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FEATURED Q&A

Are High Interest Rates Holding Back Brazil's Economy?



Brazil has some of the highest bank lending interest rates among developed and underdeveloped countries. A Banco do Brasil branch in Amargosa, in Bahia State, is pictured above. // File Photo: Rafael983 via Creative Commons.

Q At 53 percent, Brazil has the highest bank lending interest rates among 55 developed and underdeveloped countries, according to research firm Trading Economics. As of July, annual consumer credit card interest rates surpassed 270 percent for unpaid balances. Meantime, Brazilian borrowers must pay lending rates that average 38 percent higher than the rates the lenders must pay, a far larger spread than in other locations such as Argentina and Mexico, according to a 2017 World Bank report. Why are lending rates so high in Brazil? How much are the high rates holding back the country's economy? Should efforts be made to bring the rates down, and how can that be accomplished?

A Mario Mesquita, chief economist at Itaú Unibanco: "International comparisons on credit interest rates or spreads are not straightforward, given the inexistence of a standard measure. It is important to note that the most commonly used measure for lending interest rates and spreads in Brazil takes into account new loans only. In this sense, we believe it is more appropriate to focus our analysis on other indicators. Since 2017, the Brazilian central bank has released an index to evaluate the cost of credit, the Cost of Credit Index (ICC). The ICC takes into account the interest rate charged in overall outstanding loans, instead of the new loans only. In July, the average interest rate and spread using the ICC index were 20.9 percent and 14 percent, respectively. According to the central bank, between 2015 and 2017, the delinquency cost represented 37.4 percent of the spread. It was followed by administrative expenses (25 percent) and taxes and the credit

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TOP NEWS

FINANCIAL SERVICES

Mexico Requiring Permits for Cryptocurrency Exchanges

Mexico's central bank put into effect new rules requiring cryptocurrency exchanges to secure permits in order to operate.

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CREDIT CARDS

Discover, Mexico's Prosa Sign Deal for Greater Card Acceptance

Under the deal, Discover and its network affiliate cards will now be accepted on Prosa's network in Mexico.

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INSURANCE

ComparaOnline Buys Colombia's CompraMejor

ComparaOnline, a Chile-based price comparison site for financial products has acquired Colombia's CompraMejor. The Chilean company's founder, Sebastián Valin, said the company is now setting its sights on expanding in other countries in the region.

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Valin // File Photo: LinkedIn.

FINANCIAL SERVICES NEWS

Mexico Requiring Permits For Digital Currency Exchanges

Cryptocurrency exchanges, such as those offering Bitcoin, must now have a permit from Mexico's central bank in order to operate in the country, according to an announcement that the Bank of Mexico released on Sept. 10 and put into effect the following day. Digital currency exchanges will be required to specify the fees they charge upon registering with the central bank. "In order to continue promoting the proper functioning of payment systems and the sound development of the financial system, it is advisable to establish a regulatory framework that, on the one hand, allows the development of innovation in payment services in the country ... and at the same time, establish conditions that are adequate to mitigate the risks associated with such services," the bank said in a statement. Mexicans are the second-largest buyers of cryptocurrencies in Latin America after Brazilians, Coingeek reported Sept. 14. A recent survey showed that 26.5 percent of Mexicans had purchased cryptocurrencies. Last March, Mexico's Congress approved legislation that includes regulation of cryptocurrencies. [Editor's note: See related [Q&A](#) in the March 8-21 issue of the Financial Services Advisor.]

Brazil's BTG Pactual May Retain Stake in Petrobras Africa

Brazilian investment bank BTG Pactual may keep its stake in Petrobras Oil and Gas BV, or Petrobras Africa, rather than selling it as planned in order to avoid having to book a loss, Reuters reported Sept. 14, citing an unnamed source with knowledge of the matter. Earlier this year, oil trader Vitol had entered talks with a consortium it was leading to acquire the company in a bid estimated to be as high as \$2.5

billion, Reuters reported in June. Brazilian state oil company Petrobras owns half of PetroAfrica, as the company is known. BTG Pactual has a 40 percent stake, and Helios Investment Partners has a 10 percent stake. If the Vitol-led consortium had bought PetroAfrica at the price it had proposed, BTG would be forced to book a loss because it had paid \$1.5 billion for the 50 percent stake, which it acquired in 2013, the source told Reuters on condition of anonymity because of the private nature of the talks. BTG had previously decided to sell its stake, but it now believes that PetroAfrica will begin generating a stable cash flow. The company is participating in two deepwater oil exploration blocks off the coast of Nigeria. If Vitol raised its bid for the company, BTG would still consider selling, the source told the wire service. BTG, Vitol and PetroAfrica declined to immediately comment. Valor Econômico also reported Sept. 14 that BTG was planning to retain its stake in PetroAfrica, but added that the investment bank had not made a final decision.

INSURANCE NEWS

ComparaOnline Buys Colombia-Based CompraMejor

Chile-based ComparaOnline, a price comparison site for financial products, has acquired Colombian online insurance company CompraMejor, Chilean newspaper *Diario Financiero* reported Sept. 10. ComparaOnline already has an office in Colombia as well as 60,000 site visits per month in the country, the newspaper reported. CompraMejor has some 400,000 site visits per month. The Chilean company made the acquisition through a combination of cash and shares, said Sebastián Valin, ComparaOnline's founder. He declined to disclose the purchase price. ComparaOnline has approximately 10,000 active clients, *Diario Financiero* reported. The company is now aiming to boost its presence in Argentina, where it recently opened an office, as well as in Peru and Mexico, said Valin.

NEWS BRIEFS

Banco do Brasil Expects to Incur Additional \$72 Mn in Health Insurance Costs

Banco do Brasil is expecting to incur an additional 300 million reais (\$72 million) in employee health insurance costs this year, the state-run lender said in a securities filing, Reuters reported. The amount of its health insurance-related expenses depends on employees' approval to health insurance bylaws, Banco do Brasil said. The changes are not expected to change the bank's expense target for this year, Banco do Brasil added in the filing.

Discover, Mexico's Prosa Ink Deal for Greater Card Acceptance

Discover Financial Services and Mexican payments network Promoción y Operación, or Prosa, have partnered to expand acceptance of the Discover card in the Latin American country, the companies said Sept. 13 in a statement. Discover and its network affiliate cards will now be accepted on Prosa's network in Mexico, at stores and ATM locations. The companies said they are looking at other opportunities to work together in the future.

Financial Advisor Pleads Guilty in Bribery Scheme Involving PetroEcuador

A Miami-based financial advisor on Sept. 11 pleaded guilty to involvement in a bribery scheme involving Ecuadorean state oil company PetroEcuador, the U.S. attorney's office in Miami said in a statement. Jose Larrea, 40, wired more than \$1 million from his U.S.-based bank account to other accounts in order to conceal bribes involving a contractor who paid PetroEcuador officials to retain contracts and win new business, the U.S. attorney's office said. Three others have also pleaded guilty in the case. Larrea is to be sentenced Nov. 14.

ANTI-MONEY LAUNDERING NEWS

FEATURED Q&A / Continued from page 1

Ex-Venezuelan Officials Charged in Laundering Case

Twenty-eight people, including several former Venezuelan officials, have been charged in Andorra with money laundering in connection with a scheme involving some \$2 billion in bribes from companies seeking contracts with Venezuelan state oil company PDVSA, the Associated Press reported Sept. 13. Canolic Mingorance, an investigating magistrate in the tiny European principality issued the indictments

The charges followed a five-year investigation into suspicious deposits at Banca Privada d'Andorra.

in the culmination of a five-year investigation into suspicious deposits at an Andorra-based bank, Banca Privada d'Andorra. Those charged in the case include 14 people from Venezuela, nine from Andorra and five from Spain. The alleged mastermind of the scheme is Diego Salazar, the cousin of former energy minister and PDVSA president Rafael Ramírez, the wire service reported. Ramírez also was Venezuela's ambassador to the United Nations until he resigned and went into hiding last year after falling out of favor with Venezuelan President Nicolás Maduro. Among the other Venezuelans charged are ex-deputy ministers Nervis Villalobos and Javier Alvarado as well as Luis Carlos de León-Pérez, a former official at a state-run power company in Caracas. None of the Venezuelan defendants appeared in court on Sept. 13, according to local newspaper Diari d'Andorra. The defendants are alleged to have received illegal payments from companies, several of which are based in China, that then received oil industry contracts, the AP

guarantee fund (22.8 percent). The financial margin of the banks was responsible for only 14.9 percent. The delinquency cost could be reduced by enhancing Brazil's positive credit bureau and improving the legal environment. Changes in the regulatory framework, such as decreasing reserve requirements and earmarked credit, and tax burden reduction could affect the other spread components and would also lead to lower spreads and interest rates. There is no evidence that credit is holding back the country's economy. New loans accumulated over 12 months until June grew by 4.9 percent, in real terms, while Brazil's GDP increased 1.4 percent in the same period."

A Welber Barral, senior consultant at Barral M Jorge Consultores Associados and former Brazilian foreign trade secretary:

"There are historical and market explanations for why Brazil's lending rates are so high. Credit recovery is not quick nor secure in Brazil, due to an inefficient judicial system. There is an 'inflationary mentality' inherited from the hyperinflation of the 1980s, which persists through financial illiteracy. The safe and lucrative investment on federal bonds reduce the funding for credit. The lack of competition is crucial, and entrance barriers to new banks are huge. Regarding the extent to which high rates are holding back the economy, mid- and long-term projects are not financially feasible, except if external funding is provided. This directly affects investments in infrastructure and raises the costs for all economic activity in the country. Small- and medium-sized enterprises cannot access reasonable credit limits, which effectively restricts their expansion or attempts to export. More effective rules for credit recovery should be promoted, as should a reduction of bureaucracy for mortgages and personal loans. Updating procedural laws could reduce risk and delay for credit recovery. Promotion of fintechs and deregulation

of the financial market could promote competition among lenders. Modern structures of supply chain finance could facilitate credit to small exporters and SMEs."

A Joel Korn, president of WKI Brasil and senior international partner at UPITE Consulting Services:

"Overall, the Brazilian banking system is well capitalized and making significant technological strides to cope with the increasing competitive demands of the digital era. Nevertheless, real interest rates remain exceptionally high. While average return on equity of the banking system in the past five years has been approximately 16 percent, somewhat consistent with other developing economies, virtually no other country registers margins, or spreads, as high as Brazil's. While average lending rates over the last two years were reduced at a faster pace than the drop of the Selic, persistent high spreads have inhibited credit activities. According to the Brazilian Federation of Banks, the cause is the skyrocketing financial intermediation cost, which, in turn, includes loan-loss provisions. Also involved is a cumbersome legal and regulatory framework that entails lengthy recovery time, more than double the average two-year period registered in other developing countries, and ultimately a low recovery rate. Other factors that banks identify include excessive reserve requirements, provisions for labor costs and a high tax burden. The argument of excessive concentration of the private banking system as an element that inhibits more competition is mitigated by comparisons with other developing economies with equal or even higher levels of concentration and by the latitude given by the regulators for new entrants, especially in fintech. It should be also noted that the public financial institutions play a key and dominating role in lending to industrial projects, agriculture and real estate at very competitive terms. There are several initiatives that the regulators and

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reported. Managers of Banca Privada d'Andorra then hid the money in shell companies before making it available through the bank's accounts, authorities allege. In the indictment, Mingorance wrote that the defendants "joined forces to control the public bids of PDVSA and the construction of energy-related infrastructure." Andorra intervened in the private bank in 2015 after the U.S. Treasury accused it of involvement in money laundering for groups in Venezuela, China and Russia. Since then, the principality has toughened banking laws. One of those accused, De León-Pérez, has pleaded guilty in the United States to money laundering and other charges. A court in Houston is expected to sentence him this month.

POLITICAL NEWS

Argentina's Fernández Indicted on Graft Charges

An Argentine federal judge on Sept. 17 indicted former Argentine President Cristina Fernández de Kirchner and sought her arrest on charges that she allegedly controlled a corruption



Fernández // File Photo: Argentine Government.

scheme, according to a statement by Argentina's official judicial news agency. Fernández is accused of receiving bribes from business leaders in exchange for public work contracts during her presidency. Judge Claudio Bonadio, who is leading the investigation into the so-called "notebooks" corruption scandal, ordered Fernández be taken into custody and for authorities to seize roughly \$100 million from her, the Associated Press reported. Bonadio

ADVISOR Q&A

How Will the Latest Developments Alter Brazil's Presidential Race?

Q Following a decision from Brazil's electoral court barring him from the presidential race, jailed former President Luiz Inácio Lula da Silva on Sept. 11 dropped out of the race and endorsed former São Paulo Mayor Fernando Haddad as the candidate of the leftist Workers' Party. Haddad, as well as Geraldo Alckmin of the right-of-center PSDB, are both accused of campaign funding violations, allegations that both candidates deny. Also this month, right-wing presidential front-runner Jair Bolsonaro was seriously injured in a knife attack during a campaign event. How will the attack against Bolsonaro change the race? How do the legal developments affect the presidential race? Will Lula's support transfer to Haddad? What factors between now and election day will decide the election?

A Jana Nelson, former Brazil desk officer at the U.S. Department of State: "Brazil is entering a new phase in the presidential campaign, marked by corruption accusations and violence. The 13 presidential candidates are now final, no more last-minute bench substitutions. The latest polls take into account Jair Bolsonaro's stabbing and, surprisingly, show that Brazilians have less sympathy for the victim than one would have expected. The four candidates behind

alleged that Fernández has committed several crimes, including "being the boss of an illegal association" and accepting bribes between 2003 and 2015 during her own and her late husband Néstor Kirchner's administrations, La Nación reported. Fernández is currently a senator, which grants her immunity from arrest. She could be stripped of that immunity only by

the front-runner are tied, and the race now, as it has been from the start, is for second place. The question all non-Bolsonaro voters are asking themselves is: who will galvanize most votes to beat him in the second round? Neither Alckmin nor Haddad's corruption accusations seem to be a factor in a country where almost all politicians are under investigation. Although it is still a tad too early to tell by how much, it seems that Lula's popularity has transferred a bit to Haddad—his replacement on the ballot—and to Ciro Gomes, another leftist candidate. More importantly perhaps, the undecided and protest voters are starting to migrate to a defined candidate. The last two polls, Datafolha and Ibope, have shown markedly different results for the second round, meaning they are still not reliable enough. Haddad fares worst in the polls against Bolsonaro, and it is not unfathomable that center-right voters, who would normally never vote for Bolsonaro, would prefer him over another PT government. Alckmin, Marina and Ciro are all flawed candidates, each in their own way, leaving Brazilians to play eeny, meeny, miny, moe on the ballot on Oct. 7."

EDITOR'S NOTE: More commentary on this topic appears in the Sept. 13 issue of the Latin America Advisor.

a vote of two-thirds of the country's senators. Fernández's office told the AP it had no immediate comment, but the former president has denied wrongdoing in the past. Fernández has previously said Bonadio is working with President Mauricio Macri's administration to persecute opposition leaders. On Sept. 17, the judge also indicted more than 40 former business

NEWS BRIEFS

Peru's Opposition Blasts Vizcarra's Plan for No-Confidence Vote

Peruvian opposition lawmakers on Sept. 17 said President Martín Vizcarra's call to hold a vote of confidence over four of his proposed anti-corruption bills is unconstitutional, Reuters reported. If the opposition-controlled Congress delivers a vote of no confidence in his cabinet, Vizcarra would have to replace all of his ministers. But since Congress already dismissed one cabinet earlier this year, the constitution would allow the president to dissolve Congress and call for new legislative elections. Vizcarra's anti-corruption measures include new rules for selecting prosecutors and judges.

Cuba's Díaz-Canel Voices Support for Same-Sex Marriage

Cuban President Miguel Díaz-Canel told television broadcaster Telesur on Sept. 16 that he supported "marriage between people without any restrictions." Díaz-Canel said recognizing same-sex marriage, an issue that has been widely discussed as the island drafts a new constitution, is "part of eliminating any type of discrimination in society."

U.N. Security Council Renews Mandate for Colombia Mission

The United Nations Security Council in a resolution adopted unanimously on Sept. 13 extended the mandate of the U.N. mission overseeing the 2016 peace deal between the Colombian government and the Revolutionary Armed Forces of Colombia, or FARC, until next September, the Associated Press reported. The U.N. body also asked President Iván Duque's government "to renew momentum" in implementing the peace deal.

leaders and former government officials for alleged involvement in the corruption scheme, La Nación reported. [Editor's Note: See related Q&A in the Aug. 13 issue of the Advisor.]

Guatemala's Morales Defies Order to Allow CICIG Chief's Return

President Jimmy Morales on Sept. 17 defied a ruling by Guatemala's constitutional court that allowed the head of a United Nations anti-corruption commission to re-enter the country, the Associated Press reported. Administration officials claimed the court's ruling, issued

“Unfortunately, CICIG in its current manifestation has strayed far from this mandate by such actions as lobbying the national Congress...”

— Donald J. Planty

Sept. 16, does not mention commission head Iván Velásquez by name, referring only to the "commissioner," arguing that means they only have to allow someone in to head the commission, known as CICIG, but not Velásquez. Several human rights organizations on Sept. 17 filed complaints accusing the government of violating the court's decision, according to the report. Morales, who has been under investigation by CICIG for alleged corruption, announced in late August that he was shutting down the commission ahead of schedule, a move his opponents decried as a blatant effort to protect himself and his family from investigators. However, critics of CICIG say the unit has gone beyond its mandate to dismantle illegal security groups and to reform Guatemala's rule-of-law institutions, assuming a role that trumps Guatemalan sovereignty on questions over impunity. "Unfortunately, CICIG in its current manifestation has strayed far from this mandate by such actions as lobbying the national

Congress on constitutional reform measures, holding accused persons in detention for long periods without trial and politicizing the independent National Electoral Tribunal, one of the few Guatemalan institutions that works well," Donald J. Planty, a former U.S. ambassador to Guatemala, told the Advisor.

ECONOMIC NEWS

Panama Canal May See Fewer Ships Due to Trade Tensions

Increasing trade tensions between the United States and China may drive down the amount of ships passing through the Panama Canal, Jorge Quijano, who heads the organization that manages the canal, told Reuters on Sept. 13. "Most cargoes passing through the Panama Canal come from or go to the United States and China," he said. "Tensions between them could ultimately have an impact on the amount of loadings using the waterway in any direction." U.S. President Donald Trump is seeking to levy tariffs on \$200 billion worth of Chinese imports, escalating the trade war between the world's two largest economies, Bloomberg News reported. Quijano said bulk cargo of grains from Brazil could increase instead.

Brazil Poised to Launch Small Satellites

Brazil is ready to launch commercial rockets carrying small satellites from its Alcântara Launch Center as soon as it agrees to protect U.S. technology, according to Luiz Fernando Aguiar, the manager of the country's space program, Reuters reported Sept. 14. Without an agreement, no U.S. rocket can launch from the South American country. During U.S. Defense Secretary James Mattis' visit to Brazil last month, the two countries signed a deal to share real-time tracking data in space.

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Congress are reviewing. These initiatives are particularly focused on ways to improve the transparency of borrowers' credit standing to mitigate consumer lending risks, enhancement of credit processing through electronic means and adjustments in labor legislation. These measures, along with a possible easing of reserve requirements and continued efforts by the banking system to strengthen its efficiency and profitability within an ever-increasing competitive landscape, should contribute to lower lending costs, thus helping stimulate the overdue economic recovery."

A Rubens Sardenberg, chief economist at the Brazilian Federation of Banks (Febraban): "The Brazil cost affects the entire Brazilian business environment, including credit costs. According to a Brazilian central bank report, from 2015 to 2017, costs related to loan default (such as the default rate, warranty recovery obstacles and requirements relating to provisions for non-performing loans) account for 37.4 percent of banks' spread; administrative expenses, increased by law and bureaucratic requirements, represented 25 percent; tax burden and the Credit Guarantee Fund account for 22.8 percent. Banks' net revenues represented the smallest part (14.9 percent). In Brazil, loan default costs, measured by provisions for non-performing loans on loan portfolios' total expenses, are twice as large as in emerging markets and eight times bigger than developed economies, according to a sample of relevant countries analyzed by Accenture at Febraban's request. Other costs also are higher than in other countries. The official disclosure of Brazil's interest rates is distorted by the central bank's methodology. When the methodology adopted is more technically appropriate and similar to the one used in banks' net revenues, interest rates drop by half of the percentage that the central bank officially publicizes. According to the central bank, credit operations' average costs, measured by the credit cost

indicator, were 21.3 percent last December. Febraban strives to support a credit environment reform agenda in order to reduce or eliminate factors that increase Brazil's interest rates."

A Cynthia Cohen Freue, director and sector lead for financial institutions ratings at S&P Global: "Brazil has been reducing interest rates and spreads in recent years. However, we believe there is still room to continue on this path as spreads in Brazil remain higher than in other countries. In this sense, the Central Bank of Brazil publishes information about the contribution to the spreads from the different components, with the highest being delinquency rates that contribute to about 38 percent of the spread. We believe the higher delinquency rates in Brazil as compared to other peer countries are due to borrowers' payment culture. In addition, the lack of a positive bureau that could help lenders price for risk in some segments leads to adverse selection. In this sense, the central bank is working to promote sharing this information among banks. Another cause of the high spreads is the high tax burden on banks, which is ultimately transferred to borrowers. Brazil is an emerging market with high government spending, and the banking system benefits from high profitability and contributes much to the tax payments with about 23 percent of the spread. Finally, administrative expenses remain high in Brazil and contribute to about 25 percent of the spread, based on the central bank's estimation. Banks have been focusing in recent years to improve their efficiency by promoting customers to use alternative channels such as the Internet and mobile banking, but there is still work to be done to reduce the administrative cost. That said, we believe the high spreads are not the reason for the country's weak economic activity. Weak investor confidence due to political uncertainty and corruption investigations have, in our view, been the main reasons behind the recent downturn."

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