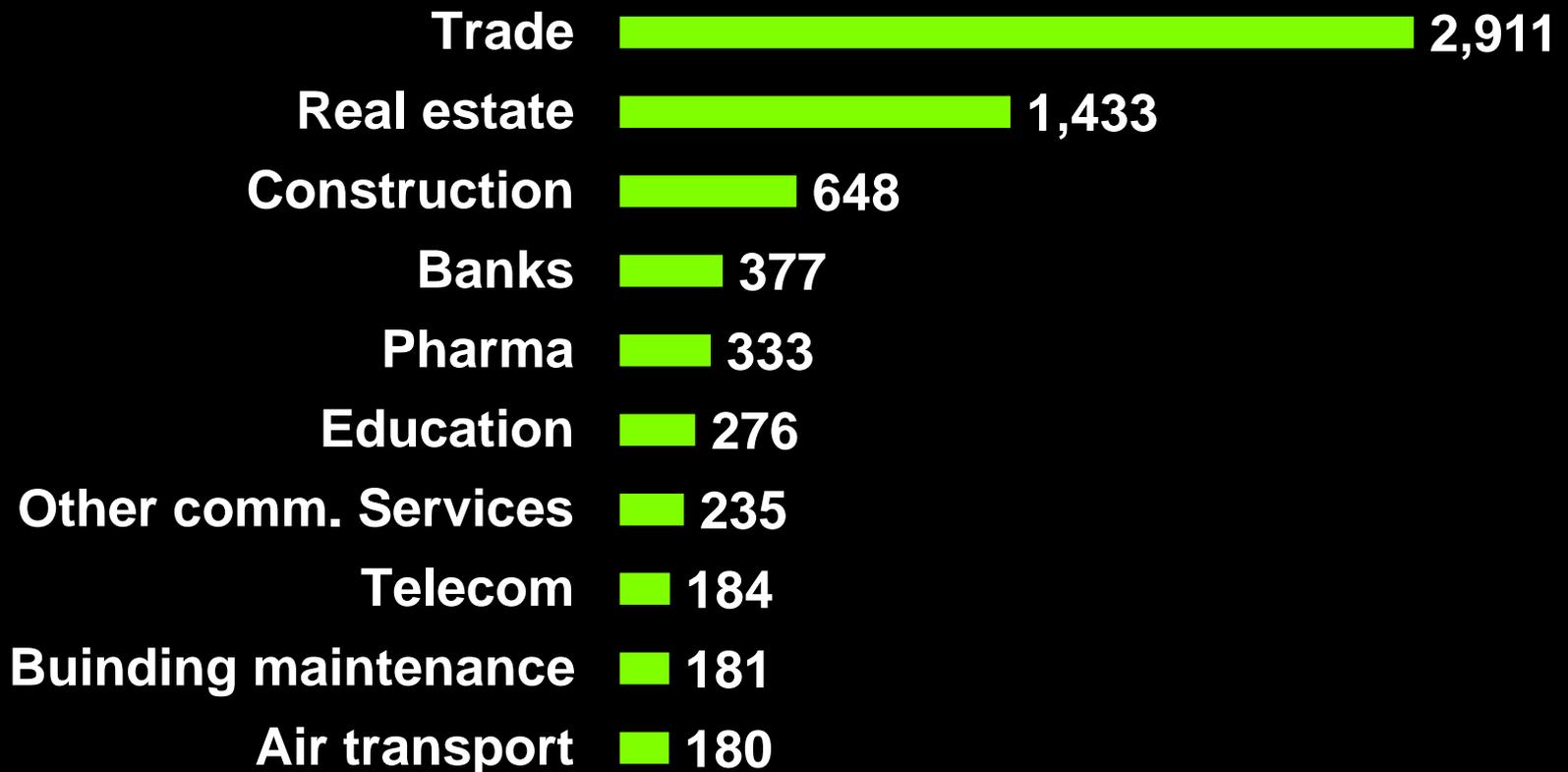


Other



# Most impacted industries due B2B Sales Tax proposal

Service intensive Industries, \$ million (2002 prices)



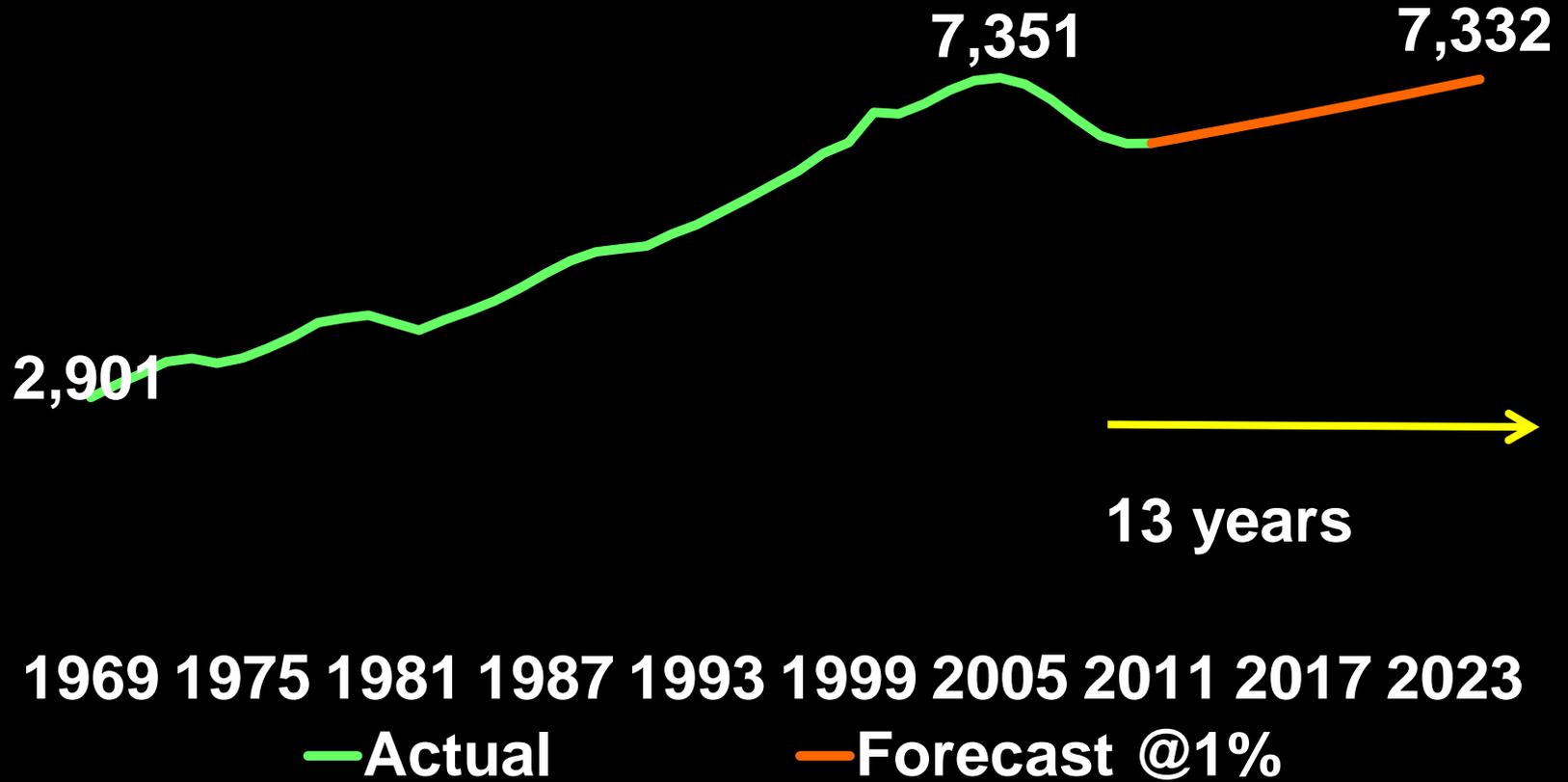
Source: Planning Board, Input-Output Matrix 2002.

# Potential results

1. Revenues fall below estimates
2. SUT B2B is to businesses what Law 7 was to the labor market
3. Loss of competitiveness
4. Complex tax system
5. Incorrect use of sales tax
6. Downgrading of GO bonds to junk status

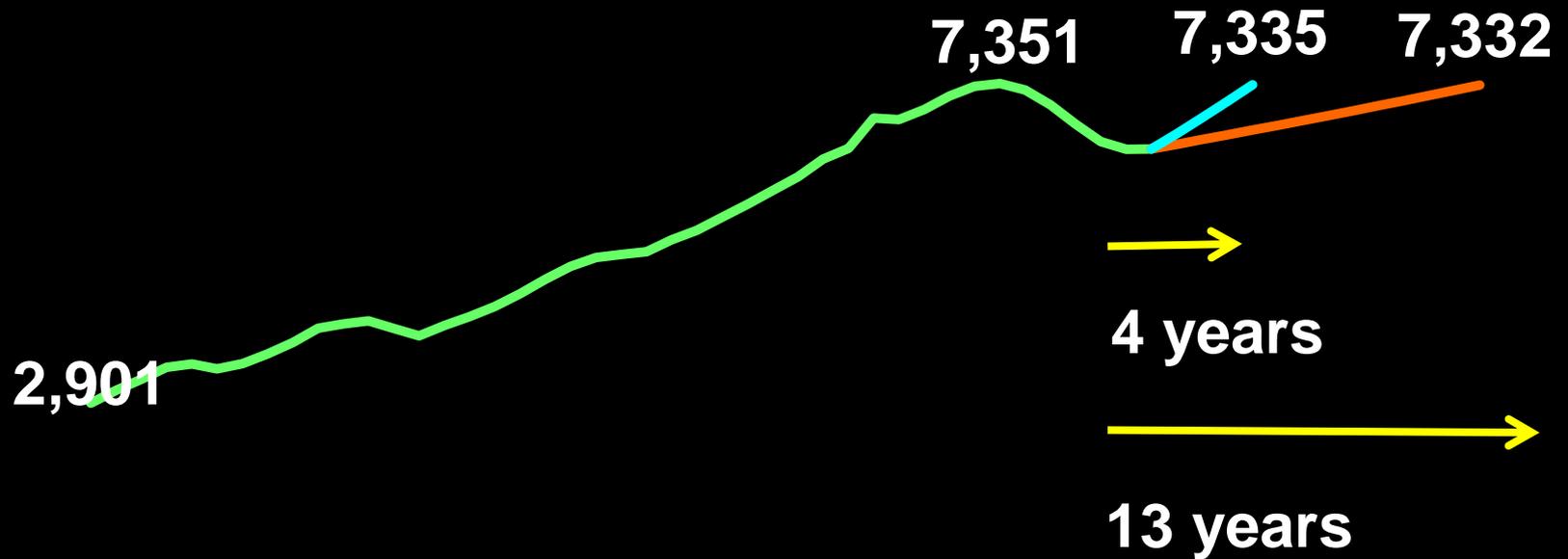
# Years to return to 2006 GNP

Real GNP, \$ million



# Years to return to 2006 GNP

Real GNP, \$ million

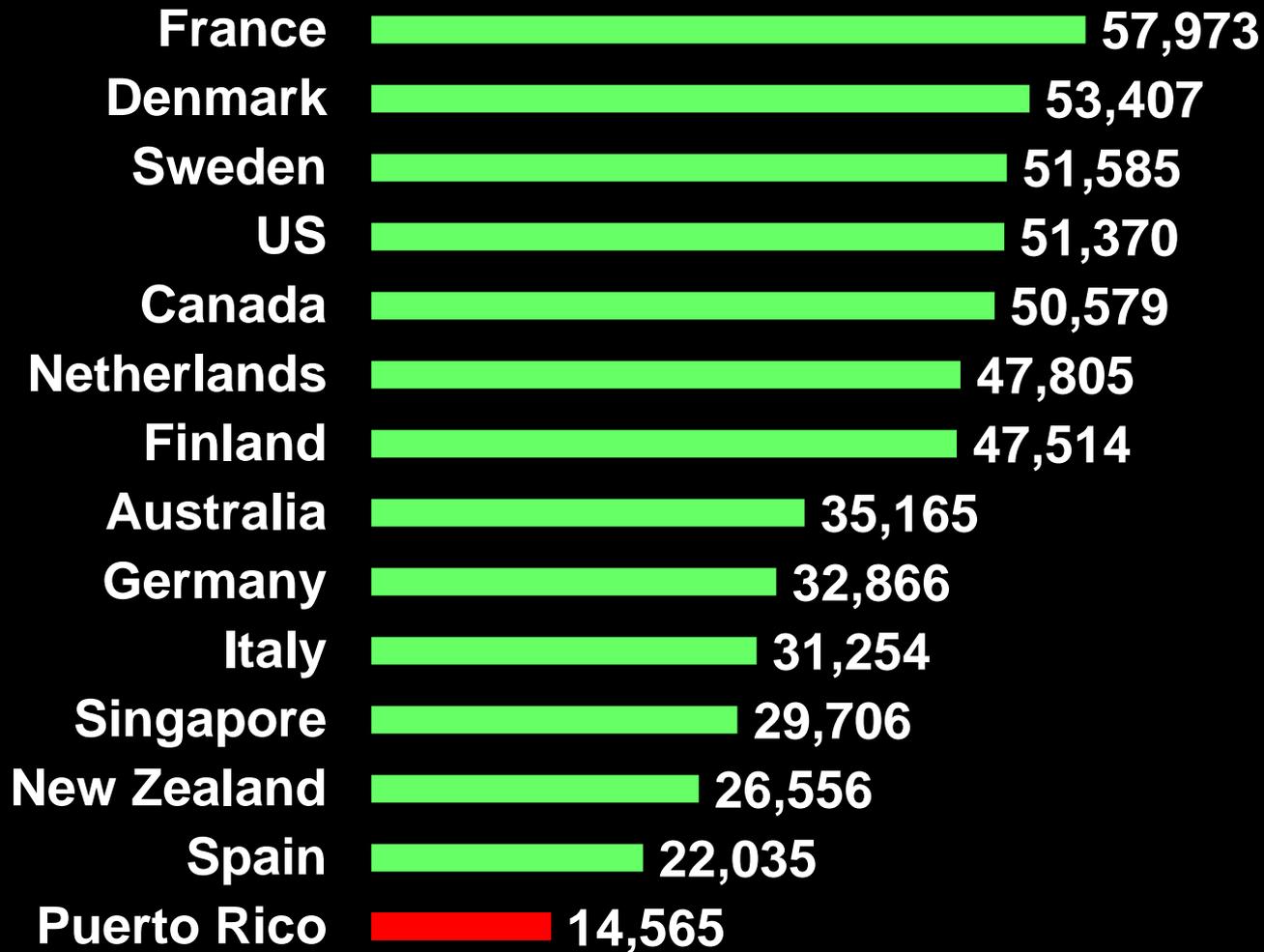


1969 1975 1981 1987 1993 1999 2005 2011 2017 2023

— Actual — Forecast @1% — Forecast @3.3%

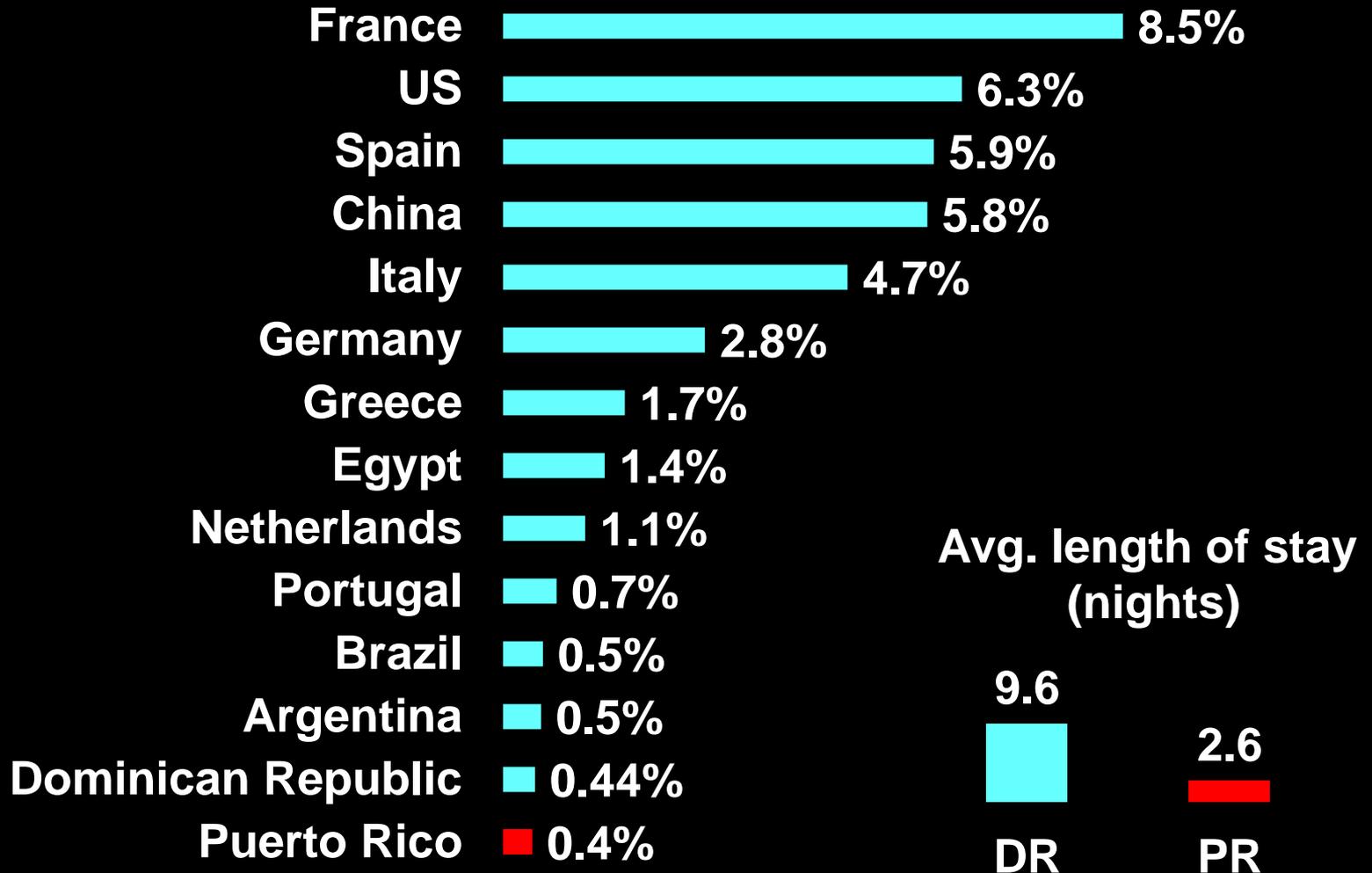
# Potential for agriculture

Value added per worker (\$ constant) 2011



# Potential for tourism

## World tourism market share (% tourists) 2010



# Puerto Rico has many assets but not leveraged effectively

Assets	Threats	Outcomes
Strong high-tech	<ul style="list-style-type: none"><li>• Limited R&amp;D &amp; local linkages</li><li>• Cost disadvantages</li></ul>	<ul style="list-style-type: none"><li>• Firms moving to lower cost locations</li></ul>
Strong services	<ul style="list-style-type: none"><li>• No promotion of services</li><li>• Declining quality in education</li></ul>	<ul style="list-style-type: none"><li>• Lose services; health &amp; education to region</li></ul>
Hub for Caribbean	<ul style="list-style-type: none"><li>• Losing lead in infrastructure</li><li>• Shrinking production industries</li></ul>	<ul style="list-style-type: none"><li>• Lose port &amp; exports to Jamaica, et al</li></ul>
Strong human capital	<ul style="list-style-type: none"><li>• Deteriorating education quality</li><li>• Ineffective institutions</li></ul>	<ul style="list-style-type: none"><li>• Squandering most critical asset</li></ul>
Attractive for knowledge workers	<ul style="list-style-type: none"><li>• Environmental degradation</li><li>• Crime and drugs</li></ul>	<ul style="list-style-type: none"><li>• Social &amp; physical environment - liabilities</li></ul>
Entrepreneurial spirit	<ul style="list-style-type: none"><li>• Risk-aversion</li><li>• Lack of support &amp; Red tape</li></ul>	<ul style="list-style-type: none"><li>• No basis for local innovation &amp; industry</li></ul>
Bridge between LA and US	<ul style="list-style-type: none"><li>• Little focus outside the US</li><li>• Even in the US, few linkages</li></ul>	<ul style="list-style-type: none"><li>• “Neither here, nor there”</li></ul>