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## FEATURED Q&A

# How Will the Peso's Fall Affect Mexico's Economy?



Mexico's peso has been battered in recent weeks and weakened further on the news Thursday that central bank chief Agustín Carstens was stepping down. // File Photo: Mexican Government.

**Q Mexico's peso has been trading at record lows against the dollar following Donald Trump's election as U.S. president on Nov. 8. On Thursday, it weakened more than 1 percent on the news that central bank chief Agustín Carstens was resigning. How will a weaker currency affect Mexico's economy, and how should Mexico's legislators, president and central bank respond? What are the biggest uncertainties going forward for Mexico's economy? What is the outlook for foreign investment in Mexico in the year ahead?**

**A Alfredo Coutiño, director for Latin America at Moody's Analytics:** "As largely expected, the Mexican peso has reacted negatively to the U.S. election results, given market fears regarding Trump's threats about trade, immigration and investment. However, the peso has its own domestic weakness since Mexico's vulnerability has increased in the past four years: fiscal and external imbalances widened, public debt accelerated, there has been persistent low growth, and most recently, increasing inflation. A currency is more subject to the negative impacts of an external shock if the economy faces wider imbalances. This explains why the Mexican peso has been hit harder than the Chinese currency, even though both countries are subject to Trump's threats. The peso's fall is the reflection of investors abandoning it and finding refuge in the dollar. The uncertainty produced by potential U.S. policies is generating not only capital flight but also delay and postponement of investment and consumption decisions in Mexico. These are the factors that will affect the real economy in Mexico, in addition to the mar-

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## Venezuela Suspended From Mercosur Bloc

The South American trade bloc said it suspended Venezuela for failing to meet basic trade and human rights standards.

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## Authorities Search Itaú's Offices

Federal police searched the offices of the Brazilian bank as part of an investigation of tax fraud and bribery allegations. The Operation Zealots probe focuses on claims that companies avoided paying taxes by bribing members of Brazil's tax-appeals council, known as CARF.

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### POLITICAL

## Brazil's Senate President Indicted

Brazil's Supreme Court voted to put Senate President Renan Calheiros on trial on charges of embezzlement. Calheiros is accused of using public money to pay child support payments for a daughter he had in an extramarital affair. He denies the allegations.

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Calheiros // File Photo: Brazilian Government.

## POLITICAL NEWS

## Brazil's Senate President Indicted

Brazil's Supreme Court on Thursday indicted the president of the country's Senate, Renan Calheiros, on embezzlement charges, Reuters reported. The high court voted to put Calheiros on trial on charges of improperly using public money in a case involving child support payments for a daughter from an extramarital affair. Calheiros is accused of falsifying Senate expense accounts by using fake receipts to receive reimbursements totaling \$1,843 per month for several months in 2005, The Wall Street Journal reported. Calheiros has denied wrongdoing, and his lawyer told the Supreme Court during a hearing Thursday that the receipts were genuine and that the charges against Calheiros are baseless.

## Trump's Success Would Benefit Mexico: Slim

Mexican billionaire Carlos Slim on Thursday said that if U.S. President-elect Donald Trump succeeds in office, then it will benefit Mexico, Reuters reported. The telecoms tycoon and Trump traded barbs throughout the campaign. Trump accused Slim, the top shareholder in The New York Times Co., of trying to help Democratic nominee Hillary Clinton win the election, despite the fact that Slim's shares have limited voting rights. Days before the U.S. presidential election, Slim said Trump's plans could "destroy" the U.S. economy. In his first public comments since Trump's victory, Slim said Trump's plans may risk the United States' role as an international leader. "I'd be more worried if I were American," he said in an inter-

## NEWS BRIEFS

## Mercosur Reportedly Suspends Venezuela

South American trade bloc Mercosur on Thursday announced it had suspended Venezuela from the group for failing to meet basic trade and human rights standards, BBC News reported, citing Brazilian sources. The suspension is expected to be confirmed later today. In September, Mercosur gave Venezuela a Dec. 1 deadline to fully comply with the trade bloc's requirements.

## Bolivia Suspends Operator of Deadly Colombia Plane Crash

The Bolivian Aviation Authority has suspended the LaMia airline's operations indefinitely following the deadly crash of one of its charter planes in Colombia on Monday, officials said Thursday, the Associated Press reported. Authorities did not provide additional details. The LaMia charter flight crashed while approaching Medellín, killing 71 of the 77 people aboard the plane, including the members of a small-town Brazilian soccer team that was headed to the finals of the Copa Sudamericana soccer tournament.

## Odebrecht Enters Plea Agreement in Petrobras Case

Marcelo Odebrecht, the jailed former head of Brazilian construction giant Odebrecht, on Thursday agreed to a plea-bargain agreement in connection with the Operation Car Wash corruption probe, according to a person close to the negotiations, The Wall Street Journal reported. The Petrobras scandal has swept up dozens of politicians and government officials. Odebrecht was one of 77 people, including current and former Odebrecht executives, to sign plea agreements on Thursday in connection with the case.

## FEATURED Q&amp;A / Continued from page 1

ket volatility that will make financial planning more difficult. Unfortunately, Mexico faces the external shock with a weak position, given its economic vulnerability. In terms of the wall, Mexico has almost nothing to do other than reject paying for it. Regarding remittances, the country has little to do. And with respect to trade, Mexico has the option to negotiate. To deal with the increasing volatility, the country might use financial resources to provide liquidity, but it might not be enough to stop capital flight. In fact, of the \$260 billion the country has available, one-third is from a loan and two-thirds are central bank reserves. Hence, Mexico's best option to strengthen its defense is reinforcing macroeconomic discipline (fiscal and monetary) to put the economy in a healthier shape and deepen structural changes to increase the accumulation of capital and consequently expand production capacity. Unfortunately, the outlook for investment does not look promising in the case of a NAFTA breakup. This is the country's main risk and uncertainty."



**Amy Glover, director of the Mexico Practice at McLarty Associates:**

"Banxico raised interest rates recently in order to stem the depreciation of the peso and lessen market volatility caused by the U.S. presidential election. The depreciation could potentially create inflationary pressures that will need to be monitored closely. Mexico's exports will now be more competitive based on the exchange rate, though U.S. imports are a large component of Mexican exports for many industries. Generally, the Mexican consumer will feel the price hikes on a wide array of imported U.S. goods, and this could affect consumer confidence. Growth is likely to remain on the sluggish side at around 2 percent in 2017, and uncertainty will remain high given that Trump has openly attacked NAFTA, a cornerstone of the regional economy. It seems inevitable that negotiations will take place between the three signatory countries, but no one yet knows what aspects of the agreement could be modified. Trump has called for raising tariffs, but that

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view with Bloomberg Television. "If he's going to close the economy ... if he's going out of the NATO and other international [bodies]." Slim added, however, that Trump's success could be Mexico's success as well, saying that a boost in the U.S. economy could lead to the creation of millions of jobs that would benefit Mexico.

## ECONOMIC NEWS

### Mexico's Central Bank Chief Carstens Stepping Down

Agustín Carstens, who has headed Mexico's central bank since 2010, will step down next July to become the general manager of the Bank for International Settlements, The Wall Street Journal reported. Carstens will have a five-year term at the Switzerland-based BIS and will begin leading it in October. He will be the first BIS leader to come from an emerging-market country. He is to succeed Spain's Jaime Caruana, who has led the global consortium of central banks since 2009. Carstens told reporters that he had "mixed feelings" about leaving the Bank of Mexico, but added that he was comfortable with the central bank's strength despite challenging global conditions. Carstens' resignation led the peso to weaken to 20.87 per dollar on Thursday before recovering slightly to 20.77. The Mexican currency had been at a level of 20.55 per dollar on Wednesday.

## BUSINESS NEWS

### Brazilian Authorities Search Itaú Offices

Brazil's federal police on Thursday searched the offices of Banco Itaú, the country's largest bank, as part of the Operation Zealots probe into allegations of tax fraud and bribery, The Wall Street Journal reported. The probe is focusing on allegations that companies avoided

## THE DIALOGUE CONTINUES

### What Does the TPP's Demise Mean for Latin America?

**Q U.S. President-elect Donald Trump said Nov. 21 that he will issue a notification of intent to withdraw the United States from the Trans-Pacific Partnership trade agreement on day one of his presidency in January. Is the TPP dead? How might aspects of the agreement be salvaged? Will the lack of a TPP significantly change the outlook for trade flows and economic activity for its signatories? What sectors of the economies involved will be most negatively affected by the TPP's demise?**

**A Nicolás Mariscal, member of the Advisor board and chairman of Grupo Marhnos in Mexico City:** "In order to take effect, the Trans-Pacific Partnership would have to be ratified by February 2018 by at least six countries that together account for 85 percent of the group's economic output. For this to happen, the United States would have to be involved, but this seems unlikely to happen given Trump's stance and the odds that Congress will refuse to ratify it. Consumers will be the main losers. The market

paying taxes by bribing members of Brazil's tax-appeals council, known as CARF. Police say they have evidence of "collusion" between a member of CARF and "a financial institution" between 2006 and 2015. CARF resolves disputes between Brazil's tax agency and the country's top taxpayers. Itaú denied any wrongdoing and said the documents the police searched for had to do with tax issues at BankBoston, which the Brazilian lender acquired in 2006 from Bank of America. BankBoston's "tax processes," were not included in the acquisition, according to Itaú, which "remain the full responsibility of Bank of America." A Bank of America spokesman said the company is "fully cooperating with the documentation request

for this agreement represented almost twice the size of the European Union's market, with the potential to bring out the best in each country and create champions by sector, in which each is more competitive. For each player, this new scenario would have different meanings. For example, Canada has a potential for huge production in the agri-food sector—a much higher potential than its internal market, and it does not have a better option than the TPP to market its products. However, for other countries, although specific agreements could be negotiated, this would be of little interest if the United States is out. Even signing agreements under this new outlook could for some be counterproductive—for example, textile industries in many countries could be affected. We need to encounter a formula so that everyone wins and so that winners don't gain at others' expense."

**EDITOR'S NOTE: The comment above is a continuation of the Q&A published in the Nov. 23 issue of the Advisor.**

presented by Brazilian authorities." Brazil's Finance Ministry, which oversees CARF, said its comptroller is part of the Operation Zealots probe and is investigating the case alongside other authorities. The ministry also said it has taken internal disciplinary measures and that in September it provided prosecutors with a report that is to be used for criminal investigations. Finance Minister Henrique Meirelles worked for 28 years at BankBoston as president and chief operating officer before leaving in 2002. He declined through a spokesman to comment on the investigation into his former employer. Operation Zealots began in March of 2015 and has implicated a number of Brazilian firms.

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is a protectionist non-starter and could lead to an all-out trade war, harming the U.S. economy as much as Mexico's. Optimally, NAFTA could be updated to incorporate issues of importance to the United States like the digital economy, intellectual property rights and investor state disputes. It will be critical for the Mexican and U.S. private sectors to work together to effectively explain the vital importance of NAFTA. Erecting barriers to trade would mean lower growth and fewer jobs for all. Today, North America is the most competitive region in the world, in large part due to joint production and cooperation on issues across the board. We should be discussing how to improve our regional competitiveness in order to compete globally."

**A Sergio Luna Martínez, director of research at Banamex:** "In the aftermath of the U.S. election, a weaker peso can be conceived as a natural market reaction to a potentially adverse external shock, namely the risk of protectionism in Mexico's main export market. The main challenge for policymakers is ensuring that most of the movement in the nominal exchange rate translates into a depreciation of the real exchange rate. Banxico understands this situation very well and has reiterated that the best way it can contribute to this adjustment is by ensuring that the level of foreign exchange pass through to inflation remains low, and that means higher interest rates. In this respect, foreign exchange depreciation should have a limited impact on households and firms, as fortunately there are no major currency mismatches in their balance sheets. However, the increase in interest rates does imply tighter financial conditions. As for investment, uncertainty about U.S. trade policy represents a major headwind: while some big-ticket projects in telcos and energy will likely materialize in 2017, necessary expansions in capacity among export-oriented manufacturing firms will probably be put on

hold in the first months of next year. This is a key reason for the recent downgrade to our GDP growth forecast for 2017 to 1.8 percent from 2.3 percent previously."

**A David Ross, global equity fund manager at La Financière de l'Echiquier in Paris:** "In the Trump election aftermath, the Mexican peso has been bludgeoned. While the weak peso may cause inflation to tick up toward 3.5 percent in the near term, the same weakness improves export competitiveness, increases the peso value of remittances sent back to Mexico, and with improved oil prices, benefits the oil industry. For a structurally sound economy with GDP growth continuing its 2 percent to 2.5 percent range and strong consumption running at an 8 percent pace in retail sales growth, this decline can have economic advantages. Realizing the importance of peso stability, the central bank responded appropriately by raising rates recently. Mexico's Foreign Exchange Commission is an additional policy tool, ready to intervene as necessary. The country's moderate debt level at 45 percent of GDP allows for additional policy flexibility. It seems that markets have overreacted to Trump campaign slogans. To expect full implementation means accepting the disruption of U.S. companies' supply chains and the negative impacts on the U.S. economy and its manufacturing workers. Full implementation also assumes the approval of a traditionally pro-free trade Republican Congress. In short, full implementation seems to be a low probability event. President-elect Trump is a self-described 'Master of the Deal.' It is quite probable that his statements are not policy, but rather initial, extreme bargaining positions to be adjusted through negotiations toward a reasonable, but 'winning' agreement. Therefore, in this global fund manager's opinion, this has been a market overreaction with Mexico now providing some of the best investment opportunities in the year ahead."

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