LATIN AMERICA ADVISOR

A DAILY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

Friday, April 14, 2017

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THEDIALOGUE

FEATURED Q&A

Are Big Profits or Troubles on Tap for Mexican Banks?

BBVA Chairman Francisco González expressed "enormous confidence" in Mexico as the bank announced a new investment in its BBVA Bancomer unit. // File Photo: BBVA.

Q Spain-based BBVA said last month that it will invest $1.5 billion in its BBVA Bancomer unit in Mexico over the next four to five years. After a meeting with Mexico's finance minister, BBVA Chairman Francisco González expressed "enormous confidence" in the country and in its business community. How healthy are Mexico's banks, and what are the major tailwinds and headwinds they face? What are the biggest effects that the policies of Mexican President Enrique Peña Nieto and U.S. President Donald Trump are having on Mexican financial institutions? How are consumer confidence levels and demand for loans holding up in Mexico?

A Alejandro Garcia Garcia, managing director and regional group head for Latin America Financial Institutions at Fitch Ratings: "Mexican banks are starting 2017 in very good financial shape, with sound capital adequacy metrics, ample liquidity, stable and good asset quality ratios as well as resilient and mildly improving recurring earnings. The medium- and long-term prospects are positive, since there are ample growth opportunities, given the still low level of financial intermediation. Also, indebtedness levels among households and businesses are reasonable and relatively lower than in other comparable emerging markets. Nonetheless, near-term headwinds and challenges are material and rapidly evolving. A more uncertain external environment, particularly driven by the potential shifts in U.S. policies toward Mexico, is exacerbating the risks and uncertainties for the Mexican economy's near-term prospects. Projections for GDP growth in 2017 and 2018 have been revised downward, while expected

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U.N. Votes to End Haiti Peacekeeping Mission

The Security Council voted unanimously to end the mission, known as MINUSTAH, after 13 years. Military personnel are to leave the country by October.

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ECONOMIC

Chile's Bachelet Unveils Pension Reform Bill

Chilean President Michelle Bachelet said the legislation would increase the size of public pensions. The current system has faced growing opposition.

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POLITICAL

Brazil's Temer Accused in Connection With $40 Mn Bribe

In plea-bargain testimony, a former Odebrecht executive accused Temer of taking part in a 2010 meeting to arrange a $40 million bribe for his party. The president denied the allegation.

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Temer // File Photo: Brazilian Government.

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POLITICAL NEWS

Brazil's Temer Accused of Being Involved With Bribe

A former executive of Brazilian construction conglomerate Odebrecht has accused President Michel Temer of taking part in a 2010 deal to arrange a $40 million bribe to his Brazilian Democratic Movement Party, or PMDB, The Wall Street Journal reported. Temer, who was president of the party and of the lower house of Congress at the time, denied the allegation, calling it a "lie." The accusation was made by Márcio Faria, a former industrial engineering chief of Odebrecht. In plea-bargain testimony released late Wednesday, he told authorities that he met with Temer in 2010 and agreed to pay the money to his party. The alleged bribe was equal to 5 percent of a contract that state oil company Petrobras' international division awarded to Odebrecht, Faria told authorities. Prosecutors have said that division of the state oil company was under the control of an appointee of the PMDB. Faria alleged in his testimony that a PMDB intermediary had requested the purported bribe and it was agreed upon before the meeting, which happened at Temer's law office in São Paulo. Also at the meeting were another Odebrecht executive, Rogério Araújo, as well as then-PMDB Congressmen Eduardo Cunha and Henrique Eduardo Alves, as well as the PMDB intermediary, The Wall Street Journal reported. During the meeting, Cunha said Odebrecht was seeking a contract with Petrobras and said that "there would be a very significant contribution to the party," if the company were to win it, Faria said in his testimony. When asked by a prosecutor whether the contribution was a bribe, Faria responded, "totally a bribe, sir, because it was a percentage of the contract," the newspaper reported. The PMDB did not respond to the newspaper's requests for comment. In a video statement, Temer acknowledged taking part in the 2010 meeting, but denied that there was any discussion of an illegal donation. "It is a lie in that meeting I heard any reference to money or any shady dealings between the company and politicians," he said, Reuters reported. Cunha later became the Chamber of Deputies speaker, but was expelled from Congress last year and in March was sentenced to 15 years in prison for his role in the scandal. The accusations against Temer were the most direct yet against the current president. During Temer's presidency, however, he has immunity from being prosecuted for any acts in which he was involved before he took office last year after the impeachment of his predecessor, Dilma Rousseff.

U.N. Votes to End Haiti Peacekeeping Mission

In a unanimous decision Thursday, the U.N. Security Council voted to end the United Nations' peacekeeping mission in Haiti in October, the Associated Press reported. The Security Council's action extended the mandate of the mission, known as MINUSTAH, for a final six months. By then, the United Nations' 2,370 military personnel are to leave Haiti. The action also created a follow-on mission, initially comprising 1,275 police who will be tasked with continuing to train Haiti's national police. That mission was created for an initial six months. The U.N. peacekeepers are credited with helping to stabilize Haiti after its 2004 coup and following its catastrophic 2010 earthquake that killed as many as 300,000 people. However, U.N. peacekeepers from Nepal were also blamed for starting a cholera outbreak that has killed at least 9,500 people in the impoverished country since 2010. Some U.N. troops also have been accused of sexual assault, including of young children, in Haiti.

U.N. peacekeepers have been credited with stabilizing Haiti, but also blamed for introducing cholera.

NEWS BRIEFS

Death Toll Rises to Five in Venezuela Protests

Violent clashes between anti-government protesters and Venezuelan pro-government forces have led to the fifth death in the past week on Thursday, The Wall Street Journal reported. Gruseny Calderón died from a gunshot wound he sustained from a pro-government follower during a protest on Tuesday in western Lara state, the state's governor's office said. Police and pro-government militias over the past week have shot and killed four more protesters, including a 13-year-old, according to the national public prosecutor's office and local authorities. [Editor's note: See **Q&A** on Venezuela in Wednesday's Advisor.]

Ecuadorean Election Officials to Recount 12 Percent of Vote

Ecuador's National Electoral Council, or CNE, said Thursday it will recount nearly 1.3 million ballots, or 12 percent of the vote, that correspond to "disputed tallies" from the April 2 run-off in the presidential election, Agence France-Presse reported. Left-wing candidate and former Vice President Lenín Moreno won in the run-off with 51.15 percent of the vote, or approximately 226,000 votes ahead of his right-wing opponent, Guillermo Lasso. Lasso has alleged that fraud took place in the election. He has refused to accept the results and is calling for a total recount.

Bank of America Taps Alcalay as New Brazil CEO

Bank of America Merrill Lynch has named Eduardo Alcalay as its new CEO for Brazil, Reuters reported Thursday, citing a bank statement. Alcalay is heading to Bank of America from GP Investimentos, where he is head of private equity. Alcalay will succeed Rodrigo Xavier, who is pursuing an "academic opportunity" at Stanford University, the bank said.

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inflation is trending upward, and business and consumer confidence have deteriorated. The near-term prospects for Mexican banks are highly sensitive to the economic environment, and this has been clearly worsening recently, with ample downside risks still on the horizon. Considering this

> **"Near-term headwinds and challenges are material and rapidly evolving."**
>
> **— Alejandro Garcia Garcia**

tougher environment, we expect loan growth to slow down materially in 2017, perhaps to the 6 to 8 percent nominal annual growth range. Asset quality is likely to worsen from the exceptionally sound metrics reported at year-end 2016, pressuring credit costs and overall profitability. Positively, wider margins on higher interest rates will likely offset the rising credit costs for major banks. Smaller banks and non-bank lenders with more concentrated business models and reliant on wholesale funding are more exposed to the worsening environment."

Felipe Carvallo, vice president and senior analyst for Latin America banking at Moody's Investors Service: "Although changes in U.S. trade policies could have a negative impact on the Mexican economy, especially on manufacturing and agricultural exports, we expect that banks' relatively low direct exposures to these sectors will help limit the damage to their balance sheets. The automotive industry would be the most vulnerable to any rise in tariffs that might result from a renegotiation, or elimination, of NAFTA, but it accounts for just 2 percent of commercial loans. Exposures to agriculture are slightly higher at 4 percent of commercial loans, but these are mainly short-term loans and benefit from different types of guarantees provided by government development agencies. While borrowers that depend on imported inputs or with significant foreign currency debt may face increased financial pressure as a result of the weaker peso, most of these are foreign-currency earners, and hence have a natural hedge. Moreover, foreign-currency loans account for a relatively limited 13 percent of total loans. Fully gauging the long-term credit impact any change in the U.S.-Mexico trade relationship will have on Mexican banks will require more clarity regarding U.S. policy plans. Despite declining consumer and investor confidence, banks are nevertheless maintaining plans to expand loan books at more than twice the pace of nominal GDP growth over the next year. The high level of uncertainly is likely to cause companies to delay investment decisions, which together with rising interest rates will likely lead to a slowdown in economic growth and in turn rising asset risks for banks. However, non-performing loans are at record low levels for the time being, and banks are well capitalized and highly profitable, notwithstanding high credit costs. Moreover, rate hikes will further boost margins at large lenders with inexpensive deposit funding. At the same time, earnings at small and mid-sized banks will decline, given their higher dependence on market funding, which will become more expensive as rates increase, potentially leading to consolidation pressures."

Nicolás Mariscal, member of the Advisor board and chairman of Grupo Marhnos in Mexico City: "Since last year, the Bank of Mexico has increased its reference rate from 3.25 percent to 6.25 percent, due to the depreciation of the peso and the rise in gasoline prices. While these measures will affect consumption levels, they will also strengthen the peso and promote investment. Regardless of the short-term challenges facing the country, Mexico is an attractive

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ECONOMIC NEWS

Chilean President Unveils Pension Reform Legislation

Chilean President Michelle Bachelet on Wednesday announced she was sending a bill for approval to Congress that would significantly increase the size of public pensions amid growing national criticism of the country's current pension system, Reuters reported. The bill would boost the amount of collectively held savings and would also include a new 5 percent payroll tax and an increase in retirement savings. All told, pensioners would see a 20 percent increase in savings, and workers currently paying into the system would see

Bachelet // File Photo: Chilean Government.

as much as a 50 percent increase. "We must advance toward a truly mixed social security system, where all play their part, where solidarity comes from personal effort, where the state and employers play their corresponding role," Bachelet said. Chile's pension system began in the 1980s under the Augusto Pinochet dictatorship, and the so-called "Chilean model" that emerged has been adopted in other countries around the world. The system has faced growing opposition in Chile, however, with Chileans regularly taking to the streets over what they say are low payouts and over the fact that pensions are managed by for-profit funds. It is unclear whether Bachelet's bill will pass in Congress, as her coalition is divided and parliamentary elections are set to take place in November, long before Congress is expected to be finished deliberating on such a bill.

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market for banking for several reasons: it has more than 120 million inhabitants, making it the world's 10th-most populous nation; it is also the 15th-largest economy and 11th in purchasing-power parity. In addition, the reforms approved during the current administration have been advancing in their implementation, and are strengthening the country's institutional framework. With regard to NAFTA, the benefits of this agreement have been supported by much statistical data that has come to light, demonstrating that the causes of unemployment in the United States are not mainly due to free trade. At first, there was talk of discarding the agreement, but now there is talk of renegotiating it. As Mexico prepares for the negotiation, it is working on ways to diversify its markets, and I trust that this process will serve to strengthen the country."

José Carlos Rodríguez Pueblita, senior director at ManattJones Global Strategies: "After the banking crisis experienced in the mid-1990s, Mexico implemented a series of measures that leapfrogged financial regulation in developed countries. Since then, Mexico's regulatory standards and strong banking sector have served as a reference point. It is no coincidence that the next general manager of the Bank for International Settlements will be Agustín Carstens, who is highly regarded for his work both as governor of Mexico's central bank and as a former secretary of finance. But the robustness of the financial sector has not come without a cost. Regulation is burdensome, bank competition is limited and service costs are high, all of which are reflected in low financial penetration. Moreover, Mexican banks are among the least-trusted private entities, according to a yearly survey performed by Mitofsky since 2004. There are, however, changes on the horizon that will shake up the financial sector. The renegotiation of NAFTA may expand market access by allowing U.S. and Canadian banks to open branches in Mexico and by making it easier to access money management services in the other member countries. In addition, the nascent fintech industry in Mexico could lead to disruptive changes. The expectation is that a regulatory network will emerge that is conducive to a healthy fintech environment of innovation with enhanced customer protections and security. The traditional banking system will have to decide to resist or adjust. BBVA, for example, has chosen to adjust to the changing landscape by investing in and incorporating new services into its product offerings."

> **"The nascent fintech industry in Mexico could lead to disruptive changes."**
> **— José Carlos Rodríguez Pueblita**

LATIN AMERICA ADVISOR
is published every business day by the Inter-American Dialogue, Copyright © 2017

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Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at
1155 15th Street NW, Suite 800
Washington, DC 20005

www.thedialogue.org

ISSN 2163-7962

Subscription inquiries are welcomed at
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