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FEATURED Q&A

Are Latin American Banks Headed for Trouble This Year?



Brazil has among the most vulnerable financial systems in the region, JP Morgan Securities analyst Natalia Corfield said Jan. 11. Above, a Banco Bradesco branch in the municipality of Caruaru is pictured. // File Photo: Patrick-br via Creative Commons.

Q Banks in Latin America have less resilience to withstand stressed conditions as compared to banks in other emerging markets, Moody's Investors Service said in a Dec. 16 report. High credit costs and weak efficiency have reduced Latin American banks' ability to withstand severe market conditions, Moody's added. Are Latin America's banks headed for trouble in 2016? Which countries in the region have the healthiest, and which have the weakest, banking sectors? Do banks need to be doing more in order to withstand a financial crisis, and if so, what? Are government regulations over banking sectors adequate in the region?

A Jacob Rappaport, managing director and head of capital markets at INTL FCStone Financial: "Latin American banks are headed for continued struggles in 2016, starting with the region's two largest economies. Brazil will continue to face the difficult challenge of absorbing losses amid a rout in energy and commodity prices, coupled with a 50 percent depreciation of the real versus the dollar in 2015. The continued weakening of the real should continue to put upward pressure on both inflation and interest rates. As interest rates rise, debt servicing becomes a major concern. Banks will have to adapt depending on how the Central Bank of Brazil addresses this currency crisis. Mexico's structural reforms have been lackluster thus far in improving regulation in the financial sector, and in creating a healthier environment for increased lending. We see the Mexican banking sector faring much better than the Brazilian banking sector, however, as Brazil continues to experience deteriorating assets and a low demand for credit

Continued on page 3

TOP NEWS

BANKING

Brazil's Tax Authority Probing Several Banks

The country's federal tax agency is investigating the banks in connection with their loans to engineering firm Schahin.

Page 2

BANKING

J.P. Morgan Sees Recovery in Global Bond Offerings

The region's banks could see some \$12.5 billion worth of new bond offerings this year, said analyst Natalia Corfield, who added that offerings in Mexico, Colombia and Peru are likely to drive the growth.

Page 2

MORTGAGES

Argentina's Central Bank Seeking to Boost Mortgage Loans

The central bank, led by Federico Sturzenegger, is proceeding with a plan to boost the number of mortgage loans. The plan is based on similar initiatives in Uruguay and Chile.

Page 2



Sturzenegger // File Photo: Argentine Government.

BANKING NEWS

Brazil's Tax Authority Probing More Than a Dozen Banks

Brazil's federal tax agency has opened an investigation into the activities of more than a dozen local and foreign banks in connection with their intermediation of loans to Brazilian engineering firm Schahin, Reuters reported Jan. 11, citing local newspaper O Estado de S. Paulo. Among the banks targeted in the probe are Itaú Unibanco Holding, Itaú BBA, Banco Bradesco, Banco Santander, HSBC Holdings,



Barreto // File Photo: Agência Brasil.

Deutsche Bank and Votorantim, the newspaper reported, citing a document from the tax agency, which is headed by Carlos Alberto Freitas Barreto. Banco Bonsucesso, Banco Fibra, Banco ABC Brasil, Bic Banco, Banco Pine, Banco Tricury and Banco Rural are also named in the investigation. The tax agency and prosecutors are examining the banks for potential money laundering for originating, coordinating or managing loans to the engineering group. Investigators are currently targeting Schahin in a probe related to the massive corruption scandal at state-run oil company Petrobras. In an emailed statement, Banco Bradesco said it follows appropriate corporate governance practices, but it would not comment more specifically on the investigation or its relations with clients, citing bank secrecy rules. Grupo Schahin's engineering branch was received a contract to operate a Petrobras drillship in exchange for a bank's cancellation of loan payments by José Carlos Bumlai, who was arrested in November in connection with the Petrobras case, Reuters

reported. Bumlai is a friend of former Brazilian President Luiz Inácio Lula da Silva.

JP Morgan Sees Recovery in Global Bond Offerings

Latin American banks could see a recovery this year in global bond offerings, a JP Morgan Securities analyst said Jan. 11, Reuters reported. The region's banks are likely to see approximately \$12.5 billion worth of new bonds this year, according to a forecast by the analyst, Natalia Corfield. That amount would be more than twice the 2014 total of \$5.8 billion, but lower than the 2012 record total of \$30 billion, the wire service reported. Last year, Latin American banks had the lowest total of bond offerings since 2008, said Corfield. A recovery this year would be focused on senior securities and is likely to be driven by lenders in Mexico, Colombia and Peru, which are facing higher needs for funding and refinancing, Corfield added. However, she said that she is "cautious" about Colombia and Brazil, whose banking systems could face higher borrowing costs, a slowdown in domestic growth and lower loan book quality. Brazil's financial system

Banks in Peru, Chile and Mexico are "the bright spot among Latin American institutions," said Corfield.

is encountering an "extremely challenging macroeconomic backdrop, which could lead to a more pronounced and prolonged non-performing loan cycle," said Corfield, adding that banks in Peru, Chile and Mexico are "the bright spot among Latin American institutions." In a Brazilian central bank survey released Monday, analysts said they expected the country's economy to contract 2.99 percent this year, a worse outlook than the previous week's forecast, EFE reported.

NEWS BRIEFS

Banco Nacional de Costa Rica to Launch Face-Recognition Technology

Banco Nacional de Costa Rica is planning to launch face-recognition technology for its mobile banking customers, Finextra reported Jan. 11. Spanish biometrics company FacePhi developed the technology, which the Costa Rican bank is planning to roll out in the second quarter. The bank is later planning to implement the technology for its Web site services. Banco Nacional de Costa Rica is the seventh bank to contract with FacePhi to use the face-recognition technology.

Argentine Central Bank Seeking to Boost Mortgage Loans

Argentina's central bank, led by Federico Sturzenegger, is proceeding with a plan to increase the number of mortgage loans in the country, the Buenos Aires Herald reported Jan. 10. The plan would be based on similar initiatives in Chile and Uruguay, the newspaper reported. The programs in the neighboring countries are based on a unit of account related to the consumer price index and could give mortgage loans cheaper installment payments and lead to fewer requirements to obtain mortgages. However, the government would have to bring down the inflation rate in order for the program to succeed, according to analysts.

Sarifa Insurance's Online Platform Fully Operational

The online platform of Jamaica-based Sarifa Insurance Brokers has been fully operational since late December, and the company has received hundreds of requests since then for auto insurance quotations, the company's president, Christopher Blythe, told the Jamaica Gleaner Jan. 11. Blythe said he's "extremely pleased" with consumers' reaction to the site.

INSURANCE NEWS

BTG Pactual in Talks to Sell Pan Seguros

Brazil's Grupo BTG Pactual is in advanced talks to sell its majority stake in local insurance company Pan Seguros, according to sources familiar with the matter, Reuters reported Jan. 11. BTG Pactual has sought to shed assets in



Esteves // File Photo: Harvard University.

order to raise cash in the wake of the arrest of its founder, André Esteves. The billionaire was arrested in November in connection with the massive corruption scandal at Brazilian state-run oil company Petrobras. Esteves has denied wrongdoing. Among the bidders for the 51 percent stake in Pan Seguros are Zurich, Italy's Assicurazioni Generali, U.S.-based Liberty Mutual, France's CNP Assurances. Axa, MetLife and Japanese insurance companies are also bidding on the stake, sources told Reuters. "Bidders are queuing up because of the lack of available targets in Latin America," a source told the wire service. BTG Pactual declined to comment to Reuters and representatives at the companies identified as bidders could not be reached for comment. BTG Pactual acquired the 51 percent stake in Pan Seguros last year. Caixa Econômica Federal's investment unit owns the remaining 49 percent and is not planning to sell it, according to one of the sources. BTG Pactual has requested binding bid offers by the end of February and is looking to have a deal by the end of the first quarter, the wire service reported. In December, first-round bids reportedly pegged the value of Pan Seguros at as much as 1.3 billion reais (\$321.9 million).

FEATURED Q&A / Continued from page 1

in a weak economy. Argentina is undergoing political change for the first time in more than a decade, which has locals optimistic that President Macri will usher in access to international capital markets and open up the Argentine economy. While this is encouraging, Argentina will assuredly face challenges as it attempts to curb already high inflation post-currency clamp, while simultaneously enduring the current economic challenges facing the broader region."

A **Melissa Diaz and Paola Sanchez, associate attorneys at Diaz, Reus & Targ LLP in Miami:**

"Although Latin American banks performed adequately last year, in 2016 the region will likely face a complex year full of external risks, such as the strengthening dollar, higher U.S. interest rates, volatile currencies and commodities, and China's economic growth. Given today's financial and economic interconnection, these risks cause volatility in global markets which in turn translate into a region's internal risks. The economies of the region will also continue to be affected by the depreciation of Latin American currencies, which affect banks' creditworthiness. In order to avoid a financial crisis, banks need to proactively manage the risks that threaten the region by reducing their exposure to these threats. Despite its slowing economy, Chile's banks are stable, and based on Standard & Poor's December Banking Industry Country Risk Assessments, it has the healthiest banking sector in the region. On the other side of the spectrum, according to the same study, the weakest banking sector in the region is Argentina's as it continues to cope with a soft economy. Latin America has a lot to learn from developed markets where financial regulation and oversight have been some of the primary drivers of the banking sector. There is a great deal to do regarding the supervision of banks in the region, and Latin American governments must do more to actively supervise and assess banks in

the region. Governments in the region could improve regulations by implementing a resolution regime such as the U.S.'s Dodd-Frank Act."

A **Fernando Albano, assistant vice president and analyst in the Financial Institutions Group at Moody's Latin America in**

Buenos Aires: "I expect economic growth will recover slightly in 2016, with the exception of Brazil. However, activity will not rebound to the rapid pace seen between 2011 and 2013, as external and domestic headwinds continue to weigh on growth. The region's economic slowdown will lead to higher non-performing loans, but banks will continue to generate income and will stay solvent. Lenders will retrench from riskier

“**Latin American banks will continue to benefit from ample net interest margins....”**

— Fernando Albano

asset classes, which will constrain earnings growth over the coming year. However, Latin American banks will continue to benefit from ample net interest margins, which will allow them to maintain higher profitability than banks in advanced economies. Over the next year, risk-weighted asset growth in Brazil will continue to decelerate as banks remain risk-averse and loan demand declines, reducing capital consumption and helping offset pressure created by declining profitability. In Mexico, retained earnings will continue to be sufficient to feed organic capital replenishment, offsetting capital consumption stemming from loan growth. Asset risks will

Continued on page 6

After Esteves was arrested, he was replaced by partners who are now in talks to sell Switzerland-based private bank BSI, which Assicurazioni Generali sold to BTG Pactual less than a year ago. [Editor's note: See [Q&A](#) about Latin America's insurance market in the Dec. 3-16 issue of the Financial Services Advisor.]

POLITICAL NEWS

Venezuela's Supreme Court Voids National Assembly's Actions

Venezuela's Supreme Court on Jan. 11 ruled that all actions of the National Assembly are void until three opposition lawmakers, who were sworn in despite a ban from the high court, are removed from office, BBC News

“The logical, sane and democratic step is for the National Assembly's leadership to revoke the swearing-in of these lawmakers.”

— Diosdado Cabello

reported. Following an appeal by President Nicolás Maduro's Socialist Party, the high court had banned four lawmakers from Amazonas state from taking office pending an investigation into the legitimacy of their election. Three of the banned lawmakers are members of the opposition and one is from the ruling party. But in defiance of the court's ruling, the assembly last week swore in the three opposition members. Opposition members have seen the court's action to ban the opposition lawmakers as a move by a court stacked with Maduro supporters and an effort to rob the opposition of its powerful two-thirds majority in the National Assembly. However, the Socialist Party leader in the assembly, and former assembly president, Diosdado Cabello, said the legislative body should adhere to the court's rulings.

ADVISOR Q&A

How Will the Fed's Rate Hike Affect Latin America?

Q The U.S. Federal Reserve on Dec. 16 raised interest rates, ending what Fed Chairwoman Janet Yellen called an “extraordinary seven-year period” during which policymakers kept the federal funds rate near zero in an effort to support the economy. How will the Fed's action affect Latin American economies, many of which are struggling with anemic growth and low prices for their commodity exports? How will the interest rate hike affect Latin American countries' ability to pay off their dollar-denominated debt? Which nations are most at risk, and which countries in the region might see any benefit from the U.S. interest rate hike?

A Uri Dadush, senior associate in the International Economics Program at the Carnegie Endowment for International Peace:

“The worry about the Fed's first interest rate increase in seven years is understandable, given weak growth in Latin America and memories of previous instances of U.S. monetary tightening that triggered large capital flow reversals and regional balance of payments crises. The China-driven stock market rout which ushered in the new year adds to the fear. However, I believe that the Fed's move is unlikely to be a cause of major disruption in Latin America this time around. U.S. policy interest rates are barely budging from zero against a background of a recover-

“The logical, sane and democratic step is for the National Assembly's leadership to revoke the swearing-in of these lawmakers,” he said, BBC News reported. “If the National Assembly is in contempt, nobody is going to recognize it.” Opposition members in the assembly, however, said they would continue to defy the Supreme Court. “We will not cede one iota of the power

ing U.S. and European economy, and interest rates are likely to remain at record lows among all the world's reserve currencies over at least the next 12 months. Moreover, the Fed's actions as well as words suggest that future interest rate hikes will be gradual and come pari passu with continued U.S. recovery. Firms and banks in Latin America that owe dollars and are not naturally or financially hedged will suffer from the higher dollar, but there are already large offsetting benefits from the high dollar in the form of stronger exports and remittance inflows. The message here is not that Latin America is out of the woods, only that if it is attacked by a bear, this time it's not the Fed. China's weakness, collapsing oil and other commodity prices, domestic struggles, precarious fiscal situations and inappropriate policies are the more fearsome predators now. Thinking about vulnerabilities, what is striking is the diversity of the continent, especially between the U.S.-linked North and the commodity- and China-linked South, and between those whose policies are supportive and those whose policies are in a mess, such as Brazil, Venezuela, Ecuador and Argentina, where change appears to be finally afoot.”

EDITOR'S NOTE: More commentary on this topic appears in the Jan. 8 issue of the Latin America Advisor.

that the people of Venezuela gave us,” said opposition lawmaker Freddy Guevara, the Associated Press reported. The opposition-controlled National Assembly, which was seated Jan. 5, has not yet passed any legislation. However, on Monday, it began debating a law to free jailed opposition leaders. Legislators also formed a committee to probe irregularities surrounding

NEWS BRIEFS

Argentine Commandos Capture Three After 15-Day Manhunt

Argentine police commandos on Jan. 11 recaptured three convicts who escaped from jail on Dec. 27, ending a massive manhunt, Reuters reported. Victor Schillaci and brothers Martin and Cristian Lanatta had been imprisoned for drug-related killings. Authorities cornered them in a rice mill plant near the town of Cayasta in Santa Fe province.

U.S. Lifts Ban on Agricultural Products From Dominican Republic

The U.S. Department of Agriculture on Jan. 11 announced it would lift the ban that had prevented 23 of the 30 Dominican provinces in which the Mediterranean fruit fly has not been detected from exporting agricultural products to the United States. The fruit fly attacks vegetables and tropical fruits, and was detected in the Dominican Republic last year. The subsequent ban the United States imposed on imports from the Dominican Republic last April resulted in the loss of millions of dollars for Dominican producers, officials said.

Haiti's Célestin Will Only Participate in Election With Reforms: Spokesman

A spokesman for Jude Célestin, the second-place finisher in the first round of Haiti's presidential election, said Jan. 7 that Célestin would only participate in the Jan. 24 runoff if changes recommended by a special commission are adopted to improve voting conditions, the Associated Press reported. The recommendations include major changes to the electoral machinery, investigations into and possible resignations of those accused of engaging in corruption during the first election and political dialogue to reach consensus in the upcoming round.

the outgoing National Assembly's rush in its final days to name 13 new Supreme Court justices, a move that opposition members say proves that the court is rigged in the government's favor.

Mexico Moves Toward Extraditing 'El Chapo' to U.S.

Mexico's government on Jan. 10 began the process of extraditing drug kingpin Joaquín "El Chapo" Guzmán, whom Mexican marines recaptured in a dramatic operation two days earlier, to the United States, CBS News and the Associated Press reported. Authorities formally notified Guzmán that he is wanted on drug trafficking charges in the United States. Mexican agents working with international police agency Interpol served Guzmán with two arrest warrants after he was sent Friday to Mexico's maximum-security Altiplano prison, the same prison from which Guzmán escaped in July through a hole in his cell which led to a tunnel out of the prison. Guzmán's attorneys have already started filing appeals against his extradition to the United States, where he is wanted in various states. The United States formally requested Guzmán's extradition last June, just before his prison escape, and again in August while he was on the loose, the Financial Times reported. The extradition process could be a lengthy one as his attorneys are expected to file new appeals even if the Foreign Ministry approves his extradition. The process could take years, Samuel González, the former head of the organized crime unit at Mexico's attorney general's office, told the newspaper. Guzmán's prison escape in July strained relations between Mexico and the United States, to which Guzmán's Sinaloa cartel smuggles tons of cocaine and other drugs. In 2014, a New Yorker article estimated that the cartel is responsible for as much as half of the illegal drugs in the United States. Mexican President Enrique Peña Nieto announced the arrest of El Chapo on Jan. 8. "Mission accomplished: We got him. I would like to inform all Mexicans that Joaquín Guzmán Loera has been detained," Peña Nieto

said in a tweet. Mexican marines captured Guzmán hours after they raided a safe house in the northwestern city of Los Mochis, in Sinaloa state. In a gun battle with the house's occupants, five suspected cartel members were killed, four other suspects were captured and a marine was wounded, The Wall Street

Mission accomplished: We got him."

— Enrique Peña Nieto

Journal reported. Guzmán escaped through a tunnel and stole a car in an attempt to flee, but authorities finally arrested him just outside of town. A U.S. law enforcement source told CBS News that Mexican authorities' trail to El Chapo had grown cold until American actor Sean Penn met with the drug lord in October for an article he was writing for Rolling Stone magazine. The meeting, which happened in October, eventually led authorities to Guzmán's hideout.

ECONOMIC NEWS

Rousseff Says Gov't Underestimated Economic Crisis

Brazilian President Dilma Rousseff said Jan. 6 that her government underestimated the severity of the country's economic crisis, calling it her administration's "biggest mistake," Agence France-Presse reported. Rousseff, who is facing calls for her impeachment, made the remarks during a meeting with a small group of journalists in Brasília. "The biggest mistake was failing to see that the crisis was so big in 2014, failing to gauge the magnitude of the economic slowdown due to internal and external problems," Brazilian daily newspaper O Estado de S. Paulo reported her as saying. Rousseff said China's economic uncertainty and Brazil's severe drought were among the biggest factors for Brazil's deep recession.

FEATURED Q&A / Continued from page 3

rise in the coming quarters in Argentina as challenging economic conditions further reduce household purchasing power and constrain industrial production. Nevertheless, non-performing loans should remain moderate by global standards. Moreover, Argentina's political transition will lay the groundwork for the government to begin tackling the country's economic imbalances and adjust policies that have affected banks' earnings. Colombian, Chilean and Peruvian economies are heavily dependent on exports of commodities, and low global prices will continue to weigh on the recovery in GDP growth in these countries. However, banks continue to grow their loan books, and asset quality is strong despite the economic slowdown, thanks to proactive management of credit growth, asset allocation and reserves."

A **Sergio Daga, researcher at the Navarra Center for International Development at the University of Navarra:** "Last year's growth in Latin America was the lowest among emerging market economies. Brazil, the largest economy in the region, is facing a contraction, and in 2016 the recession will continue. On top of that, the recent U.S. interest hike is expected to exacerbate the volatility of capital flows to the region and contribute to a sharper depreciation of major currencies; at the same time, the commodity super cycle, due to mainly China's economic slowdown, has come to an end. This new scenario is testing Latin America's resilience, especially that of its financial sector. However, from a financial point of view, an abrupt reduction in capital flows affects countries differently, depending on their domestic vulnerabilities. As Brookings non-resident fellow Ernesto Talvi has put it,

we have not one, but three Latin Americas. Taking the seven major economies in the region, the first group—Chile, Colombia, Mexico and Peru—has relatively easy access to the lender-of-last-resort facilities of the IMF, strong international liquidity, relative short-term debt and a very well capitalized banking system. In the second group, Argentina's new government faces significant economic policy challenges, and the unresolved legal external debt conflict with holdouts will limit

“ This new scenario is testing Latin America's resilience, especially that of its financial sector.”

— Sergio Daga

the scope of its banking sector to cope with major risks. Venezuela is in full-crisis mode. Data is difficult to access, and we only have to trust that authorities would act accordingly. Brazil, is an intermediate case, with very well-capitalized banks, but it is the country with the most need to approach the IMF to help adjust. In general, the international community believes that financial regulation in Latin American countries provides adequate regulatory oversight to prevent excesses. I would add that on average the countries in the region are in better position to cope with capital volatilities than in the past, but the heterogeneity among them is highly evident.”

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

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