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FEATURED Q&A

How Is Latin America's Middle Class Faring?

Q After expanding by more than 50 percent over the last decade, the growth of the middle class in Latin America is slowing down, which will affect the growth rate of economies in the region, and especially certain industries such as retailers, auto manufacturers and homebuilders, according to a recent report by Moody's. The report added that economic growth in most countries of the region in 2015 will be driven by public spending and investment rather than consumer spending. Why has growth of the region's middle class slowed down, and how is Latin America's middle class faring? What needs to be done to maintain the gains of the last decade?

A George Gray Molina, chief economist of the Regional Bureau for Latin America and the Caribbean at the United Nations Development Programme (UNDP): "Our data show two things happening simultaneously: while the rate of economic growth slows, the rate of middle-class expansion through improvements in labor income also slows—putting additional pressure on social protection programs financed by fiscal effort. At the same time, fiscal effort weakens because most Latin American tax sources (indirect taxes and natural resource taxes) are elastic to downturns in economic growth. A fork in the road opens at this point: some countries will reduce labor unit cost to spur growth in their economies, others expand social protection programs to protect workers losing jobs. An intermediate option is to accommodate external shocks through a weakening of the exchange rate (that boosts the export sector) and taking liquidity out of the financial system to slow inflationary pressures (thus reducing domestic demand). This is, in fact, already happening in some countries. Middle classes are especially vulnerable to slowdowns in growth because of their source of income—labor markets, rather than commodity or financial markets. Most

Continued on page 4

Mayor Unveils $7.5 Bn Proposed Metro System for Bogotá

Bogotá Mayor Gustavo Petro on Tuesday unveiled plans for a $7.5 billion single-line rapid transit system for the Colombian capital. Colombia's national government warned, however, about the project's escalating cost. See story on page 2.

Photo: City of Bogotá.

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NEWS BRIEFS

Chile's Supreme Court Halts Development of Goldcorp Mine

Chile's Supreme Court on Tuesday issued a ruling to suspend the development of **Goldcorp**'s El Morro gold and copper mine until indigenous communities in the area are consulted about the project, BBC News reported. The court's action upheld an appeal from the Diaguita community, which has said the project could pollute an area river.

Chief Executive Officer of Brazil's Oi Resigns

The CEO of Brazilian telecommunications company **Oi**, Zeinal Bava, a former CEO of **Portugal Telecom** who joined Oi last year to lead a merger between the companies, resigned effective immediately on Tuesday, Bloomberg News reported. Bava's departure, which comes less than three months after a unit of **Espirito Santo International** defaulted on $1.1 billion in debt owed to the Portuguese company, has led to speculation that the merger may come undone. CFO Bayard Gontijo will take over until a successor is named.

Grupo Financiero Interacciones CEO Quits to Join Banorte's Board

Mexican bank **Grupo Financiero Interacciones** said Tuesday that chief executive Carlos Hank González has resigned to join the board of **Banorte**, which was founded by his grandfather, Reuters reported. Hank González said that despite rumors, his joining the board does not mean a merger between the two banks. Hank González's father will stay on as Interacciones' board president, and executive CEO Carlos Rojo Macedo has been named chief executive and promised to continue the same business strategy.

Economic News

Chile's Inflation Rate Climbs to Five-Year High

Chile's annual rate of inflation climbed in September to a more than five-year high amid surging costs for food, the country's National Statistics Institute announced today, Bloomberg News reported. Consumer prices rose 0.8 percent last month, while the annual rate increased to 4.9 percent, higher than the central bank's 2 percent to 4 percent target range for the sixth consecutive month. Core consumer prices, which exclude the costs of produce and fuel, increased 0.6 percent in September, according to the statistics institute. Prices for food and drinks jumped 2.1 percent last month and 8.3 percent over the past year. The country's annual inflation rate has quickened from 1.5 percent last October amid the central bank's rate cuts and the peso's falling value against the dollar. The Chilean currency has fallen 16 percent in the past 12 months, making imports more expensive and driving up the cost of products. The central bank has said inflation is likely to ease amid the effects of an economic slowdown in the South American country, Reuters reported. However, over the medium term, government tax reforms are expected to lead businesses to pass some of their higher costs along to consumers, the wire service reported. Rising consumer prices have created a dilemma for the central bank, which has sought to spur the economy through easing monetary policy. The central bank cut its benchmark interest rate from 5 percent to 3.25 percent over the past year. The country's gross domestic product grew 1.9 percent in the second quarter as compared to a year earlier when it grew 3.8 percent, Bloomberg News reported. "Chile will be growing around 2 percent in 2014, but 2015 will be much better," Finance Minister Alberto Arenas told reporters earlier this week.

Arenas

File Photo: Chilean Government.

Political News

Bogotá Mayor Unveils Plans for $7.5 Bn Metro System

Bogotá Mayor Gustavo Petro on Tuesday unveiled plans for a $7.5 billion subway system for the Colombian capital, according to Colombia Reports. The plans were presented after a study of the city's soil, which led to a diversion of the rapid transit line away from Las Américas Avenue and southward along Primer de Mayo Avenue. The underground system would be able to handle more than 900,000 passengers per day and will be able to operate without conductors, according to Spanish engineer José María Villarroel, who designed the system. The single-line system would be constructed with 27 stations and trains would pass through them every two and a half minutes, according to the designers, who added that all 27 kilometers of the subway line would be 50 to 80 feet underground. Petro's administration said in 2011 that a subway system for city would cost $3.5 billion, less than half the amount it is currently projecting. Villarroel said Tuesday that part of the higher costs are due to wet soil in Bogotá. Colombia's government warned that the escalating cost would mean other projects would have to be pushed back. "The nation, due to legal restrictions, can only contribute up to 70 percent of the construction cost and cannot begin subsidizing the metro's operating cost," Simón Gaviria, the country's national planning director, told daily newspaper *El Tiempo*.

The rapid transit system would be able to handle 900,000 passengers per day, according to the system's designer.

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Company News

YPFB, Petrobras to Discuss Extending Gas Supply Contract

Bolivian state oil company **YPFB** and Brazilian counterpart **Petrobras** will hold talks about extending a natural-gas supply contract due to expire in 2019, YPFB president Carlos Villegas said Monday, Platts reported. "Petrobras authorities have officially expressed their interest in starting talks for a new contract that will cover 2020 and beyond," Villegas told the state news agency ABI. "We have accepted. Of course it is good news because the current contract concludes in 2019," Villegas added, according to EFE. The negotiations for a new contract, which could begin next year, will focus on determining price, supply volume and calorific value of the natural gas exports. Under a 20-year contract signed in 1996 and which took effect in 1999, Brazil imports about 30 million cubic meters of natural gas per day from Bolivia, paying an average of $9.30 per million British thermal units (MMBtu). In August, the two companies signed an agreement for Bolivia to export another 2.6 million cubic meters per day at an average price of $10.24/MMBtu to feed a natural-gas powered plant in Cuiabá in the Brazilian state of Mato Grosso, located near the countries' border. The contract can be interrupted at any time. Brazil does not produce enough natural gas to meet domestic demand, which has been especially strong this year as a drought has reduced output at hydroelectric power plants and required natural-gas fired plants to come online to generate power, according to Platts.

Negotiations for the new contract could begin next year.

Countdown to Brazil's Election

A Series of Views and Analysis from David Fleischer

Aécio Makes the Cut and Jockeying Starts for Marina's Votes

BRASÍLIA—There was one more last-minute surprise before Sunday's election. The **Datafolha** and **Ibope** polls conducted on Oct. 3-4 predicted that Aécio Neves would receive 26 percent of the valid vote, slightly ahead of Marina Silva with 24 percent and Dilma Rousseff leading with 44 percent.

Although surveys detected Neves' increasing support by one or two points in each successive poll since mid-September, they did not detect his sharp increase in the last few days of the campaign. On Sunday, Neves received 33.55 percent of the valid vote and Silva 21.32 percent (a small increase from the 19.33 percent she received in 2010). Dilma Rousseff received 41.59 percent of the valid vote—less than the 46.91 percent she received in 2010.

Neves performed very well in the last live debate on TV Globo on Oct. 2. Marina appeared tired and did not perform as well as she did in previous debates.

On Sunday, 115,122,883 voters went to the polls in Brazil and 354,184 overseas Brazilians in 89 countries were eligible to vote for president. These overseas Brazilians had to file a prior request at the nearest consulate where they voted with the same electronic voting machines used in Brazil.

This year, the Supreme Electoral Tribunal (TSE) installed voter registration for some 21.7 million voters using their "biometric" data—fingerprints scanned into the voter registration computer files—to insure complete security of voter identification. At polling stations, voters' fingerprints were scanned and the computer system compared the scans with the data on file. In many cities, this system did not work well, and there were many delays.

In the elections for 27 governors, 18 ran for re-election—four were defeated, four were elected (having received an absolute majority of votes) and 10 will compete in the second round on Oct. 26. All told, 14 candidates were elected in the first round.

Twenty-seven senators were also elected—one slot per state. The big winners were the PMDB with five, and PSDB and PDT with four each. The PMDB will retain a simple majority in the Senate and elect the upper house's president on Feb. 1. In the lower house, 28 parties elected at least one deputy versus 22 in 2010. The PT elected the largest delegation—70 deputies (down from 88), and the PMDB had 66 (down from 71). Thus, the PT should elect the new Chamber of Deputies president.

It remains to be seen whether Silva will support Neves in the second round. She probably will because of the hateful, aggressive, negative campaign waged against her by Dilma in the first round to "deconstruct" her candidacy. Neves traveled to Recife on Monday to enlist the support of Renata Campos, the widow of Eduardo Campos, in an effort to bring the PSB into his second-round coalition.

Several PSB leaders are known to be pro-Dilma. Another factor will be whether Lula will engage forcibly in Dilma's second round campaign because his engagement was considered light in the first round. Also, it is possible that Dilma will mount an aggressive campaign to "deconstruct" Neves (and the PSDB).

David Fleischer is emeritus professor at the University of Brasília and editor of Brazil Focus.

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Featured Q&A

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vulnerable non-poor are also vulnerable for an additional reason: besides depending on labor income, their assets (financial/housing) are not yet as strong as the middle class' are. That 37 percent of the population—close to 200 million—is vulnerable to slip back into poverty."

John Price, managing director of Americas Market Intelligence: "Favorable demographics explain much of Latin America's middle class expansion. In only 30 years (twice as fast at the United States), fertility rates have dropped from four children per mother to two, freeing time for women to augment their income. Beyond demographics, it is useful to contrast the paths of Brazil and Mexico. The commodity boom helped inject unprecedented billions into Brazil's economy. The Workers' Party (PT) engineered a policy of direct transfers to underprivileged young mothers as a reward for keeping their children in school. That stipend lifted millions out of poverty. Cheap credit created a consumption boom from 2006 to 2012, and millions of Brazilians found employment in the retail and food service sectors. But by failing to invest sufficiently in education, infrastructure and technology adoption, Brazilian productivity gains have been mediocre. With the boom cycle now over and poor infrastructure still the norm, Brazilian real wages will drop over the next 24 months, and the middle class will shrink. In Mexico, the middle class grew slowly over the last decade, due to underinvestment, and without the same natural resource boost enjoyed in South America. However, the new reforms in power generation, telecommunications, education and financial services will attract record investment in the very sectors that most impact productivity. Five years from now, Mexico will have cheaper power, faster Internet, better access to credit and improved teachers. Then the middle class will really take off, leaving Brazil far behind."

Jeff Dayton-Johnson, interim dean of the Graduate School of International Policy & Management and associate professor of development practice and policy at the Monterey Institute of International Studies: "Different people mean different things when they say middle class. Some observers, for example, refer to those in the middle of the income distribution; call this 'Middle Class A.' Many people in Middle Class A have incomes below the U.S. poverty line, though they're not poor by local standards. Indeed, more than half of working people in Latin America's Middle Class A have informal-sector jobs, according to an OECD report. Growth of Middle Class A means that millions of Latin Americans have risen out of poverty in the last decade. More subtly, it means that many Latin American economies have become less unequal. Then there's Middle Class B. These are Latin Americans who can match the consumption patterns of the middle class in rich countries like the United States (and likely the group that Moody's worries about): say, people with daily incomes between $10 and $100, as a Brookings report defined the group. Middle Class B is not in the middle at all: they are crowded at the high end of the income distribution. But if even a small share of Latin America's 600 million people spend at this elevated level, they can potentially serve as a powerful domestic motor for economic growth. Both middle classes are threatened: the first by its vulnerability, the second by slow growth prospects. More robust social-protection and social-insurance policies, one the one hand, and economic reforms to bolster productivity and competitiveness, on the other, will help protect the fortunes of Latin America's dual middle class."

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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