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LATIN AMERICAN COUNTRY RISK REVIEW

ARGENTINA

What short memories people have! As Argentina's debt swap offer (with shave included) was closing Wall St. analysts and "specialist" journalists pondered that it created "a dangerous precedent". Really? Just over a decade ago, some pretty tough castration took place on Russian debt. In the late 80's, most of Latin America renegotiated debt with partial forgiveness. Argentina's percentage of discount is not even a record. Bolivian debt was repaid at 10 % of face value. Make no mistake about it, it will happen again. Anyway, the famous swap closed with 76 % of acceptances, and just in case the Italians holding out on the barricades wanted to go home, congress passed a law on February 10 prohibiting negotiations to be reopened.

We still have to see the economic slowdown that everyone was predicting, actually feeling. Where is it, folks? The economy grew by 8.8 % in 2004. Construction activity was up 6.9 % in January, Industrial Production rose by 7.1 % and sales rose by 9.8 % in supermarkets and 15.7 % in shopping centres. Tax collection in February was 29.8 % up, with VAT revenue accounting for 2/3 of the increase. Unemployment ended the year at 12.1 % (down 2.4 points) and underemployment also declined by 2 points to 14.3 %. This being said, 54 % of those with a job earn less than U$ 240 a month, whereas the minimum survival basket is valued at U$ 255. As expected, inflation started the year badly, with food prices pushing up the overall index by 2.5 % in the first two months. With exports rising by 16.3 % last year (of which 9.3 % was accounted for by prices), and imports by 61 %, the trade surplus was still a comfortable U$ 12.13 bn. The soybean complex accounted for 22 % of exports, displacing the energy sector (18 %). With the depletion of reserves unless new discoveries are made and developed, the country may need to import oil before the decade is out. Slower agricultural activity may affect the economy in the second half of the year.

Politically, Kirchner has stiffened his stand by talking once again at arms' length with the IMF, flirting with Brazil's Lula (with whom an "energy ring" is being set, also including Venezuela, Paraguay and Uruguay), and threatening not to recognise any foreign sentences on the way privatisation contracts have been handled. Posturing and all, the Peronist PJ party lost heavily to the Radicals in a by-election in Santiago del Estero province. A major drug trafficking scandal based at Buenos Aires' Ezeiza airport was reminiscent of similar goings-on in the days of Menem when a Syrian relative of his wife was the head of customs there. The result on this occasion was a major decapitation of the air force high command. Menem himself is talking about standing for senator in the forthcoming legislative polls. Once again, social pressures are the main risk to Argentina's political and economic stability, as recent strikes and riots shown.

BRAZIL

Many countries and situations have been described over the years as "economic miracles", but I had not seen a real one in my nearly 35 years as an analyst. Now I have. In January, Brazil's primary surplus covered 92.4 % of its interest bill of U$ 4.6 bn, compared to 63.4 % a year ago. This was despite the fact that the said interest bill rose by 12.2 %. The primary surplus rose by an amazing 63.6 %. Tax receipts for the month were 56 % higher. If this holds on in coming months (and forgive me for playing the Apostle Thomas here), the country's main threat has disappeared. We shall see. Total public debt stood at over U$ 500 bn as of end January.

There was also good news on growth. GDP rose by 5.2 % last year, a 10-year high. Unemployment in January was 10.2 %, 1.5 points less than a year ago. Consumer confidence is also at a 10-year high. However, there were some warning signs.

Car production during the month was only 3.1 % higher and domestic sales fell by 0.7 %, though exports grew by 14.7 %. Overall industrial sales for the month declined by 8.1 %. Trade still seemed buoyant with a surplus of U$ 2.18 bn in January stemming from 19 % higher exports and imports rising by 7.4 5. It was Lula himself, not me, who predicted 5 % growth in 2005, said he found a country in a "post-Tsunami" state, but added that "all things are not resolved". His finance minister was more lyrical. He said that "Brazil should form part of the rich countries' club by right, not by invitation".

To be true, Lula does have a number of worries. His personal support in January was still holding strong at 66.1 %, but that of his government declined by 1,9 points to 42.6 %. In late January, 100 members of the PT party, some of them with a quarter of a century as militants, left in disgust. Some made snide remarks about a nose operation that the president was having done in early February, comparing it to Pinocchio's. More serious was the defeat of the government candidate aiming for the important post of president of the Lower House of parliament. The job went instead to a peripatetic politician who has already been a member of eight among Brazil's numerous political organisations. The murder of a US nun doing social work among the MST in the state of Pará caused quite a stir and led to the despatch of 2.000 federal troops there. The president also made eyebrows rise by accusing his predecessor FHC of corruption, but putting his foot in it by claiming that he had "kept quiet" in order not to cause problems (why he therefore chose to mention it now is not very clear).

Insisting that "Brazil does not need the IMF any more" (who does, to be sure ?), Lula predicted 5 % growth for 2005, helped by an improved agricultural sector where crops are expected to increase by 12.5 %. The SELIC interest rate was increased again by 0.5 points (to 18.75) on February 16, and businessmen dealing with Brazil complain that the strong exchange rate is making the country less competitive (though this is yet to be reflected in exports, which are doing very well). Up to now, the problem has been solved by cutting margins.

For the moment, Lula appears unassailable to win a second term in 2006, particularly if his "miracle-making" capacity is kept up.

CHILE

There has been an agreement of sorts within the ruling coalition towards holding primaries as a way to decide which of the two lady candidates will run for president. How and when these will be held is still a difficult matter to solve. Meanwhile, the desperate opposition Alianza, whilst continuing with internal squabbles, has started attacking every government move and policy, including the hitherto taboo subject of any involvement by the incumbent president in goings-on at the Public works Ministry when he was in charge there.

Though the GDP figure will not be available until March 23rd, the IMACEC composite index stood at +5.9% last year, though unemployment (at 7.5 % in January) refuses to go down. The copper price continues to break records and this has produced a healthy fiscal surplus of 2.2 % of GDP last year. Amazingly, instead of addressing all the infrastructure shortfalls and unpaid municipal debts crying out for solutions, the finance minister (whose actress mother recently admitted that "she lost count" of how much pot her son smoked when he was a folk musician), has decided to prepay some of the tiny public debt instead. Chile's external debt management in recent years has become a double-sided act of exhibitionism.

Every now and then a new loan is raised at wafer-thin spreads, to show how good the country's credit is, and not long afterwards debt is prepaid to show how healthy public finances are. Chile's trade and consumer-based "boom" will have to suffer in coming years the 80% increase in the Panama canal tolls, on which it greatly depends, and the increasing over-indebtedness of a population living above its means for the past 15 years (at least). Another risk is the energy shortfall (last year half of oil imports and all the gas came from an increasingly fragile Argentine source). These problems will put a dampener on over-optimistic growth prospects even if none is systemic.

COLOMBIA

Hopes of a lowering of tension in security matters have once again ended up being a seven-day wonder. Following major confrontations during February, the FARC announced that it was ending its fallback and escalating violence. One of their stated aims is to prevent president Uribe from being re-elected in 2006 (considering his popularity levels, the only way to achieve that seems to be his death or a disruption of the electoral process). Colombia was the only Latin American country, which did not suffer a reduction in the 2005 US aid budget. Locally, the government is planning to sell U$ 830 million of state assets this year in order to reinforce social security resources. Nevertheless, studies show that half of the aid destined for the poorest sections of the population fails to get there. Indications for 2004 continue to confirm a dynamic economy, despite all the above constraints. Industrial production rose by 4.9 % and the number of unemployed fell by 4.3 %.

MEXICO

The only political game in town is now the posturing towards the 2006 elections, as this administration is a bigger write-off than the ENRON pension fund. Recent weeks have shown that it may not be such a clear-cut course. Though Mexico City mayor AMLO is still in the lead, a recent poll showed him with a backing of just 32%. Clumsy efforts to have him ruled out of the race are unlikely to succeed, and his party, always criticized for its weak grass-roots presence in the regions, did well in recent state elections for Guerrero and Baja California Sur. PRI hopeful Madrazo has to cope with a group of five state governors who are keen on ousting him, and as for the PAN, it is at best an also ran. The discovery that the organizer of presidential trips at the national palace had drug Mafia connections did little to improve the incumbent's image. The surprising score in the polls is that of independent candidate and former Foreign Minister Jorge Castañeda, with over 11% of preferences.

The economy grew by 4.4% in 2004, which though good is still far from the 7% promised by Vicente Fox in his presidential campaign. More recently, he promised economic "reforms" to Spanish businessmen, whereas he knows very well that any such moves are nigh impossible in what remains of his mandate. Despite the high oil price, the trade deficit rose by 47.6% to U$ 8.53 bn last year. There are no overall balance of payments fears as remittances grew by 24% and direct foreign investment by 46%. Remittances by Mexicans in the USA are equal to over 70% of oil exports.

Industrial employment in Mexico is still falling, despite the four-year high growth rate, though buoyant tourism, which is more labour intensive, has taken some of the slack. The 20.4 % drop in January car exports is not a good sign. In late February, the Central Bank tightened monetary policy, but the peso is still considered as too strong particularly in the face of Chinese competition.

PERU

Full economic results for 2004 show growth at 5.1 %, with the trade surplus 273 % higher at U$2.73bn thanks to a 40% jump in exports. The Current Account deficit plunged by 93 % to just U$ 71 million and the fiscal gap was reduced from 1.8 to 1.1 %. The country hopes and may technically qualify for Investment Grade rating. However, the other side of the coin is that half the state schools cannot start the academic year next week because their infrastructure is falling to pieces. The Economy Minister (better known by his initials PPK) is trying to keep the purse strings tight. He not only refused a U$ 40 million financing for repairing the armed forces' Russian transport aircraft and helicopters (a silly saving which leaves Peru with virtually no logistical resources in case of a natural catastrophe), but is resisting a populist move by president Toledo to spend U$ 325 million by paying U$30 a month to destitute families. The number of employed in Greater Lima dropped by 1.1% in January compared to a year earlier. As strikes and other protests continued in the country, former president Fujimori was barred from standing again in 2006 by the Constitutional Court. PPK himself is thinking of running though his double US citizenship and long years spent there working for investment banks seem to have become an issue. There was a token cabinet reshuffle involving four unimportant ministries on February 25, and more worrying are the plans of Bolivian coca-leaf growers' leader Evo Morales to "franchise" his MAS part in Peru. Despite the good macro-economic figures, it is a shaky picture. As French-Armenian film director Robert Guediguian once remarked: Politics is not about making the economy better, it is about making people better".

VENEZUELA

The confrontation of the Chávez administration with the USA is gathering momentum. (Contrary to what happens in the Middle East, the Venezuelans are doing most of the banging on the table). In February 20, Chávez accused the Bush administration of trying to assassinate him, and in early March threatened to cut off oil supplies if there was any US "aggression". On the more practical front, the president said he was planning a "Bolivarian CNN" (to tell the truth, with the demise of the Mexican channel ECO in the 1990's, the region is the only common-language part of the world without a regional channel with its own voice). The national oil company will be selling its stake in CITGO and invest in joint ventures in Argentina and Brazil. With the latter country, a multi-sector agreement was signed in late February for cooperation in oil, steel and the surveillance of the Amazon. There will also be a purchase of Brazilian military equipment, to add to a similar deal (so far limited to hand weapons) with Russia. Observers worry that some of the light weapons might find their way into the hands of Colombian guerrillas. All this posturing tried to divert attention from renewed major flooding with nearly 100 dead and thousands homeless, showing that the lessons of similar disasters in the year 2000 wee not tackled. What is sure is that however much extra money Chávez is getting from oil, he is spending even more (fiscal outlays rose by 61 % last year) and his whole edifice continues to be very vulnerable to a major weakening of the oil price. Official figures give 2004 growth at 17.3 %, which is doubted in some circles, though the current Account surplus declined by 60 % to U$ 4.6 bn.

SMALLER COUNTRIES

The government in Bolivia is once again facing massive protests, whilst initiatives to modify energy sector taxation or organise a Constituent Assembly are stalled. Ecuador's authorities are planning to refinance their debt at lower interest rates. Paraguay was shaken by the kidnapping and brutal murder of the daughter of former president Cubas, with possible links to Colombian extremists. Uruguay's new Leftist administration took over on March 1st with promises to help the country's poorest citizens.