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THEDIALOGUE

FEATURED Q&A

Will Brazil's Middle Class Be Able to Bounce Back?

Brazilian Finance Minister Henrique Meirelles has said he intends to promote economic reforms and work to cut the government's budget deficit. // File Photo: Brazilian Government.

Q Brazilian Finance Minister Henrique Meirelles announced on May 20 that the government's primary budget deficit could reach 171 billion reais ($48 billion) this year, or 2.75 percent of GDP, nearly double forecasts made in March. The dire projection added fuel to speculation that authorities will soon announce fiscal measures that could cut deep into social spending for years to come. How much has Brazil's expanding middle class come to count on government programs to stay out of poverty? Will middle-class consumers bounce back from Brazil's current deep recession with the same characteristics and spending habits with which they went into it? How long will it take for consumer confidence, now near record lows, to climb back?

A Joel Korn, senior international partner in the Americas division of UPITE Consulting Services and president of WKI Brasil: "The sheer size of Brazil's budget deficit dictates bold fiscal measures. This is a foremost priority for this or any other administration in order to prevent any further deepening of the country's financial collapse and to sustain essential social programs. Finance Minister Meirelles' proposal to link the cap on public expenditures to the previous year's inflation (as opposed to fiscal revenues) is a step in the right direction to curtail government expenditure and, as a result, to reverse the fast-growing trend of expensive public debt, already pushing 80 percent of GDP. A tight budget execution in the midst of significant demands for scarce resources represents a huge challenge for the administration. Clearly it is of paramount importance in order to

Continued on page 3

TODAY'S NEWS

POLITICAL

Fujimori Has Slight Lead Ahead of Peru Election

Keiko Fujimori, the daughter of jailed former President Alberto Fujimori, has a slight lead ahead of Pedro Pablo Kuczynski before Peru's presidential runoff Sunday.

Page 2

BUSINESS

Delta, United Continental Eyeing Avianca

The U.S. air carriers are considering a possible bid for the Panama-based airline holding company.

Page 3

POLITICAL

Venezuelan Gov't to Seek Support at Caribbean Summit

The embattled government of Venezuelan President Nicolás Maduro is expected to use this weekend's summit of the Association of Caribbean States to seek support, just days after OAS Secretary General Luis Almagro called for an emergency meeting of the organization that could lead to Venezuela's suspension.

Page 2

Maduro // File Photo: Venezuelan Government.

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POLITICAL NEWS

Venezuelan Gov't to Seek Support at Caribbean Summit

The embattled government of Venezuelan President Nicolás Maduro is expected to use this weekend's summit of Caribbean leaders to round up support amid intensifying opposition domestically and from abroad, Reuters reported. The gathering in Cuba of the Association of Caribbean States begins with a dinner today, Cuban President Raúl Castro's 85th birthday, with summit meetings taking place on Saturday. The summit comes just days after Organization of American States Secretary General Luis Almagro invoked the organization's Democratic Charter, calling for an emergency meeting this month of OAS member states to discuss what Almagro has said is a breakdown of democracy in Venezuela. The action could lead to Venezuela's suspension from the OAS. "Venezuela will denounce to the ACS the most recent aggression carried out by the general secretary of the OAS, Luis Almagro," said Alí Rodríguez, Venezuela's ambassador to Cuba, local media reported. Maduro's government is facing an effort by the country's political opposition to recall the president in addition to a shift elsewhere in the region from leftist governments to more conservative ones. On Thursday, Venezuelan electoral authorities postponed a meeting with opposition leaders at which they were supposed to have announced whether they would allow the recall referendum to go forward, BBC News reported. The opposition last month submitted petitions that they said contained 1.85 million signatures of Venezuelans favoring a recall vote, but the National Electoral Council has not yet ruled on whether the signatures are valid. This weekend's ACS summit will have talks about issues including trade, transportation, sustainable tourism and climate change on its agenda, Reuters reported. The organization said 17 heads of state will be attending. Among those not in attendance will be Colombian President Juan Manuel Santos, his government said. Santos' government has been in talks with the Revolutionary Armed Forces of Colombia, or FARC, rebels for three and a half years.

> **"Venezuela will denounce to the ACS the most recent aggression carried out by the general secretary of the OAS, Luis Almagro."**
>
> **— Alí Rodríguez**

Guatemalan Attorney General Orders Arrests in Graft Case

Guatemala's attorney general on Thursday accused former President Otto Pérez Molina of arranging hundreds of bribes in exchange for public contracts and ordered the arrests of some 50 people in connection with the case, Reuters reported. Investigators say a scheme to hide bribes netted at least $130 million and continued until Pérez Molina and his vice president, Roxana Baldetti, resigned amid a corruption scandal last year. They are currently jailed pending trial and deny wrongdoing.

ECONOMIC NEWS

OPEC Decides to Leave Oil Output Levels Unchanged

OPEC member states at their much-anticipated meeting on Thursday decided to not make any changes to their levels in oil production, citing the recent rise in prices and signs that the global oil glut may be easing, The New York Times reported. Markets were down in the wake of the news, with West Texas Intermedi-

NEWS BRIEFS

Fujimori Has Slight Lead Ahead of Peru Presidential Election Sunday

Peru will elect its next president on Sunday in a runoff election between imprisoned former President Alberto Fujimori's daughter, Keiko Fujimori, and former investment banker Pedro Pablo Kuczynski. Fujimori has a slight lead over her rival, aided by her tough stance on crime and populist-style campaign, similar to the style of her right-wing father, Reuters reported. The latest Ipsos poll shows that an estimated fifth of voters remain undecided.

Hedge Fund Files $1.6 Bn Claim Against Peru in Land Bonds Dispute

U.S.-based Gramercy Funds Management on Thursday filed a $1.6 billion arbitration claim against Peru's government, seeking payment on long-defaulted land bonds that the hedge fund bought a decade ago. In the claim, Gramercy said it disputed the way Peru's government calculated the bonds' value when it agreed to honor them in 2013, Reuters reported. In a statement, Peru's Finance Ministry called the filing Gramercy's "latest attempt to discredit Peru."

Mexicans to Select a Dozen Governors in Sunday Vote

Mexicans will go to the polls to elect a dozen governors on Sunday, The Wall Street Journal reported. Many of the states holding the elections are suffering from increases in poverty and income inequality, according to government data. State services, such as the police force, remain underpaid, and crime rates have increased, according to government-accountability nonprofits. Veracruz is receiving the most attention in the lead-up to the election, as President Enrique Peña Nieto's PRI party has governed that state since 1929, and a loss would be seen as a blow to the government.

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ate oil, a global benchmark, down to $48.14 a barrel from above $50 a barrel earlier. During the meeting, the group decided on a new secretary general, Mohammed Barkindo, a Nigerian oil official. "We chose a new secretary general

Barkindo // File Photo: OPEC.

— that's pretty good," Venezuelan oil minister Eulogio Del Pino said sarcastically. Venezuela has been one of the most vocal member states to push for a freeze of lowering of production levels. However, the new oil minister of Saudi Arabia—considered the de facto leader of OPEC—said Thursday that the cartel may need to rethink its approach to managing the global oil market. "I think managing in the traditional way that we tried in the past may never come again," said Khalid al-Falih.

BUSINESS NEWS

United Continental, Delta Eyeing Possible Bid for Avianca

Chicago-based airline holding company United Continental Holdings and Atlanta-based Delta Air Lines are among the companies considering bidding on Panama-based airline holding company Avianca, according to people familiar with the matter, as air carriers seek to increase their international presence, The Wall Street Journal reported Thursday. Advisors to Avianca, one of Latin America's largest airline companies, have distributed a document to potential bidders, seeking $500 million, one of the sources said, which could develop into a full sale. However, individuals close to the matter said there may be no deal at all, as the possibility of a capital injection is still in its early stages. Avianca owns its Colombian namesake and Tampa Cargo in the same country, as well as Ecuador's AeroGal. In 2010, Avianca merged with Grupo Taca, which owned airlines in El Salvador, Costa Rica, Peru, Nicaragua and Honduras. Avianca went public in 2011 and has a market value of approximately $600 million. A deal for Avianca would be the latest in a series of airline consolidations, which have picked up steam in recent years. In the United States, eight airlines have merged into four since 2008, which control more than 80 percent of domestic capacity. Latin America has seen mergers in recent years as well, including the joining of Chile's Lan and Brazil's Tam as well as Avianca and Taca. Avianca had a revenue of $4.7 billion in 2014.

FEATURED Q&A / Continued from page 1

restore the government's credibility and to gradually regain the confidence of investors and consumers. It will take strong leadership and management to ensure that expenditures follow a criteria of quality allocations, based upon well-defined priorities, along with measures to eliminate undue subsidies. Social programs will be maintained, especially in health and education, although it is anticipated that they will be subject to a close scrutiny to validate their correct destination toward the target low-income population. Middle-class consumer spending habits have been severely affected by skyrocketing unemployment rates—so far, over 11 million people without jobs—combined with high average indebtedness levels by household. It will take time to move away from the prevailing attitude of purchasing strictly 'essential items,' likely not until the country is able to come out of the existing depression. The pace of economic recovery will be a function of badly needed fiscal and structural reforms, starting with Congress' approval of realistic social security rules. Moreover, divestment of the government's unnecessary holdings through a market-oriented privatization program, along with public-private partnerships to stimulate the unlocking of long-overdue infrastructure projects, will represent critical and welcome sources to tackle the budget constraints and to generate new employment opportunities. The initial statements from the newly appointed economic team signal that it will be going in this direction. Let's hope that the political support from Congress will be there."

Marcos Vinicius Chiliatto Leite, counselor for Brazil and Suriname at the board of executive directors at the Inter-American Development Bank: "First of all, fiscal revenues in Brazil are highly pro-cyclical. Regardless of which political rhetoric one assumes, the recent deterioration of public finance is mostly related to the decline of economic activity, which contracts public revenues. Minister Barbosa assumed a realistic approach, requesting space to accommodate frustrations of revenues expectations. Interim Minister Meirelles proposes basically the same when revising the deficit again. The main difference is the non-consideration of the proposed new tax, the CPMF (tax on financial transactions). Other changes under Meirelles include more space for expenditures that might be related to political compromises, as well as the idea that expenditure must not increase more than inflation. The latter may affect medium- or long-term fiscal results, but clearly would deteriorate the anti-cyclical aspects of fiscal policy. In summary, there is no short-term

> **"The 'new middle class' is not a natural result of market growth, but rather of active policies...."**
> **— Marcos Vinicius Chiliatto Leite**

Continued on page 4

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FEATURED Q&A / Continued from page 3

fiscal adjustment proposed by Meirelles. There is an agenda (some would say, lacking ballot-box legitimacy) to reduce the welfare state built since the Constitution of 1988, and to reduce economic and social inclusion policies developed in the recent past. The 'new middle class' is not a natural result of market growth, but rather of active policies designed to assure that the country can have balanced growth with greater equality. One example is the creation of conditional cash transfer programs for poor and extremely poor families, particularly focused on women, such as Bolsa Família. Other policies, including housing policies for low-income families; a strengthened public, free and universal health care system; assurance that the exploitation of oil reserves is controlled by the state and its resources are allocated to education; and the systematic increase of the minimum wage have led to the growth of the middle class. The interim government today questions most of these actions, and that may harm social inclusion and the middle class. The fiscal challenges are not irrelevant, but the state must act to contain the cyclical downturn of the economy and needs to protect the most vulnerable. Making promises to deconstruct the economic and social inclusion policies in hopes of generating market optimism seems to be the wrong bet for the Brazilian reality."

Monica de Bolle, non-resident senior fellow at the Peterson Institute for International Economics: "Meirelles recently announced measures to curb spending, but contrary to what many had expected, the projected adjustment is more gradual and focused on the medium term. The most significant measure is the adoption of a ceiling on nominal expenditure growth—spending would not be allowed to rise above the past year's inflation rate. The aim is to gradually reduce Brazil's astounding spending ratio—some 39 percent of GDP. This figure is comparable to those seen in advanced economies. By setting the expenditure growth ceiling at the inflation rate of the previous year, the government protects some key social programs from inflationary erosion while maintaining budget flexibility. Moreover, the proposal aligns Brazil with current fiscal best practices, as shown in recent studies by the IMF. Such ceilings complement budget targets and induce greater fiscal prudence over the medium term. Bolsa Família, the key poverty-reduction program, would not be affected by this measure. However, social security benefits, and spending on health and education, would. This said, Brazil already spends over 5 percent of GDP on education, and some 7 percent of GDP on social security—levels seen only in rich nations. The issue is that much of this spending is inefficient. Hence, even with limits on expenditure growth, it is possible to enhance the efficiency of social programs, protecting the vulnerable middle class. Brazil's recession has taken a major toll on this segment of the population. Consumer spending per capita, a measure of household wellbeing, has reverted back to levels seen in 2011. Returning to previous spending habits will therefore require growth resumption, and a reversion of current labor market trends. At the moment, unemployment is still on the rise—11 percent as of April—due to falling GDP. To restore growth, reforms that allow for greater infrastructure as well as other investments are needed, and these will take time. It is my view that investment and consumer confidence will not return with vigor until the next elections, in 2018. Until then, the country and its people are likely to continue suffering from the toxic environment created by the political crisis."

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

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