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FEATURED Q&A

Will the Pandemic Speed the Region's Adoption of Fintech?

Stay-at-home orders have led consumers in Latin America to turn to technology for conducting financial transactions. // Image: Priscilla Du Preez via Unsplash.

Q As residents of countries throughout Latin America and the Caribbean stay home due to quarantine orders designed to slow the spread of Covid-19, more consumers are turning to technology to conduct financial transactions. In one case, Argentine mobile payments start-up Ualá saw a 20 percent jump in its issuance of prepaid cards since the country's lockdown began. To what extent will stay-at-home orders across the region accelerate the adoption of fintech? Will the pandemic significantly change the way most residents of the region conduct financial transactions? Do traditional banks need to change how they do business in order not to be left behind?

A **Lindsay Lehr, senior director at Americas Market Intelligence in Oakland, Calif.:** "Adoption of digital payments has lagged in Latin America because cash payments have always been the preferred payment method of a large segment of the population, and because they are always available. However, under quarantine, in many cases the option to pay in cash has been taken away. As Latin Americans are forced to stay home, buying online is the only way to shop, and more Latin Americans than ever are wanting to participate in the digital economy to keep themselves busy during this time; video streaming, online gaming, video conferencing and use of social media skyrocketed during March and April. This increased demand for digital goods and e-commerce is driving the underbanked to use a digital payment method for the first time. If these payment methods provide sufficient value and convenience, this habit is likely to stick in the long run. Governments are also playing a part. The Brazilian government has made

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BANKING

Banco Santander Sees 82% Plunge in Profit, Increases in Americas Units

Spain-based Banco Santander said its overall profit declined 82 percent in the first quarter. However, profit rises in units including Mexico and Brazil helped offset losses due to higher provisions.

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REMITTANCES

Mexicans Abroad Send Record $4 Bn Home in March

Mexico received $4 billion remittances in March, a record level that beat analysts' expectations.

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BANKING

Brazilian Banks May Need $13 Bn to Face Provisions

Brazilian banks may need as much as 70 billion reais ($13 billion) in additional capital to face higher loan-loss provisions due to the Covid-19 pandemic, according to stress tests conducted by the central bank, which Roberto Campos Neto heads.

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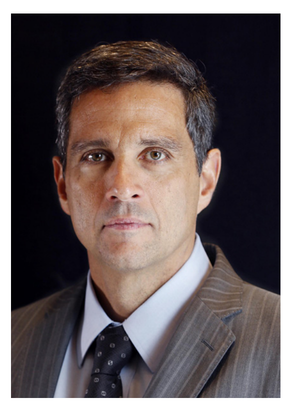

Campos Neto // File Photo: Brazilian Central Bank.

BANKING NEWS

Brazilian Banks May Need $13 Billion to Face Loss Provisions

Brazilian banks may need as much as 70 billion reais ($13 billion) in additional capital to face higher loan-loss provisions due to the coronavirus pandemic, according to stress tests conducted by the country's central bank, Reuters reported April 29. The worst-case scenario was contained in a financial stability report that the central bank compiled. The amount that the banks could need amounts to approximately 7.2 percent of their total capital. Brazil's banks also may need up to three years to return to previous levels of profitability and capital, the report said, adding that court and legislative decisions to suspend credit payments present another risk factor for banks. Factoring in the types of companies likely to experience the greatest losses due to the pandemic, in addition to losses incurred by their employees and suppliers, the report says banks' loan-loss provisions could reach 395 billion reais. Among the companies expected to be hardest-hit are ones in the power, transportation, manufacturing, retail and services sectors, according to the report. The pandemic could push up defaults by consumers and small businesses past their peaks from 2016 and 2017, respectively, the central bank said. It added that recent government measures to provide aid to banks, companies and consumers will alleviate some pressure on the country's financial system. [Editor's note: See related **Q&A** in the March 26-April 8 issue of the Financial Services Advisor.]

Santander Reports 82% Plunge in Profit, Mexico Unit Sees Rise

Spain's Banco Santander on April 28 reported an attributable profit of 331 million euros ($360.9 million) for the first quarter, a drop of 82 percent as compared to the same quarter a year earlier. The bank said the decline came after it incurred a net charge of 1.46 billion euros, mainly due to overlay provisions of more than 1.6 billion euros because of the coronavirus pandemic. The bank said profit growth in most of its markets in the Americas and growth in consumer volumes helped it achieve a 1 percent year-on-year increase in underlying attributable profit in the first quarter, to 1.98 billion euros. The figure increased 8 percent year-on-year on a constant currency basis, the bank said. In the Americas, Santander's loans and funds increased by about 15 percent, though growth was slower in Europe. "Santander's unique geographic diversification and scale continued to support greater stability and predictability in the bank's earnings in the quarter," with Europe contributing 41 percent of the bank's earnings, South America contributing 38 percent and North America contributing 21 percent, the bank said. Santander's operation in Brazil continues to represent the largest proportion of the group's underlying profit, contributing 29 percent, Santander added. Its Mexico unit contributed 10 percent of Santander's profit in the first quarter. In Mexico, Santander's profit increased by 22 percent to 249 million euros "driven by solid growth in income and the increase in ownership following successful acquisition of 16.7 percent of Santander Mexico's minority interests," the bank said. In the bank's Mexico unit, loans increased 13 percent, while consumer funds rose 10 percent. The unit's digital customers also grew 38 percent year-on-year, to 4.45 million. In South America, Santander's underlying profit amounted to 928 million euros in the first quarter, an increase of 15 percent year-on-year. Total income from the bank's units on the continent increased 8 percent "with the bank continuing to capture business opportunities, synergies and improving integration across the different countries in the region in payments methods, auto financing, consumer finance and microfinance," Santander said. The bank's Brazil unit had 694 million euros in underlying profit in the quarter, an increase of 10 percent, which was driven by lower costs and provisions. Santander Brasil's number of digital consumers increased 13 percent in the first quarter to 13.8 million, and

NEWS BRIEFS

A.M. Best Revises Outlook for Bolivia's Insurance Industry to Negative

U.S.-based credit ratings agency A.M. Best has revised its outlook for Bolivia's insurance industry to negative, Commercial Risk reported April 24. A.M. Best previously had a stable outlook for Bolivia's insurance sector, the publication reported. At the same time, A.M. Best maintained its negative outlook for Argentina's insurance industry. Both decisions were largely due to the coronavirus pandemic, the ratings agency said.

Bradesco Posts $693 Mn in Q1 Recurring Profit, Misses Analysts' Estimates

Brazilian lender Banco Bradesco posted recurring net income, excluding one-off items, of 3.75 billion reais ($693 million) for the first quarter, Reuters reported April 30. The bank's profit was down nearly 40 percent from the same quarter last year and below a Refinitiv estimate of 5.98 billion reais. Bradesco added that it is setting aside 2.7 billion reais to cover expected loan losses caused by the coronavirus pandemic. Bradesco's loan-loss provisions soared 86 percent from a year ago to 6.71 billion reais in expectation of higher loan delinquencies by consumers and companies struggling with the fallout of the health crisis.

Brazil Bank Lending Spreads Hit Narrowest Level Since Late 2018

Brazil's bank lending spreads in March hit their narrowest level since the end of 2018, the central bank said April 28, Reuters reported. In March, lending spreads narrowed to 27.5 percentage points, a decrease from 28.9 percent in February. Also in March, Brazilian banks' 90-default ratio remained unchanged as compared to the month before, at 3.8 percent.

operating expenses at the unit decreased 2 percent in real terms. In Chile, Santander had 125 million euros in profit for the first quarter, a 2 percent decline year-on-year. In Argentina, the bank had underlying profit of 59 million euros, a 745 percent increase year-on-year "thanks to the greater net interest income, efficiency improvements and a strong decrease in provisions," the bank said. Elsewhere in South America, profit grew 14 percent in Uruguay to 35 million euros, profit in Peru grew 33 percent, to 12 million euros, and in Colombia, profit more than tripled, to 6 million euros.

REMITTANCES NEWS

Mexicans Abroad Send Home Record $4 Bn in March

Mexico received a record $4 billion in remittances in March, a far greater amount than expected following shutdowns of restaurants and other businesses in the United States in an effort to slow the spread of Covid-19, Mexico's central bank said May 4, The Wall Street Journal reported. Remittances from Mexicans living abroad rose 36 percent in March as compared to the same month last year, and they rose 18 percent in the first quarter, year-on-year, to $9.3 billion. "The significant acceleration of remittances in March is difficult to square with labor market conditions and sentiment in the U.S.," Goldman Sachs' chief economist for Latin America, Alberto Ramos, said in a note. "We speculate that perhaps fearing a significant deterioration of the employment and income

"The significant acceleration of remittances in March is difficult to square with labor market conditions and sentiment in the U.S."

— Alberto Ramos

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headlines with its 'coronavoucher,' a subsidy of 600 reais paid out to informal workers and self-employed people. To receive the voucher, it is obligatory to download an app that state-owned bank Caixa Econômica Federal created for this purpose and receive the funds in a digital account. Withdrawing the funds in cash at an ATM is possible but restricted, while recipients are encouraged to use the funds to pay bills online, make peer-to-peer payments and other digital payments. Inevitably, a large portion of these recipients—the most under-digitized—will revert back to cash once business is open as usual. However, this program is exposing them to digital payments that could become a habit in the medium and long terms. Certainly, at this time, banks that can offer instant and digital account opening and rapidly deploy a debit card (physical or virtual)—a capability much more prevalent among neobanks than traditional banks—will take advantage of this trend."

A **Kai Schmitz, partner at Crestone Venture Capital and board member of Colombia-based fintech start-ups Movii and Minka:** "Stay-at-home orders have increased demand for a range of digital services, from digital media to food delivery. Most of these services are only available to those who can pay electronically. However, Latin America lags not just developed markets but also other emerging regions such as Asia in usage of electronic payments. Payment cards and digital wallets are still rarely used in the region (with the exception of high card penetration in Brazil). Infrastructure for electronic payments and real-time payment systems are fragmented and underdeveloped. Over the past few years, several digital issuers of electronic payment instruments and systems have sprung up in the region and are fortunately now able to fulfill the need. Government aid distribution has become another critical use case for electronic payment systems. As governments have stepped in to aid citizens during the pandemic, the lack of efficient payment distribution capabilities in particular to the low-income population has become a hurdle to get the money to people most in need. Fintech companies have stepped up here, too. In Colombia, banks are building a new real-time payment system using the infrastructure supplied by a fintech company. The government is now working with the banks and fintech companies to distribute welfare. Wallet adoption rates have grown tenfold in the past months. Not only do they allow users to receive welfare payments, but they also allow them to pay their bills, top up their cellular phones and transfer money to relatives without leaving the house. Associated payment cards are used to order food and groceries online and buy movies and games. In Brazil, the government is working with some of the country's large and small fintech companies in merchant acquiring and small business lending to distribute subsidized small business loans. We are witnessing several years of digital transformation in financial services happening in a couple of months."

A **David Ross, global fund manager at La Financière de l'Echiquier in Paris:** "While fintech adoption has been accelerating, the fintech industry was undergoing strong growth even prior to the Covid-19 crisis. Starting as an outgrowth of the need for digital payment solutions for e-commerce, a need that has only grown in a quarantined world increasingly reliant upon e-commerce, it was the financial crisis a decade ago that truly spurred the region's fintech revolution. Global banks, in an effort to shrink their balance sheets, left the region. In response, large local players focused on serving the biggest companies, creating opportunities in serving underbanked consumers and small/medium enterprises. It is this small/medium enterprise market that is leading the Latin American fintech industry to develop beyond just the payments business and into lending,

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prospects in the U.S., many workers may have capitalized on a favorable USD/MXN level to send part of their accumulated savings in the U.S. back to Mexico." Solid levels of remittances to Mexico have helped to support private consumption, particularly for low-income families in Mexico, Ramos said. However, he added, "Despite the March upside surprise, the expected sharp recession in the U.S. and spike in unemployment are likely to negatively impact the flow of remittances to Mexico." Analysts in a Bloomberg survey had expected $2.75 billion in remittances for March.

POLITICAL NEWS

Brazil's Bolsonaro Names De Souza as Federal Police Head

Brazilian President Jair Bolsonaro on May 4 named Rolando Alexandre de Souza as the head of the country's Federal Police, news program Jornal Nacional reported, citing an extra edition of the country's official gazette. Bolsonaro selected de Souza, who was rapidly sworn in at Bolsonaro's office without an audience, after the country's Supreme Court blocked the president's move to appoint Alexandre Ramagem, a family friend, to the position. Bolsonaro had said he would seek to appeal the Supreme Court's move to block Ramagem's appointment. De Souza had worked as a close aide to Ramagem, who headed Brazilian intelligence agency Abin, Reuters reported. De Souza replaces Federal Police Chief Maurício Valeixo, whom Bolsonaro fired in April. The dismissal led popular Justice Minister Sérgio Moro, who as a federal judge oversaw Brazil's sprawling "Car Wash" anti-corruption investigation, to resign in protest. In stepping down, Moro accused Bolsonaro of firing Valeixo in order to replace him with a trusted personal contact whom he could call to get information on police investigations. Moro said Bolsonaro wanted access to classified information and to curtail police investigations of his supporters. Bolsonaro dismissed Moro's claims as "gossip," Reuters reported. On May 2, Moro testified to police and prosecutors as part of an investigation that the Supreme Court launched into the matter. Moro brought forth to authorities recordings of conversations that he had with the president, an unnamed person with knowledge of Moro's deposition told Reuters. Three army generals in Bolsonaro's

ADVISOR Q&A

Is Mexico Facing More Economic Pain Than its Neighbors?

Q Mexico is facing a severe recession, with the International Monetary Fund predicting that Latin America's second-largest economy will contract 6.6 percent this year, more than double the 3 percent contraction it expects for the global economy. At the same time that countries around the world are bracing for the economic consequences of the coronavirus pandemic, Mexico, like other oil producers, is also facing economic damage from the collapse in oil prices. How well is Mexico's government responding to the rapidly deteriorating economic outlook? Will President Andrés Manuel López Obrador's plans, including more loans for small businesses and for housing, meaningfully boost the economy? How long could Mexico's recession last, and what elements will be key for its emergence from it?

A Alfredo Coutiño, director for Latin America at Moody's Analytics: "Mexico will end up as one of the most affected countries in the region, mainly because of its economic anemia, lack of preparedness for the virus outbreak, the delayed policy response and the high dependence on the U.S. business cycle. The fall in oil prices adds pressure to the country's foreign income and government revenues, although the country holds an insurance coverage. The United States is the main market for Mexico's exports, thus the economy is heavily subject to its neighbor's downturn. The U.S. economy is expected to contract by around 6 percent, which implies a contraction of between 6 percent and 9 percent for Mexico, based on Mexico's GDP elasticity to the U.S. business cycle. Where Mexico's economy ends up in 2020 depends on the size and speed of the policy response. So far, monetary policymakers have acted by lowering the price of credit and by increasing the quantity of money. However, a defined fiscal response was absent until recently when the government announced measures worth about 2.5 percent of GDP, including direct transfers, credit for small firms and families and resources to continue the construction of a few infrastructure projects. Fiscal measures not only have arrived late and in an insufficient amount, but also they do not represent an additional stimulus since they are the result of the redistribution of the federal budget. Those measures will not boost the economy but rather will mitigate the fall by providing some help to domestic demand. Without the policy stimulus, the economy's fall could reach a double-digit rate. The duration of the recession depends on two factors: the speed at which Mexico implements its fiscal stimulus and the U.S. recovery. In the best-case scenario, the recession will last until the end of the year, and the recovery will begin early next year. Once more, Mexico's economy will amplify its downturn as a result of the external shock and the limited countercyclical power of domestic policy."

EDITOR'S NOTE: More commentary on this topic appears in the May 4 issue of the Latin America Advisor.

NEWS BRIEFS

Two U.S. Citizens Among 13 Captured After Failed Venezuela Plot: Maduro

Venezuelan President Nicolás Maduro said May 4 that two U.S. citizens are among 13 people captured by authorities in connection with what Venezuelan officials have called a failed plot to invade the country and oust Maduro, Reuters reported. In an address on state television, Maduro showed passports and other identification cards purportedly of Airan Berry and Luke Denman. Maduro said the men, whom he called terrorists, worked at Silvercorp, a Florida-based security company whose owner claimed responsibility for the failed incursion on May 3.

Mexican Gov't Warns States Against Jailing Lockdown Violators

Mexico's Interior Department on May 4 issued a warning for state governments not to use prison terms to enforce stay-at-home orders to fight the coronavirus pandemic, the Associated Press reported. The warning came after the Querétaro state legislature passed a bill establishing prison terms of four to six years for people who violated the lockdown measures. The Interior Department said the law was disproportionate, possibly unconstitutional and discriminated against the poor.

IMF Approves $643 Mn in Emergency Aid for Ecuador to Face Pandemic

The executive board of the International Monetary Fund has approved $643 million in emergency assistance for Ecuador to address the Covid-19 pandemic, the Fund said May 1. Ecuador had requested the aid under the Rapid Financing Instrument. The money will go toward supporting the country's balance of payment needs and its most affected sectors, including the health care system.

cabinet, two of whom are active-duty and the other retired, witnessed Bolsonaro pressuring the federal police, Moro reportedly told investigators, and could corroborate the former justice minister's accounts, the source told the wire service. On May 4, the country's top prosecutor requested Supreme Court authorization to question the three military cabinet members in an investigation. Moro's resignation sparked the most serious political crisis that Bolsonaro has faced since taking office last year. He was already facing criticism for downplaying the coronavirus pandemic and doing too little to curb the virus' spread. Brazil has more than 108,000 confirmed cases of Covid-19 and more than 7,300 reported deaths due to it.

ECONOMIC NEWS

Argentina, Creditors in Standoff as Deal Deadline Looms

Argentina's government and its largest bondholders continue to be at odds over plans to restructure $65 billion in foreign debt, with neither side showing signs of budging as the deadline to reach a deal looms, Reuters reported. Three major credit groups on May 4 reiterated their rejection of the offer the government presented in April, whose deadline is May 8. The three groups, which represent some of the world's largest institutional investors such as BlackRock and Fidelity, had already said in separate statements that they would reject the deal, with some calling it "unacceptable" and not a product of "good faith" negotiations, the Financial Times reported. On May 4, the groups issued a joint statement to "make clear that they cannot support Argentina's recently launched exchange offer," saying the offer requires bondholders to "bear disproportionate losses that are neither justified nor necessary." Meanwhile, the government has been clear that it cannot afford to sweeten the deal, which includes a 62 percent haircut on interest payments worth almost $38 billion, as well as a 54 percent reduction in the face value of the debt, worth nearly $3.6 billion. Without an agreement, Argentina risks slipping into what would be its ninth default, which would hurt its access to global markets just as it faces a painful and deteriorating recession, Reuters reported.

Puerto Rico Asks Board to Delay Austerity Measures

Puerto Rico's government on May 4 said it had asked a federal control board to delay austerity measures for at least two years, warning that Puerto Rico does not have enough money to pay bondholders as it struggles with the costs of recent earthquakes, the Covid-19 crisis and the aftermath of hurricanes Irma and Maria, the Associated Press reported. Officials said they submitted a revised fiscal plan to the board that oversees the U.S. territory's finances as the island braces for billions of dollars in losses as a result of dwindling tax revenue and a drop in tourism, among other factors. In this and the following fiscal years, the coronavirus

Marrero // File Photo: Commonwealth of Puerto Rico.

pandemic will cost the Puerto Rican economy approximately $6.6 billion, which makes it impossible for the territory to pay its debt, said Omar Marrero, the executive director of Puerto Rico's Fiscal Agency and Financial Advisory Authority, El Nuevo Día reported. "Puerto Rico must be realistic and prudent in conserving its resources in preparation for unknown and unexpected events that are becoming increasingly inevitable," the new plan states, the AP reported. The government cited the costs of dealing with recent earthquakes, the latest of which was a 5.5 magnitude one on May 2.

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creating what may prove to be an example of disruptive innovation as the fintechs create a new market and value network and then scale up to compete directly with established financial institutions. Aiding these new players has been the innovative regulatory scheme in leading countries such as Mexico and Brazil, lowering the barriers to entry for these new players in the lending markets. At the same time, the Covid-19 crisis has forced the incumbent players into remote working, which often has meant using digital resources to replicate the traditional bank branch and lending processes while out of the office, instead of undergoing a digital transformation to enter these newer, but lower margin, markets. As such, Covid-19 is providing a tailwind for fintech challengers and also is hindering the incumbents from meeting their challenge."

A **Wally Swain, principal consultant for Latin America at Ovum:** "Perhaps no commercial institution typifies Latin America's conflicted relationship with the past and the future as much as the banking industry, often referred to in Spanish as a monolithic (and singular) 'la banca.' Bank branches cluster around street corners, credit- and debit-card penetration are low, and the use of cash is widespread. The latter habit is hard to change because of Latin Americans' low level of trust of individuals and governments. Cash is thought to be more secure and certainly harder to trace. At the same time, there is also a growing and vibrant fintech sector, vigorously opposed—or aggressively coopted—by 'la banca.' The pandemic should be the ideal vector for change—especially for reducing the use of paper money, which is a significant transmitter of the virus. Automatic teller machines are also a potential source of infection. Pre-paying for my lunch by credit card means I do not have to interact with the delivery person, except to receive the bag of food. With deadly airborne particles floating about, I am even less attracted to the prospect of joining a long line in a physical bank to do some trivial transaction that could otherwise be done on the web, even assuming that social distancing is strictly enforced. However, like most Covid-19-induced change, the open question is whether these behaviors are temporary or permanent. Population demographics and the length of the emergency will both play significant roles in answering this question. And then, of course, there is 'la banca.' Will it embrace the change (like lower costs from fewer branches) or resist it (because it is being disintermediated by more agile fintechs)?"

A **Fabrice Serfati M., managing director and partner at IGNIA Partners:** "The pandemic has significantly increased the usage of payment solutions. The impact on business-to-consumer fintechs has been quite relevant and, in many cases, has improved the unit economics by increasing the average balance per account holder as well as the number of monthly transactions per user, both important drivers of revenue for these companies. Some fintechs have reacted to this evolving situation by improving their product offerings. For example, Mexico's Fondeadora has continued to acquire customers by providing them with a digital card. Not sending them a plastic card has increased the profitability per user. The increase in electronic payments has also affected business-to-business fintechs that enable payment services for digital platforms. That has been the case of Arcus, which has seen its number of client transactions grow significantly. Mobile payments are all about transparency and convenience for the end user. This pandemic has accelerated the adoption rate of digital services, including payments. This trend will not be reversed. There are areas in which traditional banks can complement fintechs in providing services to customers rather than trying to compete with them."

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Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter & Associate Editor
achacon@thedialogue.org

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freetrial@thedialogue.org