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CUBA CHANGE

NEWS ALERT

A Very Serious Financial Crisis

EXCLUSIVE NEWS OF POTENTIAL INTEREST TO OUR CLIENTS & FRIENDS

Our Analysis

Cuba has not faced truly dire straits since what it calls the "special period," when the collapse of the Soviet Union brought the island's economy to its knees in the early 1990s, making food and fuel scarce and prompting hours-long blackouts. This summer, factories are closing down and production is being cut at other workplaces as the international financial crisis weighs on in the island. The government also announced new labor measures to increase agricultural output, while Cuba's trade deficit soared by 65 percent in 2008.

Cubans will have to make do with less, top communists suggested, as they insisted the armed forces are strong enough to deal with any unrest. The island's top two political bodies — the Council of Ministers and the Communist Party's Central Committee — have met on how to guide Cuba through what President Raul Castro has been quoted as calling a "very serious" crisis as he dropped economic growth projections in 2009 by nearly a full percentage point to 1.7%. Imports will drop 22.2%, or some \$3.4 billion, compared with an increase of nearly \$1 billion first projected. Exports will fall by \$500 million, compared with a jump of \$600 million forecasted.

On Saturday August 1, 2009 Raul Castro announced that Cuba will cut spending on education and health care, potentially weakening the building blocks of its communist system in a

bid to revive a foundering economy. The president of Cuba also called state spending "simply unsustainable" and said the cash-strapped government would reorganize rural schools and scrutinize its free health care system in search of ways to save money.

The problems began last summer, when three hurricanes caused more than \$10 billion in damage. The global economic crisis cut into export earnings and caused budget deficits to soar, leaving Cuba short on cash. Some of the measures taken to remedy the crisis have backfired. To try to conserve energy and lower Cuba's oil bill, the government has idled state factories during peak hours, stilled air conditioners at government offices, businesses and stores, and shortened work hours for some employees. That has led to a drop in productivity, exacerbating scarcities of basic products.

Internal Politics

Last month, the government announced that Francisco Soberón Valdes, chairman of the Central Bank of Cuba, had resigned. He was immediately replaced by Ernesto Medina Villaveiran. Soberón's resignation came a few months after the removal of a dozen ministers and some key figures, including Carlos Lage, Fernando Remírez de Estenoz, Otto Rivero and Felipe Pérez Roque. The succession of power first announced in 2006 is not going well. Fidel Castro continues to influence



**“ ...Removal of
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remittances for
Cuban-
Americans....”**



**Government's monthly
fee
food basket has been
reduced**

domestic and foreign policy. Recently he has demonstrated his continued engagement on how upper and middle ranking leaders behave, and has been involved in the details of key foreign policy events including Honduras, the summit meetings of regional leaders in Venezuela and Trinidad, and in the relations with the United States.

Former CIA analyst Brian Latell recently wrote that “ranking Cuban officials can't be sure who is in charge from day to day. They don't know who to obey or trust or how safely to maneuver around the Castro brothers, even as demands on them to improve economic performance are intensifying”. We agree.

US-Cuba Relations

US policy towards Cuba has begun to change, but we anticipate only halting progress towards rapprochement in the near period. The US government, having eased restrictions on travel and remittances for Cuban-Americans and initiated informal bilateral talks, has created momentum for further easing of sanctions. However, it will face resistance to a more comprehensive removal of economic sanctions or political détente from a determined and still-influential domestic pro-sanctions lobby. The process of negotiation is likely to be long and delicate.

Summary

With both the US president, Barack Obama, and the Cuban president, Raúl Castro, favoring engagement, we expect talks to continue. Differences over the question of conditionality will slow progress towards normalization.

There will be no radical economic liberalization, but the Cuban government will cautiously reform management through decentralization, greater management accountability, price adjustments and material incentives.

The US president, Barack Obama, has

announced the removal of most restrictions on travel and remittances for Cuban-Americans and initiated informal talks. The Cuban government has insisted on no conditionality.

In the context of slowing growth and a squeeze of foreign exchange, the authorities are curtailing fiscal spending and increasing central control of the allocation of foreign exchange.

US-Cuba negotiations may expand to include:

1. The lifting of the travel ban for Americans to visit Cuba and an end to the embargo.
2. Access to credits from the U.S. as well as from international organizations.
3. Payment for the “damage” caused by the U.S. embargo (between \$40-50 billion).
4. Access to the U.S. market to sell Cuban products.
5. Release and return of the five Cuban spies condemned by U.S. courts and currently in U.S. jails.
6. Return to Cuba of the Guantanamo naval base.
7. Increase the number of Cubans allowed to migrate legally to the U.S. (from 20,000 to 30,000 per year).
8. End of the U.S. policy of wet/dry foot.
9. An end to Radio/TV Martí transmissions to Cuba as well as the USAID Cuba Program.
10. Removal from the U.S. State Department terrorism list.

**Respectfully yours,
BabunGroup Consulting, Inc.**

Changes to US economic sanctions announced on April 13th(*)



**Tourist Restaurant
in Havana**

Family travel and remittances

The new rules: Persons with family living in Cuba (mostly Cuban-Americans) are now allowed unrestricted travel to visit, and unrestricted freedom to send remittances to, their families in Cuba. The process of sending remittances are made easier, with a general license established for financial institutions and an increase in the allowance family visitors may carry with them. Restrictions on the sending of gifts are relaxed.

Background: In 2004 Mr. Obama's predecessor, George W Bush, reduced the maximum frequency of permitted family visits from once a year to once every three years. He also narrowed the definition of "family" that applied, restricting it to only immediate family, and tightened restrictions on the sending of gifts.

The new US Congress quickly passed legislation in March to revert to the situation that existed before 2004. But Mr. Obama's April 13th change goes further than that, as it eliminates all restrictions on Cuban-family travel and removes the US\$1,200-a-year limit on the amount of remittances.

Political implications: Although it increases travel rights only for mostly Cuban-Americans, the move has far-reaching political implications within the US, as it creates momentum for removing other restrictions. It represents a major defeat for the hard-line, pro-sanctions lobby, marking the waning of its influence, and will encourage efforts to remove the restrictions on travel to Cuba by other US citizens.

Economic implications: The number of Cuban-American visitors is likely quickly to surpass its pre-2004 level of around 10,000 per month as a result of the removal of restrictions on mostly Cuban-American travel. The removal of restrictions on family remittances will allow Cuba to buck the regional trend of falling remittances inflows in 2009.

Telecommunications

The new rules: The bans on US telecommunications providers entering into agreements for fiber-optic cable, satellite links or roaming agreements with Cuban partners are removed. Obstacles to the export of donated mobile phone systems, computers, software and satellite receivers are removed. Satellite television and radio service providers are permitted to do business in Cuba.

Background: Until now, the prohibition of provision of fiber-optic cable and satellite links between the US and Cuba has contributed to Cuba's exceptionally restricted broadband access. To circumvent the restrictions, a fiber-optic cable is being laid to link Cuba with Venezuela and Jamaica. This project is due to be completed in 2010.

Political implications: To the extent that these measures remove ineffective and near-redundant restrictions, their practical effect on Cuban access to information technology, and on its domestic politics, will be slight. The completion of the Cuba-Venezuela fiber-optic cable in 2010 will hugely increase Cuban connectivity. Similarly, the permission to send donated equipment and allows television and radio services will not revolutionize the availability of telecommunications services within Cuba, as such donations and services already exist. Nonetheless, the measures clear away rules that had been irritants for bilateral relations.

**"The number of
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“Cuba received more than \$214 million from U.S. telephone companies last year....”

Economic implications: The permission for US telecommunications service providers to obtain licenses to enter into and operate under roaming service agreements with Cuban counterparts open the way for a new earnings stream for the Cuban state-owned telecoms monopoly, Etecsa, with a mobile subscriber base of 500,000 (up by 60% since early 2008). This will help to finance acceleration in telecoms investment, to upgrade and expand Cuba's communications infrastructure. As a result of heavy investment over the past decade in information technology (IT) skills training, there is potential for rapid take-up of the new communications opportunities by Cuban enterprises and research institutions. Take-up by private users will initially be slow, as individual ownership of computers is low and access to the Internet restricted.

***Note: As of August 10, 2009 these measures have not been fully implemented.**

Latest Business Headlines

- **Telecom ventures show huge potential** *By Ana Radelat*

Cuba received more than \$214 million from U.S. telephone companies last year, according to documents released by the U.S. Treasury Department — making the payments a bigger source of foreign exchange for Cuba than sugar, and nearly as big as cigars. The phone payments are also a clear indication of how much Cuba could benefit from expanded telecommunications links with the United States. “That’s a huge chunk of change, considering the limited amount of traffic the island allows,” said Enrique Lopez, a global telecom consultant and chief of Miami-based AKL Group. Lopez said Cuba has only 11 phones per 100 inhabitants. International traffic is often limited by the Cuban government, he said, whenever there’s an “event” in Cuba, such as rumors of Fidel Castro’s death or a new report of a crisis in his health. Yet U.S. carriers earned at least as much as Cuba did from the traffic — and probably much more — since Cuba’s share of the income is capped by U.S. law. Most phone traffic between the two countries originates in the United States, by exiles calling their families in Cuba.

U.S. TELECOM PAYMENTS TO CUBA

COMPANY	AMOUNT
TLD de Puerto Rico	\$72,794,349
AT&T	55,753,108
Sprint Nextel	36,927,050
Telecom New Zealand*	22,761,986
Verizon Business	11,013,107
Tata Communications*	8,085,695
iBasis Inc.	6,513,744
LD Telecommunications	596,102



Havana handles 40-foot containers

2008 payments. Source: U.S. Treasury Department.

**U.S. subsidiaries*

- Moscow signs gulf oil drilling accord**

Moscow will grant a \$150 million loan for two years to Cuba to finance deliveries of Russian construction and agricultural machinery and equipment, the RIA-Novosti news agency reported July 29. The two countries also signed a preliminary agreement on Russian oil company Zarubezhneft's operations in Cuba's exclusive economic zone in the Gulf of Mexico. "We consider that an outcome of this cooperation will be new opportunities both for Cuba as well as Zarubezhneft," said Russian Deputy Prime Minister Igor Sechin, who met with Cuban President Raúl Castro and other officials during his visit to Havana.

- Petroleum now Cuba's second export**

Oil exports are now Cuba's No. 2 export —overtaking pharmaceuticals — producing \$880 million in 2008 revenues, according to a Foreign Trade Ministry report seen by Reuters. A table in the report said nickel accounted for 39% of exports, oil for 22% and pharmaceuticals 9%, followed by sugar and tobacco products each at 6% and other products at 18% The government reported exports, excluding tourism and other services, were \$4 billion in 2008, but has yet to publish any details. Cuba consumes a minimum of 150,000 barrels per day in petroleum products, of which up to 92,000 barrels a day comes from regional energy giant Venezuela. The rest is pumped from the northwest coast along with natural gas for power generation.

- Oil drilling plans postponed**

Cuba and a consortium of foreign oil companies have once again postponed plans to drill for oil in the island's still-untapped fields in the Gulf of Mexico, diplomatic and industry sources told the Reuters news agency. Cuba had announced the consortium; led by Spain's Repsol-YPF, would drill in June or July, but now it is uncertain when work will begin in the waters that Cuban oil experts say may contain 20 billion barrels of oil. "The project has been postponed until a further date for more study," said a foreign oil industry source with direct knowledge of the plans. "It is premature to say when drilling might begin, later this year or next." A European diplomat told Reuters he had first-hand knowledge that drilling was postponed at least until the end of 2009, if not into 2010. Neither source wished to be identified.

- Brazil to fund port reconstruction**

Brazil said July 9 it would give Cuba up to \$300 million in credits to start rebuilding the port of Mariel, better known as the site of a 1980 Cuban exodus to the United States. Reuters reported that Brazilian Industry and Trade Minister Miguel Jorge said \$110 million had been approved by his government and the rest would likely be, as Brazil strengthens its ties with communist-led Cuba. He that construction, to be led by a Brazilian company, would begin "very soon" with the building of infrastructure including highways and a railroad for the port about 30 miles (50 km) west of Havana. Brazilian officials said Cuba expects the entire port project, which will be built in several phases, to cost up to \$2 billion. The first phase is projected to take four or five years to complete and cost \$600 million, they said.

- Cuba can service U.S. tourists if ban is lifted**

Jens Erick Gauld—(Bloomberg)- Cuba's tourism industry will have enough capacity for the surge of American travelers expected should U.S. lawmakers lift restrictions on visits to the island, said Miguel Figueras, an advisor at Cuba's tourism ministry. Cuba agrees with an estimate by the American Society of Travel Agents that 835,000 U.S. tourists a year, excluding cruise ships or Cuban-American family visitors, would come after an end to the travel ban, Figueras said. Cuba aims to build 30 new hotels with 10,000 rooms and 10 golf courses by 2014 without counting on changes in U.S. policy, he said.



**Petroleum is one of
Cuba's hope for
economic recovery**

**"Oil exports are
now Cuba's No.
2 export....
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“...Imports will plummet 22.2 percent, or some \$3.4 billion, compared with an increase of nearly \$1 billion first projected.”

The tourism sector represents 7 percent of Cuba's gross domestic product, Figueras said. Revenue increased 11 percent to \$1.8 billion last year from 2007.

- **Cuba slashes projections for 2009 imports, exports**

HAVANA, July 21 (Reuters) - Cuba is cutting estimates of imports by billions of dollars this year and projecting a decline in export revenues due to the international financial crisis, according to a government report shown to Reuters this week. The Economy and Planning Ministry forecast was drawn up within two months of President Raul Castro's replacement in March of Cuba's entire economic leadership team after a dismal 2008 performance. The report outlines adjustments to the 2009 plans of the old cabinet, including projections of 2.5 percent economic growth compared with the original 6 percent. The report says imports will plummet 22.2 percent, or some \$3.4 billion, compared with an increase of nearly \$1 billion first projected. Exports will decline by \$500 million, compared with an increase of \$600 million the old cabinet forecast.

- **Cigar sellers savor prospect of legal Cubans**

Mark Drajem, (Bloomberg) Cohibas, Partagas, and Montecristos from Cuba. For U. S. cigar aficionados, the names spark thoughts of civil disobedience. As President Barack Obama moves to ease restrictions on trade with Cuba, cigar lovers are savoring the prospect of legally lighting up a smoke that has long required a black-market connection and a willingness to flout the law. Cuban cigars, hand-rolled from the tobacco of the Vuelta Abajo growing region, hold a cachet in popular culture that dates back to the island's days as a playground for gamblers, novelists and mobsters. The day before Kennedy imposed the embargo, he dispatched Press Secretary Pierre Salinger to buy 1,000 Cuban-made Petit Upmanns, according to an account Salinger wrote in 2002.

The forbidden fruit carries a premium: A box of 25 Cohiba Robustos costs \$304 on the Hong Kong-based Cigars of Habanos website, where shoppers are offered the option of shipping to the U. S. without regard to the government's ban. A Dominican-made version sold online by Holt's Cigar Co. of Philadelphia sells for \$175. Because of the low acidity in the soil and a temperate climate, Cuban cigars have an earthy aroma and a "full taste" that make the best of them the finest cigars in the world, said Benjamin Menendez, a Cuban who fled the country in 1960 after Castro confiscated his family's cigar company, Menendez y Garcia. Not all Cuban cigars meet those standards.



Tobacco is one of Cuba's best known products

Country Snapshot



Land area	111,000 sq km (mainland 105,000 sq km; Isle of Youth 2,000 sq km; keys 3,000 sq km)
Population	11.2m (2007, year-end, official estimate)
Climate	Sub-tropical; average temperature 25°C average relative humidity 81%
Weather in Havana	Hottest month, August, 24-32°C (average monthly minimum); coldest months, January and February, 18-27°C; driest months, January and February, 38 mm average rainfall; wettest month, September, 183 mm average rainfall
Weights and measures	Metric system; also old Spanish units. Sugar is often measured in Spanish tones of 2,271 lbs and there is a Cuban quintal of 1014 lbs made up of 4 arrobas. For area measurement, one Cuban <i>cabalkria</i> equals 13.4 ha or 33.16 acres
Currency	There are two domestic currencies: the Cuban peso (CUP), in which prices and wages are denominated within the domestic economy; and the convertible peso (CUC), used in "hard-currency" retail outlets. 1 peso (Cuban or convertible) 100 centavos (Cuban or convertible). The official exchange rates, used in national income, fiscal and enterprise accounting aggregates are CUP1:CUC1 and 93 convertible pesos:US\$1. An "unofficial", but legal, CUP:CUC exchange rate is used for personal transactions. This rate is supposed to be freely floating, but has in unofficial effect become pegged. At the end of 2007 this rate was CUP24:CUC1. The CUP:USS exchange rate at end-2007 was therefore CUP22.2:US\$1. US dollars exchanged for convertible pesos within Cuba are subject to a 10% commission charge; there is no such charge for the conversion of other currencies into convertible pesos. Since 2002 Euros have been accepted in some tourist resorts
Time	5 hours behind GMT (April-October, 4 hours behind GMT)
Public holidays	January 1st; May 1st; July 26th-27th; October 10th; December 25th





***“Raul Castro,
took over from
his brother,
Fidel, on
February 24th
2008.”***



**The military's
influence in
government is
undeniable**

Political Structure

Official name	Republic of Cuba
Form of government	Centralized political system, with close identification between the PCC and the state
Head of state	The president, Raul Castro, took over from his brother, Fidel, on February 24th 2008
The executive	The Council of Ministers is the highest executive body; its Executive Committee is composed of the president, the first vice-president and the vice-presidents of the Council of Ministers
National legislature	National Assembly of People's Power; 614 members elected by direct ballot; the Assembly meets twice a year, and extraordinary sessions can be called
Legal system	A People's Supreme Court oversees a system of regional tribunals; the Supreme Court is accountable to the National Assembly
National elections	Provincial and national assembly's: last elections January 20th 2008; next elections due in January 2012. Municipal elections: last held October 2007; next due in April 2010
National government	The organs of the state and the PCC are closely entwined, and power devolves principally from the Executive Committee of the Council of Ministers
Main political organization	The Partido Comunista de Cuba (PCC) is the only legal political party
President of the councils of state & ministers	Raul Castro Ruz
First vice-president	Jose Ramon Machado Ventura
Vice-president of the Council of Ministers	Marino Murillo Jorge
Secretary of the Council of Ministers	Jose Amado Ricardo Guerra
President of the National Assembly	Ricardo Alarcon de Quesada

Key ministers	Agriculture	Ulises Resales del Toro
	Armed forces	General Julio Casas Regueiro
	Audit & control	Gladys Maria Bejerano Portela Yadira Garcia Vera
	Basic industry	
	Communications & informatics	Ramiro valdes Menendez
	Culture	Abel Prieto Jimenez
	Economy & planning	Marino Murillo Jorge
	Education	Ana Elsa Velazquez
	Finance & prices	Lina Pedraza Rodriguez
	Foreign relations	Bruno Rodriguez Parrilla
	Foreign trade and investment	Rodrigo Malmierca Diaz
	Justice	Maria Esther Reus Gonzalez
	Labor & social security	Margarita Marlene Gonzalez
	Light industry	Estela Dominguez Ariosa
	Public health	Jose Ramon Balaguer
	Science, technology & the environment	Jose Miyar Barrueco
	Sugar	Luis Manuel Avila Gonzalez
	Tourism	Manuel Marrero Cruz
	Transport	Jorge Luis Sierra Cruz

**“The Partido
Comunista de
Cuba is the only
legal political
party.”**

Central Bank president	Ernesto Medina Villaveiran,
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Economic Forecast summary

	2007 a	2008 b	2009c	2010c
Real GDP growth	7.3	4.3	3.0	3.7
Exports of goods fob (US\$ bn)	3.7	3.8	2.7	3.2
Imports of goods fob (US\$ bn)	10.1	14.5	12.0	13.0
External debt (year-end; US\$ bn)	17.8 b	19.6	20.0	21.3
Official internal exchange rate CUP:CUC (av)	1.00	1.00	1.00	1.00
Unofficial internal exchange rate CUP:CUC (av)d	24.00	24.00	24.00	21.15
Official external exchange rate CUC:US\$ (av)	0.93	0.93	0.93	0.93
Unofficial external exchange rate CUP:US\$ (av)e	22.22	22.22	22.22	19.58

“...Currencies had grown nearly US \$31.7 billion from a previous estimate of US \$23.8 billion at the end of 2007.”

a Actual. b Economist Intelligence Unit estimates. c Economist Intelligence Unit forecasts. d Available only domestically, for personal transactions. e "Unofficial" exchange rate used domestically, for personal transactions. Since 1994 Cuban pesos (Ps) have been exchangeable for convertible pesos (CUC) or US dollars legally, in state-run exchange houses, known as Casas de Cambio (Cadecas).

Cuba's foreign debt

As of the end of 2008, Cuba's total known foreign debts in convertible (hard) currencies had grown to nearly US\$31.7 billion from a previous estimate of US\$23.8 billion at the end of 2007. The depreciation of the U.S. dollar vis-à-vis the euro, Japanese yen, and Canadian dollar accounted in part for the substantial increase of the debt in recent years. More so, new borrowing by the Cuban government and state-owned enterprises has added billions of dollars to the country's already large public debt, much of it in default, at a rate that seems unsustainable. Long-term financing, provided through a series of strategic cooperation accords with the Chávez administration, has enabled the island to import more than 90,000 bpd of Venezuelan petroleum and refined fuels at an estimated additional burden of US\$3.4 billion to the island's national debt in 2008 alone. Total Cuban obligations to Caracas now exceed US\$11 billion.



New locomotives

Cuba Geopolitical Outlook

BabunGroup Consulting, Inc.



- **Access to professional Staff:** BGC is known as a business-driven watch group that informs/updates/advises multinationals throughout the world to understand the goings on in Cuba. Our company has substantial expertise in Cuba issues; we often provide independent feasibility analysis and other business consulting and research assignments to multinational corporations. Our company has under contract to two former ministers and over 40 experts on different industries/expertise related to Cuba.-**Contact us for a full brochure.**
- **Customized executive briefings:** BGC conducts informal discussions/briefings on Cuba issues with client's staff. The briefing sessions are general and informal business focused (not academic) presentations and discussions regarding current Cuba and US-Cuba subjects. The number and timing of the sessions is at the discretion of the client.-**Contact us for rates.**
- **Business reports:** BGC is experienced in preparing reports to help provide a preliminary strategic plan and overview of issues related to a possible economic opening of Cuba to allow the client to conduct business operations in the emerging (future) new market. This "Analysis for Strategic Direction" could be drafted as a "Quick-Response Business Plan" in the event that things suddenly change in Cuba and it becomes permissible to do business in the Island. Our first step is to conduct a confidential meeting to help develop a scope of work at no cost to the potential client; following the scope of work we would determine the cost of such assignment.-**Contact us for an appointment.**

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We have
the information
you need



on opportunities in a new Cuba

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**OVER 2,000 TIMELY
RESEARCH TOPICS ON LINE**

BabunGroup Consulting, Inc. is regarded as one of America's largest providers of strategic services related to Cuba. Since 1991, BGC has been engaged by a number of companies who are planning to expand or who for competitive or strategic reasons need to know more about future opportunities in a post-transition Cuba.