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FEATURED Q&A

How Are U.S. Fed Decisions Affecting Latin America?

Chair Janet Yellen announced last week that the U.S. Federal Reserve would leave interest rates unchanged and would begin unwinding the stimulus it put in place in the wake of the financial crisis nearly a decade ago. // Photo: U.S. Federal Reserve.

Q **The U.S. Federal Reserve on Sept. 20 announced its decision to keep interest rates steady and to begin unwinding stimulus it put in place amid the Great Recession. What effect will the Fed's decision have on emerging markets, specifically in Latin America? How vulnerable are Latin American economies to any future Fed policy changes? What can Latin American economies do to best respond to rising U.S. interest rates in the future?**

A **Alicia Bárcena, executive secretary of the United Nations Economic Commission for Latin America and the Caribbean (ECLAC):** "The decision by the U.S. Federal Reserve to leave interest rates unchanged and to start withdrawing quantitative easing (QE) in October had been somewhat expected, so there was not much effect on financial market volatility. There was, however, an immediate effect on the dollar, which appreciated as the Fed signaled that it still expects one more increase of 25 basis points by the end of the year and three more in 2018. Also, the prices of some commodities were negatively affected. Traditionally, Fed policy rate decisions have been transmitted to Latin American countries through several channels. The first is the effect of Fed decisions on general market volatility and uncertainty. For the last couple of years, this has not been such an issue, given the Fed's relative predictability. The second is the effect on the value of the dollar and hence of Latin American currencies. Rate hikes (or the announcement of future hikes) accompanied by an appreciation of the dollar vis-à-vis Latin currencies can induce portfolio adjustments and therefore affect financing flows to the region. Currency depreciations

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Venezuela's Opposition Refuses Talks With Government

Both sides had engaged in preliminary talks in the Dominican Republic, but the opposition said President Nicolás Maduro's government has failed to make progress on issues including human rights to warrant full talks.

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Argentine Government Splits Up Prisma

The government is splitting up the Prisma credit card and processing network in an effort to boost competition in the sector.

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New Prosecutor Vows to Continue 'Car Wash' Probe

Raquel Dodge, Brazil's new prosecutor general, vowed to continue the massive "Car Wash" corruption probe that began under her predecessor, Rodrigo Janot.

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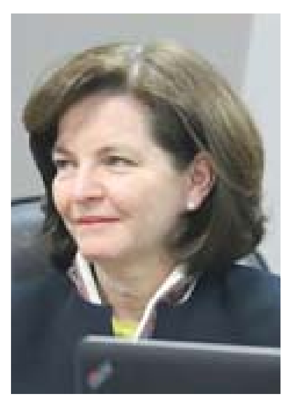

Dodge // File Photo: Brazilian Government.

POLITICAL NEWS

Venezuela's Opposition Refuses Talks With Gov't

Venezuela's opposition said Tuesday that it will not participate in talks that had been scheduled with President Nicolás Maduro's government, Reuters reported. "Negotiation is not to go and waste time, to look at someone's face, but rather so that Venezuelans can have immediate solutions," opposition leader Henrique Capriles told reporters. "We cannot have a repeat of last year's failure," he added, referring to talks brokered by the Vatican, which fell apart after opponents said Maduro's government was using them as nothing more than a stalling tactic. The government's information ministry did not immediately respond to a request by Reuters for comment. Maduro's government has promoted the talks amid widespread criticism, including from several other countries, that the government's creation of a powerful "constituent assembly" amounts to Maduro turning the country into a dictatorship. The new assembly has declared itself superior to all government institutions, including the courts and the opposition-led National Assembly. Maduro's government and the opposition held exploratory talks earlier this month in the Dominican Republic, but the opposition has said that the government has failed to make progress on issues including human rights in order to proceed with full talks between the two sides. The opposition has demanded the release of hundreds of jailed activists as well as respect for the National Assembly and a corridor for foreign humanitarian aid. Maduro's opponents have also called for the scheduling of the country's next presidential election, which is due by the end of next year, along with guarantees that the vote will be free and fair. Venezuela is suffering through its fourth consecutive year of recession, which has included shortages of food and other basic goods. Maduro's government has blamed the problems on an "economic war" it says has been waged by the opposition and exacerbated by recent U.S. sanctions. The opposition has said years of mismanagement by Maduro and his predecessor and mentor, the late Hugo Chávez, are to blame.

> **Negotiation is not to go and waste time..."**
> **— Henrique Capriles**

CORRECTION

A commentary by Paula Alonso in Tuesday's Advisor incorrectly referred to an artisan who went missing in Argentina as Santiago Montenegro. The missing artisan's name is in fact Santiago Maldonado.

New Prosecutor Vows to Continue Brazil 'Car Wash' Probe

Brazil's new prosecutor general, Raquel Dodge, on Tuesday said she is committed to continuing the "Operation Car Wash" corruption probe previously led by her predecessor, Rodrigo Janot, Reuters reported. The sprawling investigation, which centers on Brazilian construction conglomerate Odebrecht and state-owned oil company Petrobras, has implicated dozens of Brazilian politicians, including President Michel Temer, and has spurred spin-off investigations in countries throughout the world where Odebrecht has operated. During her first news conference since taking office last week, Dodge declined to comment on charges that Janot filed against Temer, but said she would not withdraw them. Janot charged Temer with obstruction of justice and with being a member of a criminal organization, just days before the end of his term as prosecutor general. The charges were based on a plea-bargain testimony by owners of meatpacking giant JBS. Janot later revoked the plea deal for JBS'

NEWS BRIEFS

At Least 14 Killed in Attack at Mexican Drug Rehab Center

At least 14 people were killed and eight were injured on Tuesday at a drug rehabilitation center in the Mexican city of Chihuahua when assailants armed with assault rifles opened fire at the facility, local police said, Agence France-Presse reported. Some 25 people were estimated to have been at the Uniting Families rehab center during the attack. In the past decade, at least a half dozen attacks have taken place at drug rehabilitation centers, and authorities said the attacks are usually perpetrated by gang members looking to target rivals hiding in the centers.

Coca-Cola Tripling Aid to Disaster-Hit Mexico, Caribbean

Coca-Cola on Tuesday announced it would triple the original amount of aid it is donating to relief efforts in Mexico and the Caribbean in the wake of Hurricane Maria and the multiple recent earthquakes in Mexico, CNN reported. The company will give an additional $4.3 million on top of the original pledged $2 million to the American Red Cross for relief efforts in the region. The company will also match employee contributions up to $100,000.

Citi Taps Marangon as President of Brazil Unit

Marcelo Marangon has been named the new president of Citi's unit in Brazil, Valor Econômico reported Monday. Marangon will replace Hélio Magalhães, who announced his retirement in June. Marangon, who holds a degree in business management, has been with Citi since 1993 and currently is a vice president at the bank. "Marcelo has stood out as a business leader with significant global banking experience," said Jane Fraser, Citigroup's president for Latin America.

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can also have adverse effects in some Latin American and Caribbean countries that have currency mismatches in public and/or private debt. Even though that average inflation rate is in a downward trend in the region, the depreciation of national currencies can produce increases in domestic inflation rates, inducing central banks in the region to increase interest rates. The possible pass-through of depreciation may reinforce the future upward pressure on domestic interest rates produced by future Fed rate increases. After a long period of exceptionally abundant liquidity and very low interest rates, the increase in the Fed's rate, together with the unwinding of the QE, will increase the external cost of financing for the region. It is expected that this increase will happen at a slow pace. On the one hand, the Fed is planning to proceed slowly and avoid surprises, and on the other, hand the Bank of England the Bank of Japan and the European Central Bank are all expected to maintain liquidity abundant in the medium turn."

A **Alfredo Coutiño, director for Latin America at Moody's Analytics:** "The era of cheap money is coming to an end and is a work in progress, particularly with the Fed's monetary cycle of rate hikes. The Fed's decision to leave the interest rate unchanged benefits Latin American economies because it eases pressures on domestic policy; any rate hike in the United States that is not followed by a similar hike in Latin America generates a reduction in the rate differential, putting the region's bond market at a disadvantage. Higher rates also produce higher costs for new debt issued by the region in international markets. Stable rates in the United States provide a benefit in terms of financial costs for governments and corporations in Latin America. Fortunately, the Fed's monetary tightening is taking place at a gradual pace, letting markets absorb the change smoothly. The same way that Latin America benefited from low rates in the United States, it will be affected by higher rates abroad. Future changes in U.S. rates will impose pressures on Latin American bonds, risk that can be deactivated if central banks match the U.S. rate hikes. Otherwise, Latin American bonds will lose attractiveness, a process that could generate capital outflows. Countries more vulnerable to the U.S. monetary cycle are those with central banks that persistently keep the policy interest rate too low and well below the neutral rate. Countries less vulnerable are those that took preventative measures and normalized monetary conditions. Since higher rates are definitely on the horizon for emerging markets, the best protection that Latin America can have is to continue reducing the main macroeconomic imbalances in terms of fiscal and external accounts, because that will reduce the region's needs of external financing."

A **Edwin M. Truman, nonresident senior fellow at the Peterson Institute for International Economics:** "The important move made by the Federal Open Market Committee (FOMC) of the Federal Reserve was not its decision against further raising the target range for the federal funds rate, but rather the decision to start reducing the size of its balance sheet. As the Federal Reserve in effect sells long-term assets over the next several years, this will put upward pressure on long-term dollar interest rates at the same time that the target range for the federal funds rate increases by between 150 and 200 basis points, according to FOMC projections. The spread between long and short rates will increase slightly, but will probably be less than 100 basis points. What will this mean for emerging market economies? For most of countries, the effects will be minimal, in part because this process of normalization will be gradual and stretched over several years. However, a few countries are vulnerable because of excessive foreign borrowing by the government or private

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owners once evidence emerged of the two owners having committed additional crimes. Dodge said revoking the plea deal did not erase the evidence the testimony provided, including the evidence against Temer. The lower house of Congress, which must vote on whether a president should stand trial for alleged crimes, began discussing the new charges on Tuesday. The body is expected the block the charges, as they did last month when discussing a graft charge brought earlier against Temer.

BUSINESS NEWS

Argentina Splits Up Prisma Credit Card, Processing Network

Argentina's government is splitting up the country's Prisma credit card and processing network, saying it wants to boost competition in the financial sector, Reuters reported today, citing Production Minister Francisco Cabrera. Visa International and 14 banks that have operations in Argentina own Prisma, and its breakup is seen as part of President Mauricio Macri's efforts to open the region's third-largest economy. "This is an important step toward

Cabrera // File Photo: Argentine Government.

strengthening the defense of competition in Argentina," Cabrera said in a statement late Tuesday. Prisma has "accepted the commitment to divest," though the details have not yet been finalized, the Production Ministry said in a statement. "The measure will allow the entry of new companies to the credit card market, which will benefit businesses, consumers and the economy in general," the statement added.

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sector, large current account and/or fiscal deficits, or exchange rate regimes that are too rigid. These countries risk crises without the Federal Reserve's normalization of U.S. monetary policy. Their leaders would be mistaken to blame the United States or the Federal Reserve for policy problems of their own making. They need to put their respective economic and financial houses in order regardless of the strength of the financial winds coming from the United States."

A **Wally Swain, senior vice president for emerging markets at 451 Research in Bogotá:** "Latin American countries are generally very sensitive to U.S. interest-rate and thus exchange-rate movements (except Panama and Ecuador, which have dollarized economies). All depend on exports of natural resources, most have weak manufacturing sectors, especially for IT-related goods and so depend on imports, and most have high levels of government debt, often denominated in U.S. dollars. These generalizations, as always, hide a rich diversity of special circumstances. On the one side (the right side?) of the ledger are the Pacific Alliance countries (Mexico, Colombia, Peru, Chile) with open economies, prudent finances and flexible exchange rates. On the other (left?) side are countries that try to close off their economies, despite their need for trade and dollar-denominated debt. Venezuela is the most extreme example, but Fed policy has little influence over Venezuela's out-of-control inflation and exchange rate. However, even the prudent managers of the Pacific Alliance watch the 'tea leaves' of the Fed closely. Colombia has received much attention recently for ending its half-century conflict with the FARC, which experts say could boost GDP by one or two percentage points. Unfortunately, the economy is currently in the doldrums, lower oil prices have seriously damaged government finances at all levels and the cost of implementing the peace accords is very high. That puts policymakers in a complex situation. Higher U.S. interest rates would have devalued the Colombian peso, stimulating exports but simultaneously making dollar-denominated debt more expensive. Luckily, the country's credit rating still holds, and still permits it to place peso-denominated bonds (domestically and externally), insulating Colombia's debt somewhat from the Fed's decisions."

A **Lourdes Casanova, senior lecturer and director at the Johnson Emerging Markets Institute at Cornell University:** "Normally the situation would have affected Latin America negatively, for a number of reasons. For one, the Brazilian stock market last year and the Mexican stock market this year had record profits. Usually when you see the U.S. dollar strengthen, money managers will decide to go back to a safer area—that is always the dollar—and cash the profits from the local stock markets. However, some interesting things have happened. The United States does not seem interested in a very strong dollar, so we don't know if the dollar will strengthen that much. Also, Mexico is facing a unique issue that came up after President Trump was elected. We don't know what will happen with the Fed in the future, though of course at some point we will have to move back to 'normal' territory. Though how quickly the Fed will raise rates, and by how much, is not clear. And lastly, Janet Yellen will reach the end of her term in February 2018. Who will replace her? What will be the policies of the next Fed chair? President Trump has said a number of times that he wants the next Fed chair to be more in line with the government's policies. So we will have to see if this year's murmurings of raising the rate end up being much ado about nothing."

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

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