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FEATURED Q&A

Will Argentina's Economic Turmoil Soon Subside?



Argentine Economy Minister Nicolás Dujovne said last week that the country's government hopes to reach a deal by later this month on early disbursements from a \$50 billion loan from the International Monetary Fund. // File Photo: Argentine Government.

Q Argentine Economy Minister Nicolás Dujovne was in Washington last week for talks at the International Monetary Fund as his country is seeking early disbursements of a \$50 billion standby loan. The talks followed Argentine President Mauricio Macri's announcement of austerity measures, including new taxes on exports as well as the elimination of several ministries in an effort to arrest economic turmoil that has sent the country's currency to record lows against the U.S. dollar. At the same time, economists in a recent central bank survey predicted a 1.9 percent economic contraction and 40 percent inflation this year in Argentina. What is at the root of Argentina's economic problems, and does the government have the right plans to boost the economy? How important to the country is an early disbursement of funding from the IMF? Which industries are being most severely hit?

A Claudio Loser, visiting senior fellow at the Inter-American Dialogue, president of Centennial Group Latin America and former head of the Western Hemisphere Department of the International Monetary Fund: "The issue that President Macri and his team confront is really, 'What is the appropriate way for Argentina to get out of its current crisis, with limited damage?' Argentina's problems are rooted in the loose policies of the Kirchner era, particularly when Cristina Fernández de Kirchner was president. Argentina's default in 2001 had a high cost in terms of the country's interaction with the rest of the world. Exchange controls and an exchange rate out of line were hidden by the effects of a commodity boom that lasted until 2012-2013. Subsequently, as

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TODAY'S NEWS

ECONOMIC

Mexico's López Obrador to Push Labor Reforms

Mexican President-elect Andrés Manuel López Obrador will seek the passage of labor reforms, including changes to the country's collective-bargaining system, said his incoming labor minister.

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BUSINESS

FirstCash Buys 154 Pawn Shops in Mexico

The U.S.-based company bought the stores in two separate deals with different ownership groups. The deals bring its number of locations to 2,444.

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POLITICAL

Brazil's Lula Quits Presidential Race, Endorses Haddad

In a letter read from outside the police building where he is jailed, former Brazilian President Luiz Inácio Lula da Silva bowed out of the presidential race and urged voters to support former São Paulo Mayor Fernando Haddad.

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Lula // File Photo: Lula Institute.

POLITICAL NEWS

Brazil's Lula Quits Presidential Race, Endorses Haddad

Jailed former Brazilian President Luiz Inácio Lula da Silva, long the front-runner ahead of the country's October presidential election, dropped out of the race Tuesday, following this month's ruling from Brazil's top electoral court barring him from the race, Folha de S.Paulo



From now on, Haddad will be Lula for millions of Brazilians."

— Luiz Inácio Lula da Silva, in a letter read by his attorney

reported. Lula has been jailed since April on a 12-year sentence following his conviction on corruption and money laundering charges and loss on appeal. With less than a month to go before the Oct. 7 election, Lula endorsed former São Paulo Mayor Fernando Haddad in a letter read by his lawyer outside the Federal Police building in Curitiba, where Lula is being held. "From now on, Haddad will be Lula for millions of Brazilians," Lula said in the letter, read aloud by Luiz Eduardo Greenhalgh, who is also one of the founders of Lula's Workers' Party. Haddad had been Lula's running mate and served as education minister during Lula's presidency. Haddad, a lawyer with a master's degree in economics and a doctorate in philosophy, has a history that contrasts sharply with that of Lula, a former metalworker and union leader whose formal education did not go beyond grade school, The Wall Street Journal reported. Still, Haddad said Tuesday that he would govern much as Lula would. "Lula was a great conciliator who always negotiated with all social classes, from trash collectors to bankers," Haddad told Globo News in an interview. "He always had the door to the [presidential palace] open for all Brazilians, and that's how we intend to govern the country."

Like Lula, Haddad has also faced legal problems. Earlier this month, prosecutors accused him of accepting money illegally in order to pay off debts related to his mayoral campaign, The Wall Street Journal reported. A judge is now considering the allegations and would need to accept them in order for the case against Haddad to proceed to trial. Haddad has denied wrongdoing. Without Lula in the race, far-right lawmaker and former military officer Jair Bolsonaro has led polls. Bolsonaro, who has publicly made denigrating comments against blacks, gays, women and indigenous people, was stabbed last week during a campaign event and remains hospitalized in serious but stable condition. A Datafolha poll released Monday showed Bolsonaro with 24 percent support, leftist Ciro Gomes in second place with 13 percent, environmentalist Marina Silva with 11 percent, center-right candidate Geraldo Alckmin with 10 percent and Haddad with 9 percent, Reuters reported. However, Haddad may start to benefit from Lula's endorsement and departure from the race. Earlier this year, Datafolha conducted a poll in which 30 percent of respondents said they would vote for whichever candidate Lula selected to replace him, The Wall Street Journal reported.

ECONOMIC NEWS

Mexico's López Obrador to Push Labor Reforms

Mexican President-elect Andrés Manuel López Obrador will seek to pass legislation to restructure the country's collective-bargaining system to raise wages and comply with labor provisions included in the recent bilateral deal reached with the United States, incoming Labor Minister Luisa Alcalde said Tuesday, The Wall Street Journal reported. López Obrador will require unions to show they have the support of 30 percent of workers before signing a so-called protection agreement with an employer, which currently can be signed without worker consent or knowledge, according to Alcalde.

NEWS BRIEFS

Peru's Vizcarra Eyes Dissolving Congress if Needed for Anti-Graft Vote

Peruvian President Martín Vizcarra told CNN en Español on Monday he will do anything in his power to hold a referendum on anti-corruption measures, including dissolving Congress, the Associated Press reported. The opposition-run Congress has recurrently blocked the president's initiatives to curb corruption in the legislative and judicial systems after a series of scandals earlier this year unveiled bribery schemes among judges and politicians.

Argentina's Central Bank Holds Key Interest Rate Steady at 60 Percent

The Argentine central bank maintained its benchmark overnight interest rate at 60 percent on Tuesday, as expected, the Financial Times reported. In a statement, the central bank's policymakers said they intended to hold the rate steady until at least December. The bank had raised interest rates from 45 percent last month after President Mauricio Macri unexpectedly asked for an early disbursement of the International Monetary Fund's \$50 billion standby deal, prompting a confidence crisis.

Financial Advisor Pleads Guilty in Bribery Scheme Involving PetroEcuador

A Miami-based financial advisor on Tuesday pleaded guilty to involvement in a bribery scheme involving Ecuadorean state oil company PetroEcuador, the U.S. attorney's office in Miami said in a statement. Jose Larrea, 40, wired more than \$1 million from his U.S.-based bank account to other accounts in order to conceal bribes involving a contractor who paid PetroEcuador officials to retain contracts and win new business, the U.S. attorney's office said. Three others have also pleaded guilty in the case. Larrea is to be sentenced Nov. 14.

Existing protection agreements would have to be legitimized through secret ballots among workers in coming years. Alcalde said the laws would improve Mexico's wages and labor conditions and increase productivity, but some business leaders are concerned the proposed model may increase labor disputes and drive down investment, the newspaper reported. The preliminary trade deal between Mexico and the United States, which Canada may join, includes labor provisions that seek to increase Mexico's low wages, which U.S. President Donald Trump sees as unfair competition. The United States would be allowed to impose trade sanctions on Mexico if it fails to implement labor reforms, including access to collective bargaining, The Wall Street Journal reported, citing two unnamed sources. Alcalde has said minimum wage would gradually increase to 176.72 pesos (\$9.20) by the end of López Obrador's six-year term, El Economista reported in August.

BUSINESS NEWS

FirstCash Buys 154 Pawn Shops in Mexico

U.S. pawn shop operator FirstCash has bought 154 pawn stores in Mexico in two separate deals with different ownership groups, bringing its store count to 2,444 locations, the company said Tuesday. The first acquisition was of 97 retail shops in southern Mexico, while the second acquisition was of 57 shops located in east-central Mexico. Since September of last year, the pawn shop operator has opened 37 stores and bought 342 existing stores in Latin America, where it is present in four countries, including in Guatemala and Colombia. "We continue to demonstrate that we have the infrastructure in place to successfully and simultaneously acquire and integrate multiple acquisitions quickly and efficiently onto our operating platform, while also opening de novo locations, particularly in our primary growth region of Latin America," FirstCash CEO Rick Wessel said in the statement.

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prices fell, the implications of the Kirchners' policies became evident, though they were hidden from official statistics. The Macri government cleaned up many of the previous problems but became overconfident in terms of the speed of adjustment that it could afford. As inconsistencies became evident, even after support from the IMF, investors retreated, with serious consequences. The recently announced policies and the strength of the proposed fiscal adjustment are appropriate, even though they will be difficult to implement. Any additional funds from the IMF will be in the form of faster disbursements. The immediate effect of the depreciation and fiscal adjustment will be a reduction in domestic demand, mainly for consumer goods. However, the devaluation has made the economy very competitive, and exports of goods and services will likely boom later in the year, helped by a recovery from a major drought. The key question that remains is the administration's political ability to survive this period."

A **Kezia McKeague, director at McLarty Associates:** "Argentina is suffering from a crisis of confidence regarding its ability to finance its debt obligations. In what the Macri administration has called a 'perfect storm,' the currency volatility began in late April as higher U.S. Treasury yields led investors to flee riskier emerging markets, just as a severe drought in Argentina was hurting agricultural output. Although Minister Dujovne's team successfully negotiated a record-breaking loan with the IMF to ensure financing, it was ultimately not enough to calm the markets in the face of additional external shocks—most recently, the Turkish financial crisis as well as uncertainty generated by the 'notebooks' corruption scandal. Argentina was uniquely vulnerable due to Macri's 'gradualist' approach to macroeconomic course correction, which softened the social cost of his reforms but required continued international lending to finance

the gaping fiscal deficit. The markets have now forced Macri to abandon 'gradualismo' in favor of an accelerated path to fiscal equilibrium. His decision to implement austerity measures and temporary export taxes reflected not only the need to assure investors but also this administration's justified conviction that eliminating the fiscal deficit is key to liberating Argentina from its historic pattern of cyclical financial crises and high inflation. However, it is too soon to tell whether the most recent measures will suffice to stem the depreciation of the peso without political costs and social unrest. An advanced disbursement of IMF funds would help reverse market fears of a default, though just as important will be opposition support of the 2019 budget bill. In the meantime, high interest rates and government spending cuts are hurting the construction sector, a sector that has been an important driver of economic growth."

A **Megan Cook and Sergio Espinosa, specialists in the political and regulatory risk/strategic affairs practice at Cefeidas Group in Buenos Aires:** "Argentina's currency has experienced a sustained depreciation since April and has lost approximately 50 percent of its value compared to the dollar since January. Rising U.S. interest rates and global uncertainty have hit emerging markets, and in Argentina this contributed to a massive selloff in credit and equity markets in late April/early May. The government responded by reshuffling the economic team and successfully seeking the IMF standby credit line to safeguard against volatility. These actions had seemed to restore market confidence. However, fresh doubts about the country's ability to meet its debt obligations prompted another abrupt devaluation in late August. The government's clumsy response—implying that the IMF had agreed to advance disbursements of the loan several hours before the IMF simply stated it would consider this request—exacerbated the

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market's lack of confidence and generated another sharp drop in the peso. The new volatility has limited the government's margin for action, evidenced by the fact that it reinstated export taxes it had previously vowed to abolish. This move—aimed at achieving a fiscal balance in 2019, a year ahead of the IMF deal target—along with a symbolic cabinet reshuffle and a likely advance of the IMF funds appear to have stabilized the peso for now. However, the sharp devaluation will fuel already-high inflation (expected to increase by 4 percent in August alone) and further erode consumption, a key driver of the Argentine economy. Importantly, these measures marked the end of the Macri administration's gradualist approach at stabilizing the economy, which had been aimed at closing the fiscal deficit while minimizing the possibilities for social unrest. The apparent stabilization of the peso will come at the cost of increased social pushback as polls show rising discontent with the country's economic direction and the Macri administration."

A **Pablo F. G. Bréard, founder and owner of Latin Context in Toronto:** "The stubborn high inflation context, which heightened social discontent and fueled a confidence shock, remains a major destabilizing factor. At the root of 'systemic inflation' reside the chronic fiscal deficits and the wage adjustment culture practiced by a combative labor union movement. Excessive leverage of a public sector dependent on external sources of finance is another systemic impediment to sustaining growth. Moreover, the lack of a domestic credit market compounds Argentina's fiscal misconduct and external vulnerabilities. Unlike the United States, Argentina does not count on its central bank (major holder of U.S. Treasury bonds) or

'willing foreign creditors' (China and Japan). Unlike Canada, Argentina does not have a mature domestic bond market dominated by institutional investors. The IMF engagement is of utmost relevance on four major fronts: 1.) The three-year credit facility takes into

“The IMF engagement is of utmost relevance on four major fronts...”

— Pablo F. G. Bréard

account the 'structural nature' of the stabilization program underway; 2.) It implies the outright support of the United States, as Argentina realigns its foreign policy toward U.S. interests in the Western Hemisphere; 3.) It unleashes funding by multilateral institutions such as the World Bank, the Inter-American Development Bank and selective sovereign wealth funds; and 4.) The early disbursement of funds will calm the furious currency market and ease the local debt restructuring (LEBAC-LETES swap) underway. The 'structural transformation' of Argentina's macroeconomic framework is inevitable, yet it will bring about harsh times for the population and outlive the current electoral cycle. Given the sharp currency devaluation (55 percent in 12 months), non-tradeable sectors (such as construction, utilities, retail and commerce) will be adversely affected by the eroding purchasing power until the relative-value price adjustment is completed."

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