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FEATURED Q&A

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

Federal Reserve Chairwoman Janet Yellen on Dec. 16 announced the first U.S. rate hike in nearly a decade. // File Photo: U.S. Federal Reserve.

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 recovering 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

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Brazilian Gov't Underestimated Economic Crisis: Rousseff

Brazilian President Dilma Rousseff said her government's underestimation of the country's economic crisis was its "biggest mistake."

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Rousseff // File Photo: Brazilian Government.

POLITICAL NEWS

Inert U.S. Missile Wrongly Shipped to Cuba

A U.S. missile that was sent in 2014 for use in a NATO training exercise was later packed up and wrongly shipped to Cuba, raising concerns about the loss of secret military technology, The Wall Street Journal reported Thursday. The Hellfire missile's manufacturer, Lockheed Martin, had State Department permission to send the inert missile from Orlando International Airport to Spain for the NATO exercise, but the missile was then sent for unclear reasons to Germany and then to Charles de Gaulle Airport in Paris and finally placed aboard an Air France flight to Havana. It is unclear whether the missile was sent to Cuba mistakenly or if the shipment was the work of spies or criminals, the newspaper reported. "Did someone take a bribe to send it somewhere else? Was it an intelligence operation, or just a series of mistakes? That's what we've been trying to figure out," an unnamed U.S. official told The Wall Street Journal. Although the missile did not contain explosives, U.S. officials are concerned that Cuba may share the missile's sensors or targeting technology with countries such as China, Russia or North Korea. State Department spokesman John Kirby told the newspaper that the department "is restricted under federal law and regulations from commenting on defense trade licensing and compliance issues," the Cuban Embassy in Washington did not respond to requests for comment. A Lockheed Martin

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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."

A **Alfredo Coutiño, director for Latin America at Moody's Analytics:** "The first rate hike implemented by the Fed means the beginning of the end of the era of cheap and abundant money in the world. The same way that the excess global liquidity benefited Latin American countries by allowing them to decrease interest rates, the withdrawal of that liquidity will affect domestic rates negatively by forcing them go up. The consequent normalization of monetary policy in Latin America implies the return to a situation of more expensive domestic and foreign financing costs. The region's economies will have to live without the help of monetary stimulus. In few cases, monetary policy will move to neutrality and in some others will turn restrictive, thus putting growth around potential in the first group and restricting it in the second. Since the region will be under policy normalization, growth is not expected to improve significantly in 2016. Inflation has started to climb above target in most countries given the pass-through effect from the currency depreciation. Even in Mexico, inflation is expected to rebound from below-target to above-target rates in 2016. Countercyclical fiscal power will be practically non-existent, given the depressed commodity prices and anemic growth. Governments will also be forced to normalize fiscal conditions. Weaker currencies and higher interest rates will affect the cost of serving external debts, thus increasing the

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NEWS BRIEFS

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 Thursday that Célestin would only participate in the 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. President Michel Martelly this week issued a decree setting Jan. 24 as the date for the second round.

Paraguayan Authorities Raid Conmebol HQ

Paraguayan state prosecutors have raided the headquarters of the governing body of soccer in South America, Conmebol, BBC News reported Thursday. Paraguay's state prosecution service said it was "searching for documentation related to the granting of commercial and broadcast rights for sporting events." The raid was part of a United States-led investigation into corruption at FIFA, the global governing body for soccer. The president of Conmebol, Juan Ángel Napout, was extradited to the United States last month and has pleaded not guilty to accepting bribes.

Constellation Building $1.5 Bn Brewery in Mexico

U.S.-based Constellation Brands said Thursday that it is building a $1.5 billion brewery in the Mexicali, the Rochester Democrat & Chronicle reported. The Victor, N.Y.-based drinks company said the brewery in the Mexican border city should be completed in four or five years.

representative declined to comment, but the company disclosed the missing missile to U.S. investigators and is cooperating with the probe, U.S. officials told the newspaper.

ECONOMIC NEWS

Venezuela Assembly Seeking to Wrest Control of Central Bank From Maduro

Venezuela's National Assembly will seek to bring oversight of the country's central bank back under its control in its first attempt to influence economic policy, opposition leaders said Thursday, Reuters reported. Lawmakers have traditionally had oversight of the central bank, but President Nicolás Maduro last week issued a decree stripping the legislature of its power to nominate and remove central bank directors just days before the opposition took control of the assembly. Overturning Maduro's decree is "the first thing we are going to present [on economic matters], because it's the most immediate and the easiest," said opposition lawmaker José Guerra, an economist and former central bank director who is expected to be on the National Assembly's finance commission. Another opposition legislator, Ángel Alvarado, said new legislation would also help control inflation by limiting the executive branch's allocation of money. Maduro said last year that the country's rate of inflation was about 100 percent, though private economists believe the figure is closer to 200 percent.

Rousseff Says Gov't Underestimated Economic Crisis

Brazilian President Dilma Rousseff said Wednesday 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. For this year, Rousseff said her top economic goals are curbing inflation and bringing back a budget surplus. Brazil's consumer price index rose 10.67 percent in 2015, its highest level since 2002, the government announced today.

LEGAL BRIEFS

Mayer Brown Advises on Acquisition by Odinsa

Mayer Brown advised Colombian infrastructure company Grupo Odinsa on its acquisition of an equity interest in Ecuadorean airport operator Corporación Quiport, the law firm said in a statement Dec. 29. Mayer Brown advised on the simultaneous negotiation of a share purchase agreement with several selling entities, a secured credit facility from Banco Itaú valued at approximately $194 million, an unsecured credit facility from Banco Santander and a master consent and waiver agreement with senior lenders to Quiport, including the Inter-American Development Bank. Partners George Baptista and Christian Fabian and associate Juan Moreno led the team.

Baptista // File Photo: Mayer Brown.

Milbank Aids Terra Nova on Green-Power Deal

Milbank, Tweed, Hadley & McCloy advised Terra Nova Renewable Partners on a green-power deal in which the company acquired a 33 percent stake in a 336 megawatt direct current portfolio of solar power plants, the law firm said Dec. 30. The acquisition is valued at $180 million in addition to a working capital adjustment. Terra Nova is a strategic partnership between SunEdison and J.P. Morgan Asset Management – Global Real Assets. Milbank also advised institutional investors advised by J.P. Morgan on Terra Nova's acquisition of 333 megawatts of wind power assets valued at $787 million.

ICSID Dismisses Case Against Argentina

The World Bank's International Centre for Settlement of Investment Disputes on Dec. 14 threw out a proceeding brought to the center by 183 Italian investors against Argentina concerning refunds for defaulted government bonds that had been issued after the country's economic crisis in 2001, Law360 reported. The ICSID tribunal dismissed the proceeding, saying that decisions in other arbitration proceedings between the Italian investors and Argentina's government had already addressed the issues brought forward in the case. The ICSID tribunal's acting secretary-general had already decided to discontinue the proceeding in August after both parties failed to pay separate outstanding $200,000 advance payments owed to the court for costs incurred during the arbitration.

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risk of defaults in the region. The wider the macroeconomic imbalances, the higher the vulnerability of a country. Countries running with wide fiscal deficits, high debt ratios and persistent external imbalances are the ones facing more risks. The monetary normalization in the United States will necessarily imply the reversion of the benefits produced by the previous monetary relaxation; thus, this time will be different: Latin America will be affected rather than benefited."

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 Fed rate hike should be seen in the context of the performance of the U.S. economy. In that regard, the increase was a long-time-planned and predicted action, already incorporated into prices in most markets. The interest rate action was taken in light of the steady recovery of the U.S. economy in the recent past, and with the expectation that prices will rise, although slowly. Clearly, there are consequences that are detrimental to Latin America: higher borrowing rates, and a stronger dollar, particularly for emerging market currencies. The two may have a slight negative effect on debt service for heavily indebted countries, including Venezuela, and to a lesser extent Brazil. However, the depreciation helps strengthen competitiveness, with particular benefits to Mexico and Brazil, the key manufacturing exporters, as well as the Central American countries that did well in the assembly industry. The risks now present have little to do with interest rates. China, the second economy of the world at current prices, is at the center of concerns. The collapse of the stock market there can clearly indicate a continued and less-than-smooth slowdown, with an impact on the world economy that far exceeds the actual and expected increase in U.S. interest rates. This will affect virtually all commodity exporters, and should be their main source of concern. Also, it should affect the Fed, which may decide to slow down the pace of interest rate increases in the next few months."

A **Desmond Lachman, resident fellow at the American Enterprise Institute:** "The Federal Reserve's recent decision to start raising interest rates, albeit gradually, is likely to cast a long shadow over Latin America's 2016 economic outlook. This is especially the case since Fed tightening will be occurring at a time that Europe, Japan and China will all be resorting to further unorthodox monetary policy measures in an attempt to kick start their slowing economic recoveries. This divergence in monetary policy stances is likely to result in a further return of capital to the United States and to a further significant strengthening of the U.S. dollar. That latter strengthening, together with slowing Chinese economic growth, is likely to contribute to the maintenance of international commodity prices at their presently very depressed levels. In certain respects, Latin America is better placed to deal with the current Fed interest-rate tightening cycle than it was in previous such cycles. For the most part, its countries have flexible exchange rates and more balanced public finances than before. However, being still highly commodity-dependent and having significant external deficits to finance, they remain very vulnerable to a combination of a reversal in capital flows, a stronger U.S. dollar and a slowing global economic recovery. A weakness of particular concern is the large amount of corporate U.S. dollar-denominated borrowing, especially in Brazil, which would make the corporate sector very vulnerable to a further strengthening of the U.S. dollar. By contrast, the commodity-importing countries of Central America and the Caribbean stand to benefit from a prolonged period of commodity weakness."

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