LATIN AMERICA ADVISOR

A DAILY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

Monday, July 18, 2016

BOARD OF ADVISORS

Diego Arria
Director, Columbus Group

Devry Boughner Vorwerk
Senior Policy Advisor
Akin Gump Strauss Hauer & Feld, LLP

Joyce Chang
Global Head of Research,
JPMorgan Chase & Co.

W. Bowman Cutter
Former Partner,
E.M. Warburg Pincus

Dirk Donath
Senior Partner,
Catterton Aimara

Marlene Fernández
Corporate Vice President for
Government Relations,
Arcos Dorados

Peter Hakim
President Emeritus,
Inter-American Dialogue

Donna Hrinak
President, Boeing Latin America

Jon Huenemann
Vice President, U.S. & Int'l Affairs,
Philip Morris International

James R. Jones
Co-chair, Manatt Jones
Global Strategies LLC

Craig A. Kelly
Director, Americas International
Gov't Relations, Exxon Mobil

John Maisto
Director, U.S. Education
Finance Group

Nicolás Mariscal
Chairman,
Grupo Marhnos

Thomas F. McLarty III
Chairman,
McLarty Associates

Carlos Paz-Soldan
Partner,
DTB Associates, LLP

Beatrice Rangel
Director,
AMLA Consulting LLC

José Antonio Ríos
Chief Executive Officer,
Vadium Technology Inc.

Gustavo Roosen
Chairman of the Board,
Envases Venezolanos

Andrés Rozental
President, Rozental &
Asociados and Senior
Policy Advisor, Chatham House

Shelly Shetty
Head, Latin America
Sovereign Ratings, Fitch Inc.

Roberto Sifon-Arevalo
Managing Director, Americas
Sovereign & Public Finance Ratings,
Standard & Poor's

THEDIALOGUE

FEATURED Q&A

Is the Mexican Economy Headed for Tougher Times?

Mexico's central bank, led by Agustín Carstens, hiked its benchmark interest rate by a half percentage point on June 30, following the peso's fall in the wake of the United Kingdom's "Brexit" vote. // File Photo: Mexican Government.

Q Mexico's central bank on June 30 raised interest rates by 50 basis points, double what was expected, as a warning to currency speculators that the government will act to protect the peso, a move Wall Street economists called 'bold.' Mexico's currency has fallen 7 percent against the U.S. dollar this year and has come under increased pressure following the United Kingdom's vote last month to leave the European Union. Meanwhile, remittances sent home from abroad have been robust and are benefiting from the currency differential, and consumer credit flows have remained strong, according to government data released last month. Are Mexico's officials handling monetary policy appropriately? How has the outlook for the country's economy changed for this year and next, in light of recent developments? As the second half of the year gets underway, what factors and risks have become most worrisome for Mexico's economy?

A **Amy Glover, director at McLarty Associates:** "Mexico has handled monetary policy responsibly for the past 20 years, and the macroeconomic stability of the country is a major strength. Globally, there is a lot of uncertainty, and uncertainty means risk. Markets will remain jittery until the U.S. presidential election is decided and a clearer trajectory for the U.S. economy becomes apparent. Mexico is heavily dependent on the U.S. economy, which means the fortunes of both countries are inevitably linked. In the context of 'Brexit' and the economic downturn in China, however, being in North America is just about the best geographical location one could hope for. The structural reforms set in motion at the beginning of the

Continued on page 3

TODAY'S NEWS

POLITICAL

Peru's Kuczynski Names Cabinet

Peru's president-elect named his 19-member cabinet, which has several technocrats, but is light on experienced politicians.

Page 2

BUSINESS

SBM Offshore Signs Deal in Petrobras Case

Shares of the Dutch offshore oil and gas company jumped in early trading today after the company signed a deal to settle a case concerning its involvement in the Petrobras graft scheme.

Page 2

POLITICAL

Brazil to Boost Olympic Security in Wake of France Attack

Brazilian authorities said they would boost security measures at next month's Olympic Games in Rio de Janeiro in the wake of last week's deadly truck attack in France. Brazilian security official Sergio Etchegoyen said visitors to the Olympics will have to accept tougher security measures.

Page 2

Etchegoyen // File Photo: Brazilian Government.

COPYRIGHT © 2016, INTER-AMERICAN DIALOGUE

POLITICAL NEWS

Brazil to Boost Olympic Security After Attack in Nice

Brazilian officials said Friday that authorities will intensify security at next month's Olympic Games in Rio de Janeiro following last week's massacre in France that killed more than 80 people during a Bastille Day celebration, Reuters reported. Authorities in Brazil had already announced they would ban trucks in some parts of Rio in order to ease traffic congestion and improve authorities' ability to respond to emergencies. On Friday, after the attack in Nice, Brazilian officials said they would boost the number of security perimeters as well as install more roadblocks across the city and increase spot-checks of visitors. The measures were announced a day after Mohamed Lahouaiej-Bouhlel, a 31-year old Tunisian living in France, drove a 20-ton truck through a crowd in Nice, killing 84 people before he was shot dead by police officers. Brazil's minister of international security, Sergio Etchegoyen, said visitors to the Olympic Games will encounter longer lines and more inspections that "may mean sacrificing comfort for the sake of security," Reuters reported. Brazil's sports minister, Leonardo Picciani, told Reuters that the country will be ready to host the Olympics. "Brazil is confident about its preparations," said Picciani. "Personnel are ready, all the protocols have been followed and we are employing the most modern security and defense techniques." Brazil is deploying 85,000 police, soldiers and other security agents for the Games, twice the number that were used at the London Olympics in 2012, the wire service reported. Officials in the South American country have also been cooperating with foreign militaries and intelligence agencies. However, it was just two weeks ago that Brazil awarded a contract to a company for the hiring and training of several thousand private security guards to screen visitors at Olympic venues, The Wall Street Journal reported Sunday. The government awarded a contract on July 1 to Artel Recursos Humanos, a small outsourcing firm that does not have a major presence in the country's security industry, the newspaper reported citing documents. The company has little, if any, providing security screeners for very large-scale events, an unnamed source told The Wall Street Journal. The firm did not respond to the newspaper's requests for comment. Brazil's Secretariat for the Security of Large Events, which awarded the contract, said the company is qualified and expressed confidence that the security screeners would be in place for the beginning of the Games on Aug. 5. [Editor's note: See **Q&A** in the July 11 issue of the Latin America Advisor.]

Venezuela Again Opens Border With Colombia

For the second time this month, the Venezuelan government opened its border with Colombia over the weekend in order to allow Venezuelans to purchase food and medicine that is scarce at home, the Associated Press reported today. More than 120,000 Venezuelans crossed the border, some traveling by buses from cities 10 hours away in order to do so. The Colombian government said so many people had crossed the border to purchase products such as sugar and flour that authorities had to send for extra staple goods from other Colombian cities. Venezuelan citizens stood in line waiting to cross from Táchira to Cúcuta, with Venezuelan troops heavily patrolling the border. A few activists handed out anti-government pamphlets, though there were no significant confrontations between the government and its critics. A year ago, Venezuela closed the border between the two countries in a crackdown against speculators who had been purchasing subsidized Venezuelan goods and then crossing into Colombia to sell them at a marked-up price. However, Venezuela is now facing widespread shortages of basic goods, in addition to triple-digit inflation and a collapse in oil revenue, which has stifled government spending. The opposition blames the government's policies for the economic crisis, while President

NEWS BRIEFS

Peru's Kuczynski Unveils 19-Member Cabinet

Peruvian President-elect Pedro Pablo Kuczynski on Friday unveiled his 19-member cabinet: a group of technocrats that has few experienced politicians, Reuters reported. Among the new ministers are consultant Gonzalo Tamayo, who will become energy and mines minister, and academic Elsa Galarza as environment minister. Ricardo Luna, a former ambassador to the United States, was named as foreign minister. Kuczynski takes office on July 28.

Ecuador's Economy Shrinks 3 Percent in First Quarter

Ecuador's economy contracted by 3 percent in the first quarter of this year as compared to the same period a year earlier, the central bank said Friday, Reuters reported. The contraction was caused mostly by the contraction of the non-oil sector, the central bank said, though it provided no further details. The country's GDP shrank by 1.9 percent as compared to the fourth quarter of last year. The bank added that Ecuador's economy is at an "inflection point," which will allow it to recover in the coming months.

SBM Offshore Shares Jump Following Deal in Petrobras Case

Shares of Dutch offshore oil and gas company SBM Offshore increased by more than 10 percent at the start of trading on Monday, following the news that the company had reached a deal with Brazilian authorities over the company's involvement in the Petrobras corruption probe, Reuters reported. The company was able to sign a leniency deal on Friday with Brazil's federal prosecutors and state-run oil company Petrobras. In exchange for paying Petrobras $328.2 million, SBM will be immune from any further lawsuits in the case.

COPYRIGHT © 2016, INTER-AMERICAN DIALOGUE

FEATURED Q&A / Continued from page 1

Peña Nieto administration were visionary in scope and are fundamental to introducing greater flexibility into the economy. The continued implementation of the reforms will be critical to the long-term success of the economy and to a reduction in socio-economic inequality. Unfortunately, the lack of robust economic growth in recent years has diminished popular support for reform. Some tangible benefits have already been felt, such as lower telecommunications and industrial electricity prices, but it may take years to boost the rate of economic growth appreciably. Negative rhetoric coming from the presumptive Republican nominee in the United States has strengthened the hand of populist forces in Mexico that would prefer less global interaction, clouding the outlook for Mexico's own presidential election in 2018. Mexico deserves applause for being one of the most fervent free trade proponents in the world. While protectionism is on the rise in the United States and Europe, successive Mexican governments have understood that market opening and improving competitiveness is the way to go. The country has demonstrated leadership both in North America and in Latin America, via the Pacific Alliance. Mexico is one of the strongest economies in the region and will remain so if it continues on the path of ambitious political and economic reform."

Sergio Luna Martínez, director of research at Banamex: "We expected Banxico to hike 50 basis points, not on the back of currency depreciation in itself, but rather on the reading by policymakers of what that depreciation implies. As the eighth-most traded currency, the value of Mexican peso conveys a lot of information, not only on both local fundamentals, but also the state of the world economy. Let's start with the latter. The Brexit was an example of how global shocks affect emerging markets. It implies recessionary risks—thus suggesting looser monetary policy—but it also implies higher risk aversion, requiring more interest rate premiums. Unless you are a safe haven, you faced a trade-off. Banxico opted for the latter. In the second half of this year, these risks factors are unlikely to ease—an example is the U.S. election. As a gauge of global risk, the peso is thus set to remain weak. Banxico in this sense also acted preemptively. On the foreign exchange and local fundamentals, I think Mexico's central bank was equally clear. We need to aim for primary fiscal surpluses. The more we do on this front, the less we need to offer in extra interest rate premiums. In terms of the yield curve, it implies a flattening with the front end increasing while the long end compresses, which is essentially what has happened. I think this is a better indicator of the effectiveness of monetary policy than the level of the exchange rate."

> **"The Brexit was an example of how global shocks affect emerging markets."**
>
> **— Sergio Luna Martínez**

Jana Nelson, vice president for Mexico, Central America and Caribbean at Speyside Corporate Relations: "The Mexican peso is the most liquid emerging-market currency, at $135 billion traded daily. It is often used to hedge risk in other markets, which means that when the global economic outlook is negative, the peso suffers the most. The Mexican central bank has aggressively defended the currency with interest rate hikes and by culling the sale of reserves, an announcement made in February. The economic indicators released in recent weeks (year-on-year exports, manufacturing and non-manufacturing index and consumer

Continued on page 4

Nicolás Maduro's administration says it is the victim of an economic war, BBC News reported.

BUSINESS NEWS

Mexico Delays Planned Bidding on Telecom Network

Mexico has postponed the planned bidding process on a wholesale telecommunications network by more than a month, Reuters reported Saturday. The announcement marks the latest stalled project in the government's telecommunications reform, which has been beset with delays since its inception. Mexico's Communications and Transport Ministry said in a statement Friday that proposals for the auction must be submitted by Oct. 20, rather than the original Sept. 8 deadline. The ministry said potential bidders needed more time to secure funding for the project. The auction is part of the government's larger telecommunications reform, which is aimed at curbing the market dominance of Carlos Slim's América Móvil and at broadening Mexico's cell phone network. The winner of the auction will receive cheap use of high-quality spectrum in the 700MHz band, as well as a 20-year public-private partnership contract to engineer a 4G LTE mobile network that mobile operators and virtual network operators could then rent. The terms of the bid were originally announced in January. The bid's winner will now be announced by Nov. 17, and the successful bidder will need to sign a contract by Jan. 27 at the latest, the ministry said.

Slim // File Photo: Carlos Slim Foundation.

COPYRIGHT © 2016, INTER-AMERICAN DIALOGUE

FEATURED Q&A / Continued from page 3

spending) point to a further slowdown of the already sluggish economy, and suggests that economic weakness is greater than originally anticipated. Add to the equation a tighter monetary policy and a less lax fiscal policy, and a recession might be on the long-term horizon. On the other hand, especially as compared to the rest of Latin America, the Mexican economy and its outlook for the second half of the year is stable. The recent hike in the interest rate is unlikely to generate high inflation. The central bank's goal of 3 percent is still far from actual inflation at 2.2 percent. Unemployment is at 3.9 percent, the lowest since 2008, and very attractive to qualified human capital from abroad. The Mexican peso's roller coaster ride since early 2015 is being adroitly managed by the central bank. Yet, the main challenges to the Mexican economy, as a whole, still remain—loss in government revenue due to low oil prices; rent-seeking behavior in economic reforms; and high cost of doing business due to corruption and insecurity."

Jonathan Heath, independent Mexico City-based economist: "Two issues have become more pressing for the Mexican economy over the past year: a steadily increasing public debt-to-GDP ratio, in spite of recurring promises to the opposite, and a structural change in the country's balance of payments, leading to a higher and more vulnerable current account deficit. The first issue has forced the government to reduce public expenditures in order to cut the fiscal deficit by 0.5 percent of GDP in each of the last three years of this administration. The second has led to an accumulated increase of 45 percent in the exchange rate, but with no visible results in an increase in exports. This has caused the current account deficit to go from an average of 1.1 percent of GDP between 2000 and 2013 to an expected 3.2 percent (or higher) deficit this year, making the country susceptible to a sudden stop shock, at a time where the Federal Reserve has initiated a new cycle in its monetary policy. Mexico's central bank has responded with an accumulated 100 basis point increase in its monetary policy rate, aimed at assuring capital inflows. While expressing concern over future inflationary pressures, the real worry is in the forming balance of payments disequilibria. Both restrictive monetary and fiscal policy responses come, however, at a time when inflation is below target and the economy is decelerating rapidly. As a result, consensus forecasts for growth are being revised downward, and the probability of an ensuing recession has increased."

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

LATIN AMERICA ADVISOR
is published every business day by the Inter-American Dialogue, Copyright © 2016

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Nicole Wasson
Reporter, Assistant Editor
nwasson@thedialogue.org

Jen Wagman
Editorial Intern

THE DIALOGUE

Michael Shifter, President
Genaro Arriagada, Nonresident Senior Fellow
Sergio Bitar, Nonresident Senior Fellow
Joan Caivano, Director, Special Projects
Kevin Casas-Zamora, Director, Peter D. Bell Rule of Law Program
Ramón Espinasa, Nonresident Senior Fellow
Ariel Fiszbein, Director, Education Program
Alejandro Ganimian, Nonresident Fellow
Peter Hakim, President Emeritus
Claudio Loser, Senior Fellow
Nora Lustig, Nonresident Senior Fellow
Margaret Myers, Director, China and Latin America Program
Manuel Orozco, Director, Migration, Remittances & Development
Jeffrey Puryear, Senior Fellow
Tamar Solnik, Director, Finance & Administration
Lisa Viscidi, Director, Energy Program

Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at 1211 Connecticut Avenue NW, Suite 510 Washington, DC 20036

www.thedialogue.org

ISSN 2163-7962

Subscription inquiries are welcomed at freetrial@thedialogue.org

The opinions expressed by the members of the Board of Advisors and by guest commentators do not necessarily represent those of the publisher. The analysis is the sole view of each commentator and does not necessarily represent the views of their respective employers or firms. The information in this report has been obtained from reliable sources, but neither its accuracy and completeness, nor the opinions based thereon, are guaranteed. If you have any questions relating to the contents of this publication, contact the editorial offices of the Inter-American Dialogue. Contents of this report may not be reproduced, stored in a retrieval system, or transmitted without prior written permission from the publisher.