INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ FINANCIAL SERVICES

FEATURED Q&A

How Will Chávez's Nationalization Threats Affect Venezuelan Banks?

Q **Venezuelan President Hugo Chávez on Jan. 29 threatened to nationalize the country's private banks if they refuse to provide 40 billion bolívars ($9.31 billion) in agricultural loans this year. Is it feasible for the banks to provide that level of loans to farmers? How would such an increase affect banks' loan portfolios and businesses? To what extent do Chávez's threats affect banking operations in Venezuela and future growth of the country's financial sector?**

A **Franklin Santarelli, managing director in the Latin America Financial Institutions Group at Fitch Ratings:** "It is difficult to comment on the probability of a nationalization of private banks, as such decisions are politically motivated and impossible to predict. However, I can say that it is feasible for banks to provide the aforementioned amount of agricultural loans since, in real terms, the level is not that different from the amount that the banking regulator recently disclosed about agricultural loan disbursement by Venezuelan banks during 2011 (36.15 billion bolívars). Given the high level of inflation in Venezuela (which Fitch estimated to average 30 percent in 2012), credit growth to the agricultural sector will likely increase outstanding loans to this sector above the required 40 billion bolívars. Venezuelan banks have provided financing to the agricultural sector on a mandatory basis for a very long period of time, and on average, Fitch believes the system has adequate tools to provide such financing and control its risk exposure. Even when it's obvious that mandatory lending rules are not in line with best practices in the financial world, it's also true that in all these years of compulsory lending, the asset quality of such exposures has been in line with the system's overall average. On the other hand, these measures always impose different pressures on individual banks as not all of

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Colombia Eyeing Measures to Slow Consumer Credit Growth

Colombia may take "macroprudential" measures to slow the growth of consumer credit, Bloomberg News reported Feb. 10, citing central bank co-director Carlos Gustavo Cano. See related story on page 2.

File Photo: Colombian Government.

Inside This Issue

FINANCIAL SERVICES BRIEFS

U.S. Announces Regulations for FATCA Implementation

The U.S. Internal Revenue Service and the Treasury Department on Feb. 8 released much-anticipated proposed regulations for implementing the Foreign Account Tax Compliance Act, a piece of legislation expected to have wide-ranging implications for banks operating in Latin America and the Caribbean. The new regulations, which amount to some 400 pages of material, would provide more "breathing room" for anxious banks to comply with the law by extending the timeframe for reporting, among other changes, according to a report in *Forbes*.

Brazil's Itaú Unibanco to Spend $6.8 Billion for Redecard Stake

Brazil's **Itaú Unibanco** has offered to buy the portion of credit card processor **Redecard** that it doesn't already own for as much as 11.8 billion reais ($6.8 billion), Bloomberg News reported Feb. 7. Itaú, South America's biggest non-government bank, plans to buy 336.4 million common shares of Redecard to complement the 50 percent share of the company it already holds, Itaú said in a regulatory filing.

JNBS Plans to Open New Life Insurance Business in Jamaica

Jamaica National Building Society (JNBS) plans to open a new life insurance company in the second half of this year, the *Jamaica Gleaner* reported Feb. 11. Barbados-based **Sagicor** currently dominates Jamaica's life insurance market, with competitor **Guardian Life** a distant second. JNBS is already a player in the general insurance market through subsidiary **NEM Jamaica**.

Financial Services News

Argentina Puts Additional Limits on Financial Transactions

Argentina's government on Feb. 8 took new steps to limit and control the use of financial transactions, a move that will likely have wide-ranging consequences for activity in the stock and bond markets, investment funds and in the futures markets, Bloomberg News reported. In December, Argentine President Cristina Fernández de Kirchner approved financial transaction legislation that increases penalties for crimes including money laundering, tax evasion and other offenses. This latest move, announced in the country's official gazette, goes further by capping the use of cash in the country's financial markets significantly, restricting daily cash transactions to 1,000 pesos ($231) per person, down from 10,000 pesos. While the new rule is aimed at money laundering and terrorist financing, according to the government, recent measures like Wednesday's are also helping to slow capital flight. Outflows totaled $18 billion in the first nine months of 2011, double the same period in the previous year, Bloomberg News reported. Keeping more money in the country will help the central bank rebuild its international reserves. "These reforms will not only close loopholes in the legislation, but will also protect the transparency of the financial system and the stock market, ensure equality among investors and protect the domestic economy and public savings," Argentina's ambassador to the United States, Jorge Argüello, told the *Advisor* last month. [Editor's note: See related Q&A in the Jan. 19-Feb. 1 issue of the *Financial Services Advisor*.]

Peruvian Banking Sector Eyes Strong Profits This Year

Peru's banking sector is experiencing robust profits and is retaining solid loan portfolios, Dow Jones reported Feb. 6. Banking sector loans increased 17 percent last year to 128.38 billion soles ($47.7 billion), a record high. The past-due loan ratio of the country's banks amounted only to 1.47 percent in December, its lowest level in nearly three years. Peru's banks have enough solvency that they are lending to other banks in South America, central bank President Julio Velarde said recently. Bank loans could rise by 15 to 20 percent this year, José Roca, head of investments at **Prima AFP**, a private pension fund, told Dow Jones. Consumer loans could increase as much as 30 percent this year as banks seek to increase penetration in Peru. Banks in the South American country saw increased profits last year. Peru's largest bank, **Banco de Credito**, which has a third of the country's market, contributed $564 million in net earnings to majority owner **Credicorp Ltd.** The parent company also owns Prima AFP. Banco de Credito's net earnings last year amounted to a 21 percent increase as compared to the prior year. The bank's return on equity was 27.6 percent. "In accumulated terms, total loan book growth for 2011 was 21.3 percent, which is certainly an outstanding performance and was above our initial expectations," Credicorp said in a statement upon the release of its results. For Peru's banking sector as a whole, for 2011 through the end of November, banks had a net profit of 3.94 billion soles and a return on equity of 24.44 percent. Banks also experienced growth across sectors, for example, with mortgages denominated in soles rising 32.3 percent last year and dollar-denominated mortgages increasing 22.3 percent.

Colombia May Adopt New Measures to Slow Consumer Lending

Colombia's government is considering new measures to slow consumer credit growth, Bloomberg News reported Feb. 10. Central bank co-director Carlos Gustavo Cano told the news service that the so-called "macroprudential" measures will work faster than interest rate cuts to slow the fast pace of consumer lending in Colombia's hot economy. "The risk is overusing the interest rate when there's uncertainty regarding the international environment," Cano told Bloomberg

News in a recent interview. "You need to have specific instruments to control credit." Policymakers likely will increase reserve requirements for banks or adopt other measures to limit liquidity, according to the report. Total lending rose $120 billion in November, up 22 percent from the same month a year earlier, according to central bank data. Consumer loans grew 25 percent in December from a year ago. Colombia's central bank on Jan. 30 surprised market analysts by increasing the country's benchmark interest rate 25 basis points to 5 percent, noting that figures from last year's fourth quarter show an economy with "strong momentum." The move disappointed President Juan Manuel Santos, who had expressed worry over increased borrowing costs. [Editor's note: See related Q&A in the Feb. 9 issue of the Dialogue's daily *Advisor*.]

Banco do Brasil Reports Lower Profit, Beats Estimates

Banco do Brasil on Feb. 14 reported a lower fourth-quarter profit as compared to the year before, but beat analysts' estimates after gaining market share and trimming expenses, Bloomberg News reported. Adjusted net income for Brasília-based Banco do Brasil, the region's largest bank by assets, declined to 3.03 billion reais ($1.77 billion), as compared to 3.7 billion reais for the same period a year earlier. The average estimate in a Bloomberg survey of 11 analysts was for adjusted net income of 2.6 billion reais. The bank's stock rose on the news. The bank's loans increased 20 percent, a quicker pace than the industry's average, and higher funding from demand deposits helped improve net interest margin, **Itaú BBA Securities** said Monday in a report. Banco do Brasil's increasing income also helped to offset a 656 million real loss from the bank's **Banco Votorantim** unit, which primarily handles vehicle loans. Banco Votorantim's average delinquency rate increased in

Bendine

File Photo: Brazilian Government.

Featured Q&A

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the banks have the right tools and commercial network to tap this segment and hence, their asset quality trends may differ. Last but not least important, every time the authorities introduce new compulsory lending rules, the ability of banks in the system to execute their own business plans are interrupted and in some cases, the existence of mandatory lending rules undermine the banks' ability and willingness to provide financing to other sectors. This certainly does not bode well in terms of the desired increase in banking penetration."

A **Bret Rosen, Latin America sovereign-debt strategist at Standard Chartered:** "The banking system in Venezuela possesses substantial liquidity in bolívars given the dearth of viable destinations for credit within the overall economy and thanks to the country's draconian capital controls. Clearly, directed lending of the type that the president is pushing entails a number of risks for the financial system; loans would be made according to a political determination rather than their economic viability. Should the system be forced to make loans based on this criterion, one could expect nonperforming loans to increase as well as a deterioration of overall loan portfolios; credit to small farmers could present a series of operational and logistical problems. Chávez's threat to nationalize private banks further harms Venezuela's overall investment environment and dissuades financial institutions from expansion. Deposit rates remain very low, and, in fact, highly negative in real terms due to the excess liquidity in the system, while certain interest rate caps do not encourage loan growth. The failure of the private sector to grow in recent years has left the system with few options, and hence a large portion of the system's assets ends up in government bonds or obligations of PDVSA."

> "One could expect non-performing loans to increase as well as a deterioration of overall loan portfolios."
>
> *— Bret Rosen*

A **Beatrice Rangel, director of AMLA Consulting:** "The head of the Venezuelan banking watchdog (SUDEBAN) said in October that 'the national banking system is living one of its best times … both in terms of liquidity, which is around 6.98 billion dollars, as well as solvency.' Assuming that he was right, President Chávez will most probably need to print a lot of money to achieve the lending target he set to benefit the rural sector. According to this agency, profitability increased 35 percent year-on-year in 2011. But a close look at the triggering factors of such an auspicious situation reveals that it was basically due to currency arbitration and lending to the government. This seems to indicate that there are not many other attractive destinations for credit. To earmark so much money to credit for farmers not only seems to contradict the regime's economic strategy while running counter to the logic of banking, but also sets the foundation for a financial crisis. In an election year, this seems a bit of an odd policy to adopt."

A **Carlos Alberto Molina, professor of finance at IESA in Caracas:** "On Jan. 29, President Hugo Chávez announced the creation of the 'Ezequiel Zamora' fund to centralize the agricultural loans that Venezuelan banks currently manage. The banks will transfer their agriculture loans to the government-managed fund, receiving agricultural bonds in exchange. By December 2011, Venezuelan banks were financing

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December to 5.8 percent. CEO Aldemir Bendine said he expects Banco do Brasil's default rate to remain stable this year. The default rate at the end of December stood at 2.1 percent.

Economic News

Nicaragua's Central Bank President Quits Amid Flap With Ortega

Nicaragua's central bank president, Antenor Rosales, has resigned amid a disagreement with President Daniel Ortega about using central bank reserves to provide funding to a regional development bank for the eight-nation ALBA bloc, which is led by Venezuela, Bloomberg News reported Tuesday. During a meeting in Caracas on Feb. 4, Ortega and other leaders of the bloc agreed to place 1 percent of their reserves with the new bank. In Nicaragua's case, the figure would be about $17 million. Two days later in Managua, Rosales told reporters that no other countries should be allowed to use Nicaragua's reserves. "The resignation of Rosales sends a bad message to the people of Nicaragua," opposition lawmaker Wilfredo Navarro said in a speech to the National Assembly, Bloomberg News reported, citing a local television station. "He was defending the legality of the country's central bank institution. Withdrawing funds for an unknown bank is a violation of the institution." Ortega has named Finance Minister Alberto Guevara as Rosales' replacement, according to ruling Sandinista Party lawmakers. Ortega's government has sent Guevara's appointment for approval to the National Assembly, said chief Sandinista legislator Edwin Castro. He did not say whether Guevara would continue as finance minister. Castro added that Rosales' stepping down was not a result of his disagreement with Ortega, but instead was "normal government procedure." The new development bank aims to back sustainable projects, fight poverty and support member nations' sovereignty and integration with a "just, dynamic, harmonic and equitable economic exchange," the bank says on its Web site. Venezuelan President Hugo Chávez said Feb. 4 that his country is willing to provide $300 million in funding to the new bank.

Rosales

File Photo: www.lavozdelsandinismo.com

Research Alert

Mexico Lost $872 Bn From Illicit Flows Over 40 Years: Report

Mexico's economy lost $872 billion between 1970 and 2010 in illicit financial outflows, according to a report released Jan. 30 by Washington-based Global Financial Integrity, a program of the Center for International Policy. On average, illicit financial outflows accounted for 5.2 percent of the country's annual GDP over that period.

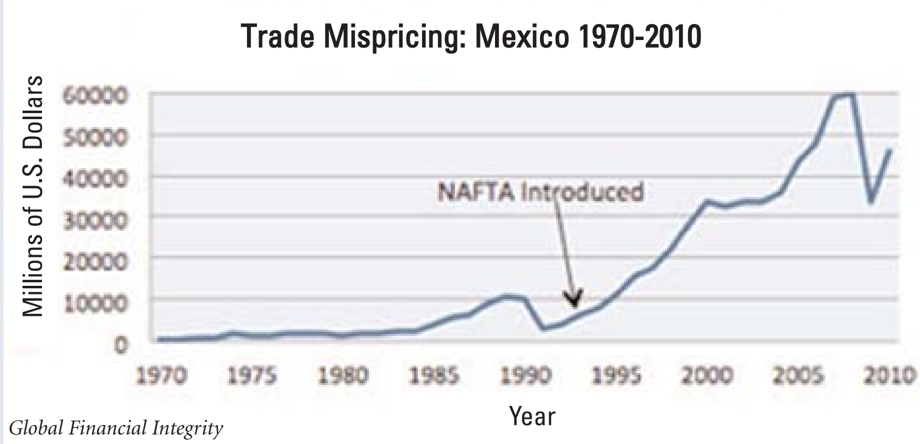
"We consider such outflows from developing countries to be the most damaging economic condition hurting the global poor, while at the same time significantly impacting the national security and foreign policy interests of western nations," said Raymond W. Baker, the advocacy group's director.

The outflows represent cross-border transactions of illegally earned, utilized or transferred money, but the report's authors suggest that the figures are conservative because data related to drug smuggling, human trafficking and some forms of trade mispricing is unavailable.

According to the report, trade mispricing is one of the most common ways for money to flow illegally out of the country, accounting for around 80 percent of illicit outflows in the 1990s and 2000s.

Trade manipulation, over-invoicing imports or under-invoicing exports, rose sharply after NAFTA was introduced, said Baker. In the 24 years prior to the free trade agreement, illicit outflows measured 4.5 percent of GDP. They increased to 6.3 percent of GDP in the following 17 years.

The study recommended a series of policy changes to staunch the illicit outflows, including entering into an automatic exchange of information agreement with the European Union, strengthening the computerized system for detecting trade manipulation and focus on pursuing macroeconomic stability.



Global Financial Integrity

Record Number of Tourists Visit Mexico Despite Drug War

Despite Mexico's brutal drug war, which has killed tens of thousands of people in the past five years, the country last year welcomed a record number of foreign tourists, according to new data from Mexico's tourism agency, the *Los Angeles*

Times reported Feb. 13. The number of tourists arriving from outside the country by air increased last year to 22.7 million, the highest number since the Bank of Mexico began tracking foreign tourist arrivals in 1980. Each of the last five months of 2011 experienced growth in the figure, said officials. In addition, Mexicans logged 167 million visits to tourist locations and the total of foreign and domestic tourists was 2 percent higher than in 2008, which had been Mexico's best year for tourism, said the tourism agency, known as SECTUR. Fewer tourists from the United States arrived in Mexico by air last year, but more tourists from countries including Brazil, China, Russia and Peru landed in Mexico as compared to 2010. While the Pacific resort city of Acapulco has suffered a surge in violence, mainly away from the principal tourist locations, Cancún and Los Cabos have generally avoided drug-related violence.

Political News

Guatemala's President Calls for Considering Drug Legalization

New Guatemalan President Otto Pérez Molina, who campaigned on vows to fight crime with an iron fist, said Feb. 13 that the Central American country should consider legalizing drug consumption and transportation, the Associated Press reported. Pérez Molina said the United States' inability to reduce the consumption of illegal drugs has left Guatemala, which has suffered a surge in drug-related violence, little choice but to consider legalization. The new Guatemalan president, a retired general who took office last month, said he would try to gain support next month from other Central American leaders during a regional meeting next month. "We're bringing the issue up for debate. Today's meeting is intended to strengthen our methods of fighting organized crime," Pérez Molina said after a meeting in Guatemala with Salvadoran President Mauricio Funes. "But if drug consumption isn't reduced, the problem will continue." After the meeting, Funes also said legalization should be discussed. However, after returning to El Salvador, Funes said he is not personally backing drug legalization, saying it would "create a moral problem." Funes added, "Imagine what it would mean ... Producing drugs would no longer be a crime, trafficking drugs would no longer be a crime and consuming drugs would no longer be a crime, so we would be converting the region into a paradise for drug consumption. I personally don't agree with it and I told President Otto Pérez so," the AP reported. Guatemala and other countries in Central America have among the world's highest murder rates as traffickers move cocaine and other drugs from South America through Central America and to the United States. In a report last May, the U.S. Congressional Research Service said 95 percent of the cocaine arriving in the United States moves through Mexico, with 60 percent of it having first gone through Central America. The U.S. Embassy in Guatemala City said Washington opposes drug legalization because "the evidence shows our shared drug problem is a threat to public health and safety." The embassy also said legalizing drugs would do nothing to stop criminals who also engage in extortion, kidnappings and the trafficking of people and weapons. Pérez Molina's pivot from promising an iron fist against crime to calling for a discussion of drug legalization may be an effort to pressure the United States into providing the Central American country with military aid, which U.S. lawmakers have banned because of past Guatemalan human rights abuses, Anita Isaacs, a political science professor at Haverford College in Pennsylvania, told the AP. "This is kind of like a shot across the bow, saying if you don't help us, this is what we can do," said Isaacs.

> "We would be converting the region into a paradise for drug consumption."
>
> — *Salvadoran President Mauricio Funes*

POLITICAL & ECONOMIC BRIEFS

Venezuela's Capriles Calls for 'Balanced Elections'

Venezuelan presidential hopeful Henrique Capriles on Feb. 13 called for "balanced elections" in the South American country as he seeks to unseat long-ruling President Hugo Chávez, the Associated Press reported. Capriles won the Feb. 12 primary, becoming the opposition's choice to face Chávez in the country's Oct. 7 election. Capriles, the governor of Miranda state, also criticized expropriations of businesses, farms and apartment buildings during Chávez's presidency, which began in 1999.

Chilean Central Bank Leaves Interest Rate Unchanged at 5%

Chile's central bank decided Feb. 13 to leave their benchmark interest rate unchanged as the country is experiencing faster growth than expected, Bloomberg News reported. Policymakers, led for the third meeting by new bank chief Rodrigo Vergara, kept the overnight interest rate at 5 percent. Chile's economy is estimated to have grown 6.3 percent last year and the central bank is expecting growth of 3.75 percent to 4.75 percent this year.

Bolivia's Morales Seeks to Tap Central Bank Reserves

Bolivian President Evo Morales has proposed using $1.2 billion of central bank reserves to finance industrial projects, Bloomberg News reported, citing state news agency ABI. Morales' administration on Feb. 13 sent legislation to lawmakers that would make local town halls partners with the central government in the projects. The Bolivian central bank currently has $12 billion in international reserves, ABI reported.

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51.71 billion bolívars in agriculture loans, close to 20 percent of the total system loans. The minimum percentage of agriculture loans a Venezuelan bank has to give is set every month by the government, and it is now 20 percent. In his announcement, President Chávez threatened to nationalize private banks (65 percent of the system assets). He specifically mentioned the three biggest private banks, Banesco, Mercantil and BBVA Provincial for not granting enough agriculture loans. Surprisingly, these banks are granting 29 percent, 53 percent and 38 percent of their loans to the agricultural sector, respectively. These percentages are similar to the 41 percent of the biggest state-owned Venezuelan bank, and certainly higher than both the law's minimum and the system average. Transferring agricultural loans to the newly-created government fund means that Venezuelan banks will lose the control of these loans. These limitations on doing business restrict the sector's growth. Threatening private banks with nationalization prevents future investments not only in the banking sector, but also in the whole economy. Given the current level of agricultural loans granted by private banks, the nationalization threat can only be understood from a political point of view: Blaming the banks for the failure in public policies for the agricultural sector."

"Threatening private banks with nationalization prevents future investments not only in the banking sector but also in the whole economy."

— ***Carlos Alberto Molina***

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

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