

# HALLGARTEN & COMPANY

---



## COUNTRY INVESTMENT STRATEGY

Armen Kouyoumdjian  
akouyoumdjian@hallgartenco.com

October 1, 2004

---

## LATIN AMERICAN COUNTRY RISK REVIEW

### ARGENTINA

There are four matters which have dominated the Argentine scene over recent times and they should still be at the forefront of any analysis. One is whether growth is slowing down. Many commentators think it is, but the figures they advance are with respect to the previous month, rather than the same period of last year, which in my view is what counts. What is true is that the devaluation-led export boom never happened. Export volume was 15 % in 2003, and nil so far this year, with all the increase coming from higher prices. On the other hand, the second quarter GDP advance of 7 %, making a first semester total of 9 %, is hardly a recession. Industrial production accumulated an 11.6 % advance in the first 8 months, with the August figure still up 10.5 %. The motor industry led the field. Capacity utilisation rose from 66.2 % in 2003 to 71.8 % this year. In the same period, construction rose by 25.2 %, with August still buoyant at 11.6 %. Tax collection in August was 40 % higher (+ 57.5 % for the activity-sensitive VAT), in-line with the 8-month total of 41.7 %. If that is a slowing economy, most governments would love to have it.

Despite pressure from creditors, the IMF and others, debt negotiations are still dragging on, and whereas Kirchner confirmed on a US visit that the offer would not be increased, some further cosmetic concessions might be made. Just to concentrate the mind, the 2005 budget, which foresees revenue up by 12% and expenditure by 14.8%, allows for just US\$ 3.3 bn to interest payments. The IMF, though lambasted by the president at the UN General Assembly, still postponed a US\$ 1 bn September repayment, which proves once again that non-performance is not really that dangerous.

The third and fourth elements have to do with politics and are linked. Poverty and destitution, which affect respectively 44.3% and 17% of the population, are still a big worry. Unemployment in the second quarter was at 14.8%. Though this was 1.5 points lower than a year earlier, it marked a 0.4 increase over the first quarter. This should not be taken as a proof of slowdown. Today's growth anywhere does not create a lot of jobs. Real salaries are still 15 % below the pre-crisis 2001 level. Plans to cut VAT from 21 to 18% seem to have been abandoned, and there was tension recently between the Economy and Planning ministers as to how to approach the problem of the frustrated utility companies. The President of the Central Bank has just been replaced by Martin Redrado ("the playboy of the financial world"), a dashing figure who has been in and out of many public sector financial slots

over the years, and whose appointment is seen as an end to any pretense towards an independent Central Bank. This malaise is grist to the mill of an alliance of populists and strong-government proponents, whose figureheads are former minister Lopez Murphy and businessman Blumberg who lost a son murdered by kidnapers. With Menem, also scheming in his corner, it could make for uncomfortable rides to the October 2005 mid-term legislative polls.

## BRAZIL

In my 34 years of analytical career, I have rarely seen "economic miracles", and if I had been an Apostle (admittedly a very hypothetical possibility), I would have voted with Thomas in my disbelief. I have no reason or way to disprove the statistics coming out of Brazil in recent months, but my long memory and experience remind me that the country has been a past master in manipulating information.

Anyway, the greatest miracle has been on public accounts, where the August primary surplus was up 120%, accumulating an 8-month total of U\$ 22 bn. This covered 76% of the interest bill for the same period (itself 18 % lower than last year, at U\$ 29 bn. This was not all, the economy grew at 5.7 % in the second quarter, the best performance in 8 years, accumulating a first semester total of 4.2%. Exports in January-August rose by 35%, compared to 30% for imports, and the trade surplus was a record U\$ 22 bn, with preliminary estimates for September pointing to a U\$ 25 bn total. Tourist revenue for the first 8 months was up by 36.4% to U\$ 2.1 bn.



Taking-in by the euphoria, Standard & Poors improved the country's rating from B+ to BB- on September 17, three degrees short of investment grade, which is what the administration now says it aims for. Facing local elections next Sunday, where the test would be the control of major towns, may reflect recent improvements in the popularity of both the government and the president. The latter's personal positive rating was up 4 points to 58%, whereas that of his government improved 9 points to 38% in 3 months.

What about the downside? Isn't there some bad news? Sure, but the blinkered analysts and the journalists who lick their private parts in their articles will not tell you. Even S & P's rating communiqué repeated the classical analytical mistake of confusing balance of payments and fiscal accounts. In the midst of this euphoria, unemployment in August rose from 11.2 to 11.4%, after three months of falls (a rather short Spring). The Sao Paulo judiciary has been on strike for the past 3 months and bank employees nationwide for 4 weeks (some happy campers there..!). The government may have a U\$

125 bn additional liability for various ongoing court cases, and interest rates are on a rising trend. The SELIC was raised by 0.25 points to 16.25% in mid-September, with three out of eight Central Bank directors pushing for a higher rise, which could come soon, particularly with the 2005 inflation target being raised from 4.5 to 5.1%. Banks immediately raised their already usurious interest rates to borrowers. Despite claims of imminent oil self-sufficiency (a promise I have been hearing for 31 years), oil imports were 54 % up and domestic output 1.2 % lower to August.

President Lula continues to shine on the international scene, whilst championing a law restricting press freedom in his country. He pushed for an anti-hunger initiative at the United Nations, financed by a tax on international arms sales (do not laugh too much). Pity that his domestic "Plan Fome" got nowhere. In April 2005, he will host the first ever Arab-Latin American summit in Brasilia, admittedly a long-overdue event considering the large Middle Eastern element in the region's population, particularly in business and politics. He was also fingered by the US (already weary of his carnal relations with Venezuela) of not doing enough in fighting drugs trafficking.

## CHILE

Somebody should point Chilean economists towards a World Bank study just released, admitting that high growth does not improve income distribution, contrary to what all the proponents of grow-at-any-social-or-environmental-cost pretend. Chilean workers are finding that out at their own expense. Unemployment in the quarter to August was at a 3-year high of 9.9%, 0.5 points above the year-ago level, with no less than 17 towns having a double-digit rate. How does this square up with the recent Central Bank revision of 2004 growth to a range between 5 and 5.5%? As was said before, the growth is an empty condom inflated by the hot air a debt-financed consumer splurge and high export prices, not to mention statistical manipulation (a new Industrial Production Index may add up to 0.3 points to GDP). Price-cutting also helps, otherwise how come Producer Prices increased by 15.6% in January-August compared to only 2.2% for Consumer Prices? Who else ever writes or even knows about the Chilean Producer Price Index? (Certainly not the mental castrati on Wall St.!).

Not that all the statistics are that good, mind you. The July IMACEC composite index was a disappointing 4.5%, August retail sales were up by just 0.3 % on last year, and housing starts were down 16.4 % in numbers and 7.7 % in surface area. Restaurant turnover was only 1 % higher in the first semester, during which time internal tourism fell by 9 %. Thinking that high commodity prices will last forever, the nincompoops who run exchange rate policy have once again pushed the dollar down by nearly 10% in recent weeks. Is Chile a stable country? In the past three and a half years, the exchange rate has gone from 600 to 800 pesos per US\$ and down to 600 again, with two ministers at a coterie of Chicago boys talking it further down in recent weeks. Still, they raised the Central Bank overnight rate by 0.25 points to 2%, the first increase in 54 months. The October 31st municipal elections are just over a month away, and rightly seen as a gigantic opinion poll towards the crucial December 2005 legislative and presidential elections. One major challenge is the determination of a single candidate from the ruling coalition, which currently has no fewer than seven or eight hopefuls.

## COLOMBIA

Just to prove that everyone does negotiate with terrorists, president Uribe has now been talking to the para-military organisations, offering them immunity from extradition to the USA if they would play ball with him. So far, neither they nor the FARC have responded in any significant way. To avoid appearing too weak in front of his American security mentors and bankrollers, Uribe also declared that land confiscated from planters (up to 150,000 hectares) will be distributed to landless farmers. All this may be part of his reelection bid, and his backing is currently a comfortable if not overwhelming 54.2%. This did not stop truck drivers staging a long national strike, which is putting several sectors under strain.

Led by buoyant construction and manufacturing sectors, the economy accelerated its growth to a commendable 4.4 % in the second quarter, accumulating a first half total of 4.1 %. A new IMF agreement for US\$ 1 bn will be sought in early 2005.

## MEXICO

Watching the slow demise of the Fox administration with over a third of its mandate left, is like being forced to go to the opera when you are not very fond of the lyrical art. The heroine takes such a long time to die, whilst singing silly songs, and you cannot wait for it to end due to the boredom. In his September 1st annual address, the president admitted that his "democratic project failed in his objective". Now he tells us! The whole point of ousting the PRI was because it was not a democratic way to run Mexico. The president is pulling all stops to stop the PRD mayor of Mexico City (known as AMLO for short) from standing in 2006. It now looks as if he overstepped the mark by secretly meeting with the judiciary to influence a semi-fabricated court case to invalidate AMLO's tenure. The strange thing is that the disappearance of AMLO from the July 2006 race would only favour the PRI, already making big gains in state elections. Fox cannot stand again, and the way his administration is going, his party will be lucky to run a thatched roof café in Cancun a few years down the road.

The 2005 budget goes for modest growth of 3.8 % and inflation of 3 %. This is based on the oil price averaging a conservative US\$ 23 per barrel. Fiscal figures are still clouded by creative accounting. Whereas the "deficit" for 2004 is put at only 0.3 % of GDP, the "public sector borrowing requirement" is actually 2.6 %, and if it were not for the high oil price, the figure would be 4.1 %. There is some talk of belt-tightening, but this does not square up with other discussions on how the oil surpluses should be spent (at federal or state level). The government claims it will insist on its ill-fated plan to impose a 4 % VAT on food.

## PERU

It may be as boring for you to read as for me to write, but things continue unchanged in the country. The government is a mess, with the president, his wife, brothers and party all mixed up in corruption scandals and internal disputes. Toledo is totally unrepentant, even by regional standards. He publicly told civil servants "not to be ashamed" to hire people from his own party for public office. Growth is still comfortable, with GDP advancing 3.8 % in July and accumulating 4.1 % in the first 7 months. Both GDP and exports (up 32.2 % in January-August) have been broadly based, and the currency has only lost its unequalled stability by being pushed up some 5 % against the dollar despite Central Bank intervention.

A worrying development is that of tourists being sequestered at a site near Cuzco by coca leaf growers protesting against eradication.

## VENEZUELA

President Hugo Chavez must be laughing all the way to the ballot boxes. The Carter Foundation which certified his country's recall referendum process as clean has now expressed doubts about the validity of the forthcoming US presidential elections in Florida, an obvious case of the pot calling the kettle black. Reinforced on the strength of his victory. Chavez is pushing on the accelerator of his ongoing hobbies. He is accelerating the controversial agrarian reform, and the short-term social help plans with the help of the extra oil revenue, which he has been overspending. With the opposition coalition breaking to pieces (just think if they had won the referendum!) in the run-up to the forthcoming municipal elections, the business community has thrown-in the towel and is talking to the man. The US has not given up on attempts to destabilize him, and have moved an obnoxious ambassador from Santiago to Caracas probably with that remit.

Even the rating agencies like the man, with Fitch IBCA improving their score from B- to B+ in mid-September. The economy, which will grow at over 10% this year, is creating jobs again, and unemployment in August, at 14.2%, was 3.6 points below the year ago level.

The Finance Minister is conservatively forecasting a slowdown of growth to a range of 3 to 5 % in the next two years, but with inflation remaining in double digits at over 15%.

#### SMALLER COUNTRIES

With the security situation deteriorating again, the government in **Bolivia** is caught between conflicting pressures as to how much to renationalise the energy sector. **Ecuador's** president may have survived the risk of impeachment and is taking about a major new oil find. **Paraguay** is faced with a major challenge following massive land invasions by farmers. **Uruguay's** hitherto left-wing presidential favorite Tabare Vasquez may not be able to make it to the top job unless he wins an uncertain first round victory.