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COUNTRY INVESTMENT STRATEGY

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LATIN AMERICAN COUNTRY RISK REVIEW

ARGENTINA

Security, security, security, these reports have persistently warned about. Matters finally came to a head when Buenos Aires rioters started attacking public buildings, and there was tepid response from the authorities, with controversy as to who gave or failed to give what order. The matter was serious enough for president Kirchner to hasten his return from a trip to Venezuela, and fire his Justice Minister by radio even before landing. Said minister, Gustavo Beliz, did not go quietly. Being an Opus Dei sympathising loose cannon, considered a Mr. Clean, he has been dining out very publicly ever since by describing what an unspeakable character president Kirchner is, even (particularly) for his subordinates. The president's backing has recently fallen by nearly 20 points (to 49 % by late July), the lowest of his 15 month tenure. A lot of people are getting uneasy about his internal struggles with other Peronist party factions, the revived trade wars with Brazil, and the seemingly unstoppable wave of crime and violence. Foreign investors (forgetting the bond holders, who came back with a wishful-thinking counter-offer of 45 %) are not impressed either. Visiting Hewlett Packard president Carly Fiorina walked out of the presidential palace, after Kirchner had not showed up for a meeting 45 minutes after the appointed time.

Economic figures still look good but it may not last. Buenos Aires property prices (measured in US\$) and supermarket sales are reportedly back to their pre-crisis levels. Tax revenue was up 43.5 % in the first semester, and industrial production 12.2 % higher. Exports rose by 13 %. Capacity utilisation as of June stood at 70.6 %, compared to 50 % in early 2002. The bad news is that it is all



slowing down. June exports were up only 1 %, supermarket sales actually fell by 2.5 %, and the economy grew by only 4.8% in May. The number of poor and destitute people may have fallen, but despite 2 million people in emergency programs, there were still 15.5 million poor as of March, of which 5.5 million were destitute (i.e. one out of six Argentines in urban areas cannot even feed themselves, in one of the world's breadbaskets!). The worst scenario is one of increasing violence in the midst of a political vacuum, and a slowing economy.

BRAZIL

In the midst of the 1980's debt crisis, A Japanese banker privately commented in London that "Apocalypse tomorrow is better than Apocalypse now". It looks as if apocalypse, at least the financial one, may have been postponed in Brazil for a while. As several months of fiscal statistics have shown an improving trend, let us admit that things are actually better. In the first semester, the interest bill was 16.8 % down (to US\$ 20 bn) and was covered by the primary surplus to the tune of 74.6 %, thanks to a 10.4 % increase in tax revenue. This still means paying over US\$ 100 million of interest each day, and leaves an overall deficit equal to 4% of Latin America's largest GDP, but the improvement is indeed impressive. President Lula felt rich enough to forgive US\$ 36 million of debt owed by Gabon. Figures will look even better if the idea of masking the deficit further by taking some expenditure completely out are introduced from 2005.

There is also good news on other aspects of the economy. Unemployment in the five largest cities was down to 11.7 % in June, having peaked at 13.1 % in April. Industrial and retail sales have been surging ahead in recent weeks, even though the average income to June (US\$ 292) was 0.5 % below the year-ago level. First semester bankruptcies were 15 % down.

Where is the catch? There are existing and potential problems. The scandal series continues, with the top brass at the Central Bank found out to have kept undeclared (and untaxed) accounts abroad. This led to the resignation of the director for Monetary Policy, with the chairman also in a shaky situation. Massive demonstrations against economic policy have taken place all over the country, notwithstanding the improved figures, and the MST landless movement has started violent farm invasions again, which already claimed several lives.

As has been mentioned on previous occasions, the likelihood of cutting domestic interest rates much further is remote, and the risk of international rates going up is very real. The administration does need to create a "feel good" attitude in the run-up to the October municipal polls, but there is still tension



within the Cabinet as to which way economic policy should point. Consumer interest rates, which give usury a bad name, limit the scope of a sustained retail boom. Though the recent statistics are very encouraging and take some heat off the government, complacency would be dangerous. Another risk is the increasing wish of Lula for Brazil to play up its historical ambition of regional leadership, and this may divert his attention away from domestic problems.

CHILE

In those old silent movies, when someone cut off the locomotive from the rest of the train, and the engine driver continued forward unperturbed, the passengers in the carriages initially did not notice as the inertia still pulled them. However, they soon slowed down and eventually stopped and were not amused. Such is the state of Chilean growth, where, at what is supposed to be the start of a virtuous circle, 52 % of those polled in July did not expect the economy to improve over the next 12 months. Statistics continued to be very mixed. New home sales grew by just 1.2 % in Greater Santiago during the first semester but fell heavily in provincial cities. June retail sales were only 0.8 % up on a year ago, despite massive discounts and credit facilities. To top it all, unemployment is still rising and reached 9.6 % in June (0.5 higher than a year earlier). The average graduate has to wait 8 months for a job. Of course, a 87 % increase in copper exports in the first semester looks good in the statistics.

Paradoxically, the Lagos administration's backing, at 57 %, is stronger than economic perception. This might do to no small extent with the disarray of the opposition, with its main parliamentary leader failing, despite a panoply of dirty tricks, to totally block legal moves against him, which might prove that he may have indulged in bisexual activities with minors. The revelations on General Pinochet's finances (which in fact were not revelations at all, as the man's Riggs Bank statements had been published abroad over 4 years ago) have not helped either. Presidential candidate Joaquim Lavín is slipping in the polls, though the ruling coalition still has the difficult task of agreeing on a common candidate. The process will come to a head after the October municipal elections.

COLOMBIA

Keen to capitalise on his reelection ambitions, President Uribe has been trying to move on all fronts. He announced higher pension contributions and sales tax to pay for a virtually bankrupt social security system, and an ambitious privatisation program to bring in US\$ 10 bn through the sale of utilities and state banks. This could be a risky path to tread, as Colombians have historically been privatisation-adverse, and the mixed (to put it mildly) experiences in other countries are not exactly an encouragement. Politically, he invited the paramilitary leadership to address Congress, and despite the controversy such a move created, hinted that the FARC could also be asked to do the same. On such matters, two drug cartels stole the limelight by announcing in mid-July that not only were they stopping their feud and were ready to face justice, but also offered to give US\$ 1.8 bn to the poor. Observers took in all this with a healthy dose of skepticism.

MEXICO

Did you know that President Vicente Fox was a "charismatic and capable leader" ? Neither did many Mexicans, but that was how US Democratic candidate John Kerry described him in his first interview on policies towards Latin America. To be fair, Fox was the only regional serving president that Kerry could name without prompting. In real life, the beleaguered president suffered the ignominious resignation of his chief of staff, who wrote to him a 19-page letter which arguably was the loudest political door-banging in history, and finally forced Mrs. Fox to abandon her presidential ambitions on July 12. Latest trade figures to June show exports doing well (+ 14.2 %) but this belated improvement may be short-lived as US growth appears to falter (car exports fell 9.5 % in the first semester). More serious is the fact that oil reserves will be depleted by 2020 or before, unless new major deposits are found (and then what in terms of public finances and exports?). Attempts to distract opinion by

accusing former president Echevarria (1970-76) of "genocide" (for the 1971 death of a few students, not to be confused with the more serious 1968 Tlatelolco massacre) came to nothing. One major development, after years of dithering, is the official recognition of the bank rescue cost (US\$ 70 bn) as public debt. This will of course increase the debt stock by 50 % at a stroke

PERU

President Toledo, together with his wife and some brothers, continue to have the corruption spotlights pointed at them. The head of state has tried to shake the heat off by saying he would open his and his spouse's bank accounts to public scrutiny.

The relative failure of a general strike called on July 14 lifted his backing levels from 6 to 11 %, but with the opposition capturing the presidency of congress in late July, the machinery to oust him may gather speed. Those less sanguine offer a new Constitutional Assembly as an alternative to a political crisis. The presidential family is not alone in facing corruption accusations, which have claimed the Justice minister with three other Cabinet members also vulnerable. Statistics continue to be good, and even countries like Chile should heed as a warning the uselessness of good statistics, if they do not make the population feel better. GDP grew 4.2 % in May, accumulating 3.9 % in the first five months (and official estimates for over 4.5 % for the full year). Urban employment is up, exports rose 28.6 % in the first semester, and the fiscal deficit continues to fall. One should sympathise with Toledo when he says that his administration's main failure is "not having been able to communicate our successes to the population".

VENEZUELA

Tensions are understandably rising in the run-up to the August 15 referendum. President Chávez has continued to pull all the stops to stack the uncertain cards in his favour. Among such moves was to hang "NO" signs on military trucks during a parade. His own post-referendum posture is unclear. Smart thinking suggests that if he is soundly defeated, it would be risky to stand again immediately (and probably lose) as it would probably put an end to his political career. He may wish to wait until 2006, and hope to cash-in on the opposition's disarray (whoever is elected in case of a successful recall will only serve the remainder of the Chavez term). Aware of the main criticism directed at it, the opposition signed a "governability" pact on July 25 promising a national unity government. This may be easier said than done when the time comes. Growth expectations for this year have been revised downwards to 8 %, and inflation continues at a high level, accumulating 12 % for the first six months alone.

SMALLER COUNTRIES

Though the positive results of the referendum in Bolivia were predictable, what to do next is less clear. Another "final" decision to export gas through Peru should be seen as nothing more than posturing at this stage. Ecuador's president Gutierrez is trying to stop his already depleted PSP party from getting a terminal trouncing in the October 17 local elections and get himself a reprieve by moving closer to the Right. Paraguay's panorama continues to be plagued with endless corruption scandals. Uruguay's presidential front-runner Tabaré Vasquez appears to be marking time, and is not guaranteed to get-in at the first round.

