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COUNTRY INVESTMENT STRATEGY

Armen Kouyoumdjian
akouyoumdjian@hallgartenco.com

April 1, 2005

LATIN AMERICAN COUNTRY RISK REVIEW

ARGENTINA

President Nestor Kirchner has powerful enemies and powerful friends. Among the former are the Chileans who expect him to starve the local economy of energy in order to supply gas under contracts that should never have been signed, and the bondholders who stayed out of the exchange offer but are belatedly rocking the boat. To the opponent list one should add the Vatican (under old management), after local bishops tried to interfere with domestic health policies, and multinational companies he has singled out as whipping boys. On the fan club side, the Americans want to cooperate with him in military technology, Lula is a good friend and Chavez puts his money where his mouth is by buying several billion US dollars of the newly issued bonds. The debt exchange procedure had to be suspended, after New York vulture funds took the country to court.

The economy continues to do well. Capacity utilisation in February was 69.9% (vs. 67.1% a year earlier) but there are wide variations between sectors. GDP in January rose by 9.1 %, higher than the final figure of 9 % for all of 2004. The leading 69 corporations saw earnings increase by 38.2 % last year to US\$ 3.17 billion on sales 13 % higher at US\$ 27.7 bn. (However, 26 companies made a loss and 12 had lower results). The Central Bank spent US\$ 2.22 bn in the quarter to February to stop the weakening of the dollar vs. the peso. The downside continues to be the social pressure, hence the idiocy of Chilean businessmen or Italian bondholders who thought 22 % yields were risk-free. Just get it in your small heads folks that Kirchner (or Lavagna, who has ambitions to succeed him) are not going to worsen a social crisis for you to be happy. Nearly 5 million people are working on the black labour market with no social benefits. Nearly 32 % of the workforce in Greater Buenos Aires is unemployed or under-employed, and the average income for those who work is US\$ 222 a month, less than half the Chilean level. High inflation in the early part of the year has also affected purchasing power. This translates among other things into criminality, such as the 25 travellers, most of whom foreign, who were fleeced on board the official transfer bus between Buenos Aires airports this week, a mere 200 meters from the Ezeiza exit gate.

BRAZIL

What a relief. They had me seriously worried for a while. Though the Vatican criteria for miracles was much debased in recent years, what happened to fiscal results up to January looked material worthy

of canonising the economic team. Thankfully, Brazil's fiscal accounts returned to form in February. During that month, the primary surplus of US\$ 1.45 bn covered only 34 % of the US\$ 4.25 bn interest bill, though the good January results meant that the coverage for the first two months was 64 %. Note that Brazil's public interest bill is running at over US\$ 50 bn annually, and its interest rates are still going up (both abroad and at home, where SELIC rose by another 0.5 points to 19.25 % in mid-March). In a rare harmony with my own oft-repeated warnings, the IMF said on March 24 that the public debt (US\$ 350 bn) made the country "vulnerable". GDP rose by 5. % (to US\$ 602 bn) last year, and the trade surplus for the first quarter reached US\$ 8.32 bn, but unemployment rose 0.4 points to 10,6 % between January and February, though it still was 1.4 points below a year earlier. Anyway, Brazil recently decided that it did not need the IMF anymore, so did not renew its programme.

The long heralded Cabinet reshuffle gave birth to a mouse on March 22 when only two relatively secondary portfolios changed hands (Planning & Social Security). The latter has a deficit of nearly US\$ 14 bn which the government wants to cut by 40 %. I have been hearing this pious wish for the past 15 years. Brazil's lawmakers have other priorities, such as a recent draft law making it compulsory for any X-rated movies or photographs to show male actors wearing preservatives (it was rejected). Lula's popularity dipped 4 points to 58 % in March.

Whatever the positive thinking about the country in some circles might be, bear in mind that this is going to be a bad year for the agricultural sector (the highest ever dip in crop size is expected). Also, relations with the new president of the lower chamber are not good (making legislating more difficult), and to cap it all, a leading magazine has accused the ruling PT of having received financing from Colombia's FARC guerrillas. Violence is not abating, with the reappearance of the death squads last week resulting in thirty dead.

CHILE

The two pre-candidates of the ruling Concertación have agreed to take part in primaries on July 31, preceded by two national and eleven regional debates. The thought of two women pulling each other's hair on podiums 13 times in three months is intimidating, as the underdog opposition candidate promises that sparks will fly once he knows who will stand against him. Lavín is also being prodded for primaries by former senator Sebastian Piñera, so do not be surprised if each side ends up fielding two candidates and the contest goes into a second round.

In the meantime, Chile's diplomats are working overtime on more fronts than Hitler's armies in early 1945. Frantic efforts to ensure the election of Interior Minister Insulza as Secretary General of the OAS later this week, damage limitation acrobatics in the face of Peruvian accusations about Chile having supplied weapons to Ecuador in the midst of the conflict between the two countries, and finally having to explain why the country pretends to be so cool but behaves like any tropical republic. I have referred in my past writings to the difference in work ethic illustrated by the butler character of Anthony Hopkins in the movie "The Remains of the Day". The butler is in charge of overseeing a crucial political gathering organised by his master, as his father is dying in an upstairs room. He does not flinch from doing his duty. In Chile, President Lagos cancelled at the last minute a journey to four European countries because his 108-year old mother is very ill. When you have high responsibilities, you have no family. Official visits abroad means heavy preparation work by embassies, chanceries, heads of state, and are not like an outing to the cinema. Presidential hopeful Soledad Alvear once abandoned a crucial FTA negotiation because her irresponsible son was in a motorbike accident.

The economy grew by 6.1 % last year, fiscal results were comfortably in surplus, and the positive trade balance was a record. What for, if unemployment has been going up, public services (health, education and justice) are not improving, and wages are low? Growth itself is vulnerable, as industry is being starved out of energy due to lower gas supplies from Argentina (factories are bearing the full brunt of the cuts, as the authorities do not wish to risk public wrath by cutting off households in an

election year). The problem may soon hit the electricity sector if rainfall does not manifest itself to allow hydro power to take the slack from gas-fired turbines.

COLOMBIA

Good economy and violent politics continue to define Colombia. Nation-wide unemployment in January was 13.2 %, 3.8 points below the year-ago level. The authorities felt confident enough to announce the prepayment of US\$ 1.25 bn of IADB debt that was not due until 2008. On the downside, a Liberal party congressman was assassinated in his office on March 18, his two brothers having suffered the same fate previously. Former president Alfonso Lopez Michelsen, also of the Liberal party, has called for all political forces to unite and force president Uribe into a second round and possible defeat in the 2006 elections.

MEXICO

Writing fiction in Latin America is a thankless task, as real happenings often go beyond the most prolific imaginative mind. How else can you explain that in a staunchly nationalist country like Mexico, the favourite for the July 3rd governorship election in the Estado de Mexico (the area adjacent to the capital and considered a crucial constituency) decides to pretend to be Jewish in order to improve her chances. Standing on behalf of a Leftist coalition of the PRD-PT parties, the lady in question is said to be called Citlali Ibañez Camacho, the illegitimate grand-niece of PRI president Avila Camacho (1940-46). However, the lady has made a political career under the name of Yeidekol Polensky Gurwitz (note she would not be contented in changing her name just to Sarah Levy), pretending to descend from Polish Jews. Anyway, whatever her name and religion, she is the front-runner.

Securing that election will be a feather in the PRD cap, as its Federal District mayor (AMLO) is still the front-runner in the presidential polls for 2006, though he still has to overcome the obstacle of a politically-inspired impeachment trial which, if successful, could bar him from standing. Though he lost the first round in a parliamentary committee, few believe that he can be easily removed from the scene, and the efforts of the Fox administration in that direction are likely to end up counter-productively. Both Fox's PAN and the former rulers at the PRI have serious internal splits, though the PRI is more experienced at handling dissent. When asked their party preferences, voters still put the PRI ahead with 38.5 % of preferences, whereas the combined support of PAN & PRD is less than 30 %. It is interesting to note that whilst 29% of Mexicans trust the military, only 4% trust deputies and 3% senators. The move to give the vote to up to 4 million expatriate Mexicans appears to go nowhere.

The economy may be marking time a bit. January industrial production rose by 3.1% and Fox has promised to create half a million jobs in the formal labour market this year, as well as introducing a Lula-inspired "zero-hunger" plan. Trade is still in deficit (US\$ 1.67 bn in January/February) with exports up 11.5 % and imports 13.6 %. 2004 was a bumper year for corporate earnings, where the 148 leading companies quadrupled their bottom line to US\$ 16.51 bn on sales 15.8 % higher at US\$ 275 bn. The main medium-term worry is the exhaustion of oil reserves, and the urgency of the matter has led to previously blasphemous mumblings about risk contracts and privatisation for PEMEX. The company needs US\$ 20 bn a year in investment to stand any chance of maintaining adequate levels of production. Unless it stops contributing to the government coffers, it just does not generate that much cash.

PERU

The economy grew by 5.3 % in January, and the figure for February should also be good. Trade results are still buoyant. However, the government is in a mess: the president is more and more cornered each day on corruption charges and it is a miracle if he is still in power. The prime minister is fed up with the whole situation and wishes to resign, preferably soon. The respected economy minister

(known by his initials PPK) threatens to resign if congress creates more expenditure. Vultures fly over the political corpse, but sometimes they fly away again, such as the mayor of Lima, Luis Castañeda. Leading the polls for 2006 at the head of the centrist PSN party, he then announced that he would not stand. Former APRA president Alan García is already launching his bid on social issues. The Chavez influence is also starting to be felt, with plans to send the soldiers out on "social action" programmes as in Venezuela, obviously not welcomed by the commanders. A drifting situation held afloat by high commodity prices.

VENEZUELA

Overspending the oil bonanza, president Chavez has been restless in his moves at home and abroad. He does not seem to be too worried that all is not fun and games in his own government coalition, where disputes are arising for candidates wishing to stand for the August municipal and December legislative elections. There is also tension between the civilians and the military supporters of the regime, and he has announced the creation of a one million-strong reservist militia "to protect the regime". Abroad, apart from investing in Argentina's newly exchanged bonds, he is spending US\$ 1.7 bn on Spanish defence equipment, and just to make sure that the US administration is doubly upset, he received Iran's president Khatami on an official visit mid-March. The Bolivarian regional news station will be run by Caracas-based Uruguayan-Armenian journalist Aharonian, which means that there will now be an Armenian cynic at each end the South America.

There is talk of restructuring some of the country's public debt to improve its profile (no details given), and the economy appears to be ticking on pretty well in the early months of 2005.

SMALLER COUNTRIES

Bolivia is still in a governance mess with on/off resignations of its president, and attempts to bring forward elections to next August. **Ecuador's** judges have surprisingly lifted legal procedures against two former presidents and one vice-president who had been in exile for years. Increasing violence in **Paraguay** may lead to the involvement of the armed forces in public security duties. **Uruguay's** 2004 trade results show a record level of exports (+32.5%) though imports jumped even higher (+42.3%).