LATIN AMERICA ADVISOR

FINANCIAL SERVICES ADVISOR

A PUBLICATION OF THE DIALOGUE

www.thedialogue.org

July 26-August 8, 2018

FEATURED Q&A

What Can Brazil's Banks Expect After October's Election?

Brazil's Workers' Party on Aug. 5 selected Fernando Haddad, 55, to be its presidential backup option in case former President Luiz Inácio Lula da Silva is barred from standing for election in October. // Photo: Brazilian government.

Q **Brazil's Workers' Party will seek to raise the taxes banks must pay in order to force them to lower their margins and also charge consumers less if its candidate wins the country's October presidential election, former São Paulo Mayor Fernando Haddad said July 23. Also, presidential hopeful Ciro Gomes of the leftist Democratic Labor Party recently said he would oppose privatizing state-owned bank Caixa Econômica Federal. What is at stake for Brazil's banks and other financial services providers in this year's presidential election? What are the most significant changes the sector could see under the country's next president? Which candidates and proposals would be best, and which would be worst, for the health of the country's banks?**

A **Paulo Vieira da Cunha, partner at Verbank Consulting, LLC in New York:** "At the center of the electoral debate are security and fiscal policy. While some of the long-winded, basically useless and soon-to-be-forgotten party platforms mention aspects of banking and finance, these are not at center stage. Most likely, they will not matter at all in the campaign. However, banks do play a role in fiscal policy—especially, and critically, state-owned banks in policies for compulsory credit allocation. Together, these structures produce a banking system where nearly 50 percent of credit is allocated through public banks and/or public policy programs. When in power, the Workers' Party, or PT—notably during the administrations of Dilma Rousseff—used, enlarged and abused the actions of state banks BNDES and Caixa. These actions were part and parcel of the fiscal crisis that ensued in 2015. Not

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Hackers Post Card Numbers on Social Media in Chile

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Evertec Posts Stronger Second Quarter Growth

Puerto Rico-based transaction processing company Evertec said its second quarter revenues grew 10 percent to more than $113 million.

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REMITTANCES

Remittances Sent to Mexico in June Rise 23 Percent

Remittances sent home to Mexico from workers abroad reached $3.14 billion in June, a 23 percent increase. U.S. Rep. Ted Poe (R-Tex.) said during a hearing in July that the United States should consider charging a fee of 1 percent on remittances sent abroad.

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Poe // File Photo: Office of Rep. Ted Poe.

BANKING NEWS

Hackers Post Card Numbers on Social Media in Chile

Chile's bank regulatory agency has confirmed that a group called the Shadow Brokers, best known for hacking the National Security Agency in the United States in 2016, gained access to some 14,000 credit card numbers in Chile and published them on social media, Agence France-Press reported July 26. The banks affected by the attack, which included Santander, Itaú, Scotiabank and Banco de Chile, have scrambled to cancel the cards and notify clients of the intrusion. The government did not disclose the potential financial losses involved. In a Twitter post, individuals using the Shadow Brokers name said they conducted the attack in order to draw attention to three unnamed individuals held by authorities for hacking, El Dínamo reported

HSBC Sees Revenue Gains of 3.2 Percent in Latin America

Global financial services giant HSBC said Aug. 6 its Latin America revenue grew 3.2 percent in the first half of the year to $344 million. Lending in the region helped to offset narrower margins, especially in Mexico due to interest rate gains, the company said. Latin Americans had 22,678 customer accounts with the bank at the mid-year mark, down about a thousand accounts from the year-earlier period, with more than 17,000 of those in Mexico. HSBC remains heavily invested in Asia by comparison, which accounted for 49 percent of its revenue in the first half of the year, while Latin America contributed 5 percent. Overall, the bank posted a 4.5 percent increase in pre-tax profit for the first half, a higher figure than markets expected. In 2016, HSBC closed on a deal to sell its entire business in Brazil to local lender Banco Bradesco for $5.2 billion. Although HSBC said it took a $1.7 billion accounting loss on the sale, the company said the deal took a "significant step" toward its goal "to reduce complexity." The transaction was expected to decrease its risk-weighted assets by around $37 billion.

Santander Brazil Unit Beats Estimates for Second Quarter

The Brazilian unit of Spain's Banco Santander on July 26 beat estimates by reporting second-quarter recurring net income of 3.03 billion reais ($807.23 million), 30 percent higher than the same period last year. The figure was also 14 percent higher than a consensus estimate by Reuters of 2.65 billion reais. The Brazilian unit's loan book also grew 4 percent in the second quarter, to 368.2 billion reais. Earlier this year, Santander Brasil's chief executive officer, Sergio Rial, said he was pushing for double-digit expansion of the bank's loan book, Reuters reported. The bank said it also maintained its asset quality, and its 90-day default ratio declined by 0.1 percentage point, to 2.8 percent, in the second quarter. The bank also reported higher return on equity, and it posted a profitability of 19.5 percent in the April-through-June period, 0.4 percentage point higher than in the second quarter last year. Santander Brasil said it gained two million clients in the 12-month period through June, reaching 22.7 million. More clients also helped the bank to increase its fee revenue to 4.28 billion reais, a 12.7 percent increase from the same period last year. Despite the Brazil unit's strong performance, Spain-based Santander as a whole reported a 3 percent decrease in its net income for the second quarter due to one-time integration costs related to Banco Popular. The bank's Brazil unit was the largest contributor to Santander's earnings, at 26 percent, followed by Spain at 15 percent and Britain at 14 percent, the bank said. "During the quarter, we have seen particularly strong growth in Brazil, Spain, Mexico and the U.S. and this has more than offset a more challenging environment in other markets," said Santander's executive chairman, Ana Botín.

NEWS BRIEFS

Brazil Increases Mortgage Financing Threshold

Brazilian regulators on July 31 took steps that could make an additional $20 billion in funds available to finance homes in the country, Reuters reported. The government's National Monetary Council, CMN, raised the price threshold of homes eligible to be financed by a worker severance fund to 1.5 million reais ($400,000). "The new threshold will allow companies to sell current inventory, easing new launches," said Luiz Antonio França, head of Abrainc, an association of homebuilders.

Evertec Posts Stronger Q2 Revenue Growth

Puerto Rico-based transaction processing company Evertec said July 31 its second quarter revenues grew 10 percent to more than $113 million. The company also increased its 2018 revenue forecast and market guidance. The quarterly growth reflected the impact of its acquisition of Chile-based PayGroup a year ago, as well as elevated sales volumes in Puerto Rico driven by post-hurricane relief benefit programs and insurance proceeds, the company said. Evertec manages a system of payment networks that processes more than two billion transactions annually in Latin America.

First Data Sees Stronger Results in Latin America

New York-based card processor First Data on July 30 reported better-than-expected earnings and revenue for its second quarter, MarketWatch reported. The company posted net income of $341 million in the quarter, up from $185 million in the year-earlier period. In Latin America, revenue in First Data's Global Business Solutions segment was $85 million, up 32 percent, driven by strong growth in Brazil and Argentina. In its Global Financial Solutions segment, Latin America revenue was $36 million, up 6 percent versus the prior year.

INSURANCE NEWS

Itaú Unibanco Sees Improved Results From Insurance Unit

Brazilian financial services group Itaú Unibanco said July 30 that its insurance business helped boost net income to 12.8 billion reais ($3.44 billion) in the first half of 2018, up 3.7 percent from the same period of 2017. Insurance and services net income accounted for 56 percent of that total, the company said. Commissions, fees and profits from insurance operations were up 8.2 percent when compared to the first half of 2017. Chief executive Candido Bracher said that during the second quarter, the company implemented an open platform for its insurance operations and started to offer products from other insurance companies, which should further strengthen insurance results in the future.

Argo Group Names Moreno to New Latin America Role

Bermuda-based specialty insurer Argo Group Holdings on July 25 appointed Manuel Moreno to the newly created role of chief underwriting officer of Latin America. A former executive with Willis Towers Watson, Moreno will be responsible for the strategy and execution of all underwriting operations in the Latin America market. He will report to Jorge Cazar, Argo Group's head of Latin America. Cazar took over that job a year ago and opened a Miami office focusing on the company's Latin America expansion last November. Moreno has also served as vice president of energy and engineered risk for AIG's Latin American operations, among other roles at the company. The global specialty insurance market was valued at $220 million in 2017 and is expected to reach $290 million by the end of 2023, according to a report released last year by Orian Research.

REMITTANCES NEWS

Remittances Sent Home to Mexico Rise 23 Percent in June

Remittances sent home to Mexico from workers abroad reached $3.14 billion in June, according to preliminary estimates from the central bank released Aug. 1. The figure is a 23 percent increase over the same month last year and exceeded economists' expectations, according to Goldman Sachs analyst Alberto Ramos. Given a 10 percent depreciation of the Mexican peso over the last year, remittances grew 37.4 percent year-over-year in June when measured in local currency terms, Ramos told clients in a research note. In May and April, remittances also exceeded expectations by a large margin. In related news, U.S. Rep. Ted Poe (R-Tex.) said during a House Foreign Affairs Committee hearing in July that the United States should "charge a fee" to immigrants who work in the United States and send money back to their home countries. "Shouldn't the United States charge a fee, one percent, for these transactions to occur?" Poe posited, The Washington Examiner reported. "Specifically foreign workers in the U.S. sending money back to Mexico and any other country where those remittances go each year so that part of that income generated in the United States stays in the United States, so that the taxpayers don't have to pick up the difference of that $138 billion, with a small fee." Poe derived those figures from a recent Pew Research Center study on global remittances, according to the report. The study estimates that workers sent $28 billion in remittances from the United States to Mexico in 2016.

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surprisingly, the Temer administration did much to redress them. A much needed, long debated and courageous reform was implemented—a legislative change that eliminates all forms of subsidized lending by any public agency and/or program, unless it is explicitly recognized in the budget. The left (including PT and PDT) could and most likely will try to resuscitate public banks, introducing new distortions and waste, as was the PT's policy of 'national champions,' which produced such pearls as Eike Batista's imploding EBX group, the food conglomerate JBS and the construction megastructure Odebrecht, which are under restructuring and at the core of the 'Lava Jato' scandal. The problem for all this would be the fiscal cost—and the fiscal situation in the years ahead is dire. All major candidates recognize it. For this reason, some form of social security reform being implemented in 2019 is quite likely, regardless of who wins. Likewise, given a very 'centrist' Congress, privatization of BNDES and/or Caixa is not in the cards. Regarding the banks, and the financial system at large, the most imminent danger is that, in search of revenues, some desperate minister of finance may attempt to reintroduce the CPMF, the maligned fiscal-transactions tax in effect from 1993 to 2007."

A **Lindsay Lehr, senior director, and Cesar Boralli, consultant, both at Americas Market Intelligence:** "Adjusted fiscal policy and reforms will become extremely necessary in Brazil after 2019. Debt to GDP is already surpassing 80 percent and therefore any misstep or even lack of reform could lead to another devastating economic crisis. Lower inflation and interest rates are also not sustainable without the expected reforms. When looking at the top-ranked candidates according to recent polls, we can draw three potential scenarios that might occur as a result of the elections. In the best-case scenario, the new president would continue to work on the reform agenda, focusing on pension reform. GDP would grow, with help from controlled inflation. Interest rates would be kept low with the real around 3.30 to the U.S. dollar. Banks and financial

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ECONOMIC NEWS

Mexico Consumer Confidence Makes Surprise Comeback

Mexico's consumer confidence index in July rose by the most on record, the national statistics agency said Aug. 3, Reuters reported. The consumer confidence index jumped 15 percent to 101.7 in July when adjusted for seasonal factors, the highest level since 2008 and the biggest percentage gain on record in data going back to 2001. The "very large and unexpected" spike in consumer confidence is "hard to square" with recent macroeconomic data, Goldman Sachs analyst Alberto Ramos told clients in a research note. Wire reports attributed the significant increase in sentiment indicators to the outcome of the July 1 elections and the landslide victory by Andrés Manuel López Obrador. Another factor could be workers' remittances sent home from abroad, which reached a higher than expected $3.14 billion in June, a 23 percent increase year-over-year. In May and April, remittances also exceeded expectations by a large margin, putting cash into the pockets of primarily low-income Mexican consumers who have a propensity to buy consumer goods. The U.S. economy has grown strongly in recent quarters, providing jobs in industries employing migrants.

Nearly Half of Brazil Agencies Pay Extra Salaries: Audit

Internal auditors in Brazil found that 44 percent of the federal government's agencies spend nearly $200 million each year combined on improper payroll costs, Folha de S.Paulo reported Aug. 6. The audit by Brazil's Federal General Accounting Office found that all three of the main branches of government made irregular payments to a combined 12,658 employees. More than 4,000 cases are under investigation. The report identified 21 different

ADVISOR Q&A

What Will It Take for Latin American Economies to Grow Faster?

Q In the latest update to its World Economic Outlook, released in July, the International Monetary Fund lowered its economic growth forecast for Latin America to 1.6 percent this year. The IMF had forecast 2 percent growth this year for the region in its April report. The IMF cited factors including strikes and political tensions in Brazil, trade tensions hindering Mexico and tighter financial conditions in Argentina among the reasons for the lowered expectations for growth. Will economic conditions in the region continue worsening this year, or will there be a turnaround? What are the biggest threats to Latin America's economic growth in the second half of this year? Which factors provide the most hope for a pickup?

A Alicia Bárcena, executive secretary of the United Nations Economic Commission for Latin America and the Caribbean: "The region has seen sustained GDP growth, which will continue in 2018 for a second consecutive year after contracting in 2015 and 2016. Internal aggregate demand in the region has bounced back, in light of an increase in private consumption and the recovery of investment owing to improved external conditions, especially in the terms of trade. However, various factors have led us to lower our forecasts published in April. The uncertainty generated by the 'trade war' and the revision of major trade agreements such as NAFTA and the Pacific Alliance suggest that external stimuli could negatively affect the region's growth in the future. Additionally, the increase in energy prices and the possible inflationary pressures that may result could push up domestic interest rates, therefore restricting the potential growth effects of credit for consumption and investment. Persistent imbalances in some economies have diminished their capacity to invest, thus stifling potential growth. The process of fiscal consolidation adopted in some countries implies a lower fiscal impulse than initially estimated. In short, there are several reasons why we have revised our growth forecasts for the region downward, but we are confident that it will continue growing, albeit at low rates."

A Barbara Kotschwar, senior private sector specialist at the World Bank: "Latin America came into 2018 with an economic bounce; by mid-year, however, the growth spurt has lost steam, as reflected in the downward revisions of the growth numbers. Although higher commodity prices may boost growth prospects for countries such as Chile and Colombia, the factors that led to the downward growth revisions—tighter financial conditions, weaker currencies, market stress in the large South American countries, political turmoil and a truckers' strike in Brazil—will continue to influence growth prospects for the rest of the year. Stable elections in Colombia and Mexico mitigate the political risk somewhat, but the region's outlook continues to be subject to headwinds from rising global protectionism and, particularly for Mexico, the uncertain outcome of NAFTA renegotiations. Effects of recent U.S. tariff policies, if sustained, should begin to be felt in the second half of this year, and would temper the second quarter's uptick in Latin American economies..."

EDITOR'S NOTE: More commentary on this topic appears in the July 27 issue of the Latin America Advisor.

NEWS BRIEFS

Lower Inflation in Jamaica Triggers IMF Consult

A sharp drop in Jamaican domestic food prices has led to lower-than-expected inflation and automatically triggered a consultation with the International Monetary Fund, the Jamaica Gleaner reported Aug. 4. The Bank of Jamaica said factors such as better weather, oil price considerations and foreign exchange rate changes were behind the unexpected consumer price drop. The next IMF mission is slated to visit Jamaica in September. The Jamaican dollar has slid in value this year, trading at a new record of 135.44 per U.S. dollar on July 31.

Mexico Offers U.S. New Rules of Origin Proposal

Mexican Economy Minister Ildefonso Guajardo said Aug. 6 his negotiating team has put forward a proposal to update the North American Free Trade Agreement's "rules of origin" clauses, a sticking point in talks with the United States the two countries hoped to wrap up this month, Reuters reported. The rules would establish new levels for what percentage of a car needs to be built in the NAFTA region to avoid tariffs. Guajardo also said that Canada might join Mexico and the United States for the NAFTA talks soon.

Lula Wins Party Backing With Haddad as 'Plan B'

Brazil's once-dominant Workers' Party on Aug. 4 named imprisoned former Brazilian President Luiz Inácio Lula da Silva as its candidate to run for president again in October's elections, Folha de S.Paulo reported. Lula, who has been jailed on bribery charges, leads most opinion polls, but courts are likely to block his candidacy. On Sunday, the party named former São Paulo Mayor Fernando Haddad, 55, as Lula's running mate on the slate, placing the left-leaning politician as the party's 'Plan B' candidate if Lula is not allowed to run.

kinds of problems, ranging from payments for pensioners already deceased, employees receiving disability payments who have kept their employment, people who kept two government jobs in situations where this was not allowed, and employees who kept jobs in the private sector while concurrently working for the government. Last March, when the audit took place, Brazil had a monthly payroll of around $6 billion. A separate auditing unit in Brazil disclosed this week that a government program aimed at helping low-income citizens paid about $1.4 billion to people who should not to have received benefits. The government acknowledges that nearly a third of the program's benefits are paid improperly, but cited a recent Supreme Court decision that changed the formula used to determine benefits. Because it has been "too complicated" to delete some individuals from the program, the benefit is still being paid to 151,000 people, according to the report. Brazil has been trying to pull out of its deepest recession on record, as many families in Brazil's "fragile middle class," boosted by the commodities boom of the past decade, have struggled to remain out of poverty. Inflation in Brazil likely slowed in July for the first time in two months, a recent Reuters poll showed, suggesting high unemployment and idle capacity have kept a lid on underlying price pressures.

POLITICAL NEWS

Venezuela Arrests Six in Alleged Drone Attack on Maduro

Six people have been arrested after an apparent attempt to assassinate President Nicolás Maduro during an Aug. 4 speech in Caracas, Interior Minister Néstor Reverol said on local television, CNN reported. One of the detained had an outstanding arrest warrant for his alleged role in the August 2017 attack on a military base in Valencia, and another was previously arrested during the 2014 anti-government protests. Two drones armed with powerful explosives detonated, one losing control and falling into an apartment building and the other, perhaps disrupted by authorities, also exploded some distance away from Maduro, according to Reverol. When it became apparent the explosion was an attack, troops assembled on the parade ground scattered. Several were injured. Initial media reports after the incident, which was broadcast live on television, suggested the loud boom echoing through the streets may not have been assassination attempts at all, rather possibly a gas generator explosion at a nearby building. Authorities now say they have

Maduro // Photo: @NicolasMaduro via Twitter.

identified the drones and types of explosives used, however. Maduro immediately blamed Venezuelan nationals living in Miami for financing the operation and also accused Colombia's outgoing president, Juan Manuel Santos, with being behind the plot. Both countries denied those charges. "I can say unequivocally there was no U.S. government involvement in this at all," John Bolton, President Donald Trump's national security adviser, told Fox News. Colombia also rejected Maduro's accusation, Agence France-Presse reported. "It is absurd and unfounded to say that the Colombian president is responsible for the supposed assassination attempt on the Venezuelan president," the foreign ministry said in a statement. Countries around the world condemned the attack. Spain's foreign ministry in a statement rejected "all kinds of violence used for political ends" and called for a peaceful, democratic resolution to the "serious crisis" in Venezuela. Attorney General Tarek William Saab said the attempted assassination targeted not only Maduro, but also the military's entire high command on stage with the president at the time, the Associated Press reported. "We are in the midst of a wave of civil war in Venezuela," Saab said.

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institutions would benefit from increasing liquidity and growing lending across the retail and corporate sector. And, with better capital ratios, private-sector banks would gain market share from public-sector banks. Geraldo Alckmin is the most likely candidate to generate such a situation. In a neutral situation, we would expect the new president to continue some of the reforms underway, while holding a weak majority in Congress. GDP would grow at a low rate, inflation would be around its target, with interest rates slightly higher than today's and the real at the current level (3.70). Banks would not be threatened by this scenario but it could mean flat growth, especially on the corporate side, as lending would tend to decline. Jair Bolsonaro would be the president under this assumption. Negative impact on the banking sector would result from a government opposed to reforms and against privatization. Banks would need to be selective in terms of credit offering, as the sector would experience increased delinquency rates. Small- and mid-size banks would be hurt more than larger financial institutions under this scenario. Ciro Gomes would be the president elected in such a scenario."

A **Cynthia Cohen Freue, director and sector lead for financial institutions ratings at S&P Global:** "At this stage, it is unclear who the candidates are and what their proposals are. We consider that the Brazilian financial system is exposed to the risk that a new administration could attempt to use government-owned banks to boost economic growth, as seen in previous administrations since 2007, when their market share grew significantly from just above 30 percent prior to 2007 to 53 percent in May. However, we consider this could be difficult given their capital restrictions. Government-owned banks could also be impaired by the following: loosening underwriting practices; renegotiating loans; reverting measures taken by the current government that strengthened the independence of the board of government-owned entities; or promoting certain sectors of the economy through lower interest rates. All these measures further distort the system, in our view. Conversely, if privatization is included in the agenda, and performed in an orderly and transparent manner, while promoting competition and reducing distortions, it could have positive implications for the financial system's health. On the other hand, the largest commercial banks in Brazil have shown significant resilience during the latest downturn. They have maintained resistant operating performance even during the worst times of the cycle, thanks to their healthy net interest margins, strong pricing power and business diversification. Although the tax burden on Brazilian banks is relatively high when compared to other financial systems, a new administration could be tempted to raise taxes in order to increase their contribution to society. This in turn could have a negative effect on the financial system, as banks will likely transfer these higher costs to the ultimate borrowers, increasing the cost of credit for the country as a whole. Finally, the financial system would benefit from an administration that promotes healthy competition among financial institutions, while improving business and investor confidence and achieving sustainable economic growth."

> **"The largest commercial banks in Brazil have shown significant resilience during the latest downturn."**
> — Cynthia Cohen Freue

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

FINANCIAL SERVICES ADVISOR
is published biweekly by the
Inter-American Dialogue, Copyright © 2018

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Financial Services Advisor is published biweekly, with the exception of major holidays, by the Inter-American Dialogue at
1155 15th Street NW, Suite 800
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www.thedialogue.org
ISSN 2163-7962
Subscription inquiries are welcomed at
freetrial@thedialogue.org