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FEATURED Q&A

Do Microlenders Have Excessively High Interest Rates?

Q Microlending in recent years has been hailed as an effective strategy for poverty reduction. But some microlenders have come under scrutiny for charging high interest rates. An article last month in *The New York Times* said the average interest rate charged by Mexican microlenders is approximately 70 percent, with rates surpassing 100 percent in some cases. Why are microlenders' interest rates so high, particularly in Mexico? How much profit is too much when it comes at the expense of the poor? Are microlenders adequately policing themselves or must governments toughen regulation so that poor borrowers are not exploited?

A Kai Schmitz, executive vice president at Microfinance International in Washington: "Microloans are a labor intensive and risky product. The lack of credit history, references or previous banking history makes an individual assessment of each borrower necessary. The unstable environment many microborrowers live in and their very limited cash flow means that every negative impact on their circumstances usually affects their ability to pay—even if they do intend to repay. Many microloans need to be restructured in the course of their term, further increasing costs. To be sustainable, not to mention profitable, the interest rate needs to cover the cost of capital, borrower assessment and loan administration, and also the risk

of default. These costs vary widely. Income from loans depends on the structure of fees and interest. It is therefore impossible to identify one interest rate at which microloans become usurious. Regulation could make microloans unavailable as regulators tend to underestimate the costs involved. Commercial providers of microloans who can expand quickly will only do so if a business case exists. However, microborrowers are at the same time among the most fragile consumers and need some protection against abuse or

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Gunmen in Jamaica Battle Police Over Reputed Drug Lord

Police patrol Jamaica's government declared a state of emergency Sunday in Jamaica's capital, Kingston, as gunmen defending reputed drug lord Christopher "Dudus" Coke openly fought with police. See brief on page 2.

Photo: Jamaica Observer.

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NEWS BRIEFS

Violence in Jamaica's Capital Leaves at Least Three Dead

Violence in Kingston left at least two police officers and one civilian dead Sunday as Jamaican Prime Minister Bruce Golding declared a state of emergency to deal with violence prompted by the planned extradition of a suspected drug lord, according to local media reports. Gunmen attacked four police stations in Kingston in a show of support for Christopher "Dudus" Coke, who is facing extradition to the United States on drug and weapons charges. Golding initially opposed Coke's extradition before changing his position earlier this month.

Mexican Prosecutors Accuse Pemex Official of Illicit Fuel Sale

Mexican prosecutors have accused a senior official at state oil firm Pemex with the illicit sale of diesel fuel that generated a loss of \$13 million for the company, the attorney general's office said Sunday. The official, identified in the Mexican press as Maria Karen Miyasaki Hara, is accused of transferring shipments of fuel to several private companies, including one belonging to her husband, Reuters reported.

Citibank Colombia Sells \$50 Million in Local Bonds

The Colombian unit of Citigroup on Friday sold 100 billion Colombian pesos (\$U.S. 50 million) in local bonds to grow its banking business, Dow Jones reported. Citibank Colombia's three-year bonds will pay 3.29 percentage points above the rate of inflation, according to the Colombian stock exchange. The sale, for which demand was 281 billion pesos, was the third tranche of the bank's program to sell 1 trillion pesos in bonds.

Economic News**Argentina's Economy Grew at Fastest Pace in Nearly Two Years in March**

Argentina's economy grew 8.1 percent year-on-year in March, its sharpest climb since July 2008, the government said Friday, Reuters reported. April was marked by strong factory production, rising consumer spending and an increase in farm exports, making it appear that the country's recovery from the global economic crisis is taking hold. "The rebound is giving way to pure growth in the first quarter," Enrique Dentice, an economist at the University of San Martín told Reuters. Argentina's trade surplus also narrowed amid rising demand for imported goods, the government said. Demand for vehicles is increasing in Brazil, leading to rising production in Argentina, the region's third-largest car manufacturer. Argentina's industrial production increased 10.2 percent year-on-year in April and economic activity increased 1 percent in March as compared to February. Argentina's official economic reports have been questioned by many

economists, who argue the government has underreported inflation and exaggerated growth data for political reasons. Analysts have said Argentina's industrial production is on track for a good year, but that high inflation could lead to demands for higher wages. Private economists have forecast inflation of between 20 percent and 30 percent by the end of the year. Last year, the country's economy grew 0.9 per-

“The rebound is giving way to pure growth in the first quarter.”

— Enrique Dentice

cent according to government statistics. However, many analysts believe it actually contracted by at least 2 percent. The government has forecast 5 percent gross domestic product growth for 2010. For this year's first quarter, the government said unemployment declined to 8.3 percent, down one-tenth of a percent from the same period in 2009.

Featured Q&A

Continued from page 1

monopolistic behavior of dominant commercial microlenders. Mexico has a few dominant and very commercial microlenders, some focused on short-term consumer lending. More competition and appropriate regulation combined with incentives for banks to make smaller loans may help to reduce costs. Multilateral and development shareholders of MFIs can also influence their investees to adopt fair lending policies—something that may not have been a priority in Mexico. "

A Thomas Morante, partner at Holland and Knight in Miami & Yani R. Contreras, foreign legal counsel at the firm: "According to the Microfinance Analysis and Benchmarking Report for Mexico 2009 issued in January by the Microfinance

Information Exchange and ProDesarrollo, Finanzas y Micro-empresa, several factors—some the result of the international financial crisis—gave rise to new risks related to the microfinance industry's activities. These factors included reduction of capital, the rising cost of funding, the contraction of demand for financial services and the decrease in borrowers' ability to pay. This is the environment that microfinance institutions faced in 2008 and 2009 and may have contributed to higher interest rates. In addition, increased competition—not only among microfinance institutions but also with other financing suppliers such as department store chains—coupled with the high investment costs to expand operating infrastructure also contributed to an increase in microlending interest rates. In Mexico,

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Mexico's Central Bank Keeps Key Interest Rate Unchanged

Mexico's central bank on Friday kept its overnight interest rate unchanged at 4.5 percent for the ninth consecutive month, saying inflation is remaining in check and that the European debt crisis could bring new risks to the economy, Bloomberg News reported. The central bank, led by former finance minister Agustín Carstens, said economic uncertainty is on the rise as fears grow about European countries defaulting on their debt. Also, industrialized countries are likely to keep their monetary policy "accommodative" for longer than anticipated, the central bank added. "Going forward, the uncertainty associated with the European crisis presents risks that weren't previously contemplated," the bank said in a statement. It is unlikely that Mexico's central bank will increase interest rates before its U.S. counterpart does, economist Ricardo Aguilar at **Invex Casa de Bolsa** in Mexico City told Bloomberg News. "We don't see why Banco de Mexico would separate itself" from the Federal Reserve, he said. Mexico's rate of inflation is at its lowest level since December. Consumer prices fell 0.32 percent in April from March, the largest monthly drop in three years, the central bank said earlier this month. Prices increased 4.27 percent in March as compared to the same month last year.



Carstens

File Photo: Mexican Government.

Company News

Petrobras Board Proposes Issuance of \$80 Billion in New Shares

Brazilian state-controlled oil company **Petrobras** said Friday that its board would seek shareholder approval for the issuance of as much as 150 billion reais (\$U.S. 80 billion) in new shares,

The Dialogue Continues

Was the Iran Nuclear Deal a Victory for Brazil?

Q After talks with Brazil and Turkey, Iran agreed May 17 to send about half of its uranium to Turkey. In return, Iran is to receive nuclear fuel rods processed by Russia and France for use in medical research. The agreement did not avert the Obama administration from announcing last Tuesday that the United States and major powers including China and Russia had agreed to impose new U.N. sanctions on Iran over its nuclear program. Was the deal involving Brazil a victory for President Luiz Inácio Lula da Silva following criticisms of his engagement with Tehran? What will the agreement with Iran do for Brazil's prospects as a leader and negotiator on the global stage?

A Susan Kaufman Purcell, director of the Center for Hemispheric Policy at the University of Miami: "The deal was a victory for Lula, who showed the world that he could negotiate a nuclear deal with the Iranian government while the United States could not do so. Yet all deals are not alike. Lula was willing to accept a deal that didn't require Iran to stop enriching uranium, which it could subsequently use to make a nuclear weapon. The United States, in contrast, wanted a deal that would prohibit such enrichment. Lula's more tolerant posi-

tion relates to his belief that it is illegitimate for the United States to decide which countries can or cannot develop nuclear weapons. He wants Brazil to be free to develop its own nuclear capability. Lula believes that if Washington were to succeed in preventing Iran from developing a nuclear capability, this would set a precedent that could then be used against Brazil. It is unclear whether the agreement that Lula just negotiated, jointly with the Turkish government, will lead to Brazil's playing a greater global leadership role. Lula is a popular and charismatic leader who, because he rose from poverty to the presidency of Brazil, is a hero to masses of people throughout the world. Whether future presidents will want, or be able, to follow in his footsteps is debatable. There is some discomfort in Brazil regarding other aspects of Lula's behavior toward Iran, such as his approval of Iran's recent fraudulent presidential election and the regime's crackdown on the protesting students. For some Brazilians, Lula's negotiating success has come at a big cost to Brazil's image abroad."

Editor's note: The above is a continuation of a Q&A published in the May 20 issue of the Advisor.

Bloomberg News reported. The company's board proposed raising a cap on the

The moves are part of a plan to pay for \$220 billion in spending through 2014.

issuance of new preferred shares from 200 million to 2.4 billion and also estab-

lished a limit of 3.2 billion new voting shares, Petrobras said in a regulatory filing. Petrobras, which is based in Rio de Janeiro, is planning to raise as much as \$25 billion in an offering later this year. Also, it plans to use new stock to buy 5 billion barrels of government-owned reserves. The moves are part of the company's plan to fund \$220 billion in spending through 2014. The company has scheduled a shareholder meeting on June 22 to seek approval for the increased cap on new stock.

Featured Q&A*Continued from page 2*

microlenders' higher interest rates were a function of increased costs of collection on unpaid loans in connection with a larger portfolio at risk, higher salaries and the fact that the average amount of credit in Mexico is significantly lower than in other countries of the region (the cost of a transaction is higher when amount of credits are small). To address increased costs and ensure adequate profits, higher interest rates were charged in Mexico whereas in the rest of the region operating expenses did not increase significantly given improvements in operating efficiency."

A Earl Jarrett, general manager of the Jamaica National Building Society in Kingston:

"The evidence in Jamaica has been that microlending is positively impacting family outcomes, particularly in the areas of job creation, improved quality of life and self-esteem. A November 2008 study of small communities in Jamaica by the Tropical Medicine Research Institute of The University of the West Indies found that microloan borrowers of one microfinance company, JN Small Business Loans Limited, were investing more funds in education, health and nutrition, property and consumer goods, as compared to persons of a similar status who were not involved in microenterprise. The study even recognized that increased wealth sometimes

resulted in inappropriate health decisions, and suggested that feasible interventions be identified and delivered as a service within the microlending program. Interest rates charged by microlenders are generally higher, reflecting their significantly higher risk exposure. However, what the interest rates mask is the fact that microlending firms provide many additional services to borrowers such as close supervision of businesses, management education and financial literacy. The experience to date is that microfinance borrowers tend to have lower rates of default and, over time, work to acquire shelter and provide greater stability within their communities. With respect to regulation of the microfinance sector, I believe that markets should be self-regulated, and there may be a need for greater competition within the sector. Instead, the emphasis should be placed on establishing a credit bureau for microfinance lenders and creating collateral registries, and governments could provide credit guarantees where risks are particularly high. These, I believe, are important first steps before the sector becomes burdened by regulations."

The Advisor welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.

Advisor Audio



Click [here](#) to listen to the May 19 Inter-American Dialogue discussion on

The Honduran Truth Commission

with
Eduardo Stein,
Coordinator of the commission
and former vice president
and foreign minister of Guatemala

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Erik Brand

General Manager, Publishing
erikbrand@thedialogue.org

Gene Kuleta

Editor
genekuleta@thedialogue.org

Matthew Schewel

Reporter, Assistant Editor
matschewel@thedialogue.org

Inter-American Dialogue:

Michael Shifter, President

Peter Hakim, President Emeritus

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Marifeli Pérez-Stable, Senior Fellow

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Viron Vaky, Senior Fellow

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