

HALLGARTEN & COMPANY



COUNTRY INVESTMENT STRATEGY

Armen Kouyoumdjian
akouyoumdjian@hallgartenco.com

December 1, 2004

LATIN AMERICAN COUNTRY RISK REVIEW

ARGENTINA

"Yellow River is in my mind and in my eyes" went a famous song by Elton John a few decades ago. China's Yellow River is locally known as Huang Ho, and that reminds us of Chinese president Ho Jintao, who was on a triumphal tour of South America recently, on his way to the APEC leader's summit in Santiago. The week before he arrived in Buenos Aires, President Kirchner told his people that they would be hearing "great news", though he did not specify its nature. Minds started working overtime: a settlement of the Malvinas dispute? A major increase in pensions? No, it was the visit of president Ho. It was going to solve all (well, most) the country's problems. Though China is showing great interest in Latin America, and announced a US\$ 20 bn investment plan in Argentina's oil and mining sectors, there are no free meals in the Orient either, and there has to be a mutual advantage. Anyway, no Chinese magic will solve Latin America's history of Two Hundred Years of Ineptitude.

Relations with Italy were less cordial, as the several hundred thousand bond holders there, backed by their prime minister Mr. Berlusconi made a big enough last-minute fuss to postpone the closure of the deal into early 2005. It was not all bad news for Mr. Kirchner, as his tame Congress voted to give him what is being described as the strongest powers ever had by a democratically elected head of state in Argentina. Meanwhile, as another presidential plane (Tango 10) had landing gear trouble, it has been decided to sell Tango 01 (which it seems is worth little more than scrap). A number of urban explosions have yet to be clarified, and the "piquetero" protesters have been flexing their muscle again.

Economic figures continue well, with September activity up 8.1% (for a 9-month cumulative total of 8.6%) and October industrial production up 7.8% (11.1% for the 10-month total). Capacity utilization stood at 71.3%, up from 69.5% a year earlier. Trade figures for the first 9 months show a surplus 29% down though still at US\$9.54bn, despite the 68.3% surge in imports. Commodity volumes and prices dominate export performance, thus making it vulnerable. In the first 9 month, the soybean complex accounted for nearly 25% of total exports, followed by oil and gas products (14%) and other grains (9%).

BRAZIL

President Lula's latest moves have definitely been to the Right, reshuffling his cabinet (with more to come), smiling to the Americans and continuing on regional initiatives, such as the "South American Union" which is being launched on December 9. Oh yes, President Ho of China also dropped in, and the Brazilians declared his country "a market economy" which is needed as a status to join some trade organizations. In recent weeks, the minister of defense left the Cabinet after a long period of tension with the armed forces, and the presidents of the official Banco do Brasil and BNDES also went, accompanied by the radical presidential adviser Frei Betto and press secretary. No wonder that on a visit to Maccio Lula was called a traitor by demonstrators. There is an obvious parallel with Poland's Solidarity movement leader, who graduated from a militant metal worker to a conservative paunchy head of state in a couple of short decades. Criminal violence in Rio is once again getting out of hands. In one recent week alone, over 20 tourists were mugged, which led the USA to issue a negative travel warning. No wonder President Putin's minders did not allow him to meet with Romario at the Maracana stadium.

With the usual Brazilian trick of bribing coalition partners (this time it cost the treasury U\$ 235 million in extra budget allocations), the PMDB was "persuaded" to stay in the coalition. Meanwhile, the landless peasants of the MST and students demonstrated against the government in Brasilia.

The economic news was mixed. The country's 21st largest bank, Banco Santos, had to be intervened on November 12 because of liquidity problems. Eyebrows were raised when it was revealed that the president's own PT party had nearly U\$185 million deposited there (which is a lot of money for any party to have anywhere!). The SELIC interest rate had to be raised again (+ 0.25 to 17.25%) on November 11, though rates charged to the public by the banking system range from 36% for car loans to 141% for post-dated cheques.

Latest statistics show October unemployment down 0.4 from a year earlier, at 10.5%, but the improvement was mainly due to there being fewer job seekers. There were contradictory figures related to job creation in the formal sector. The government said an (unlikely) total of 1.8 million such jobs were created in the first 10 months, but the figures issued with the employment statistics referred to only 0.77 million having been created in the 12 months to October 2004. Supermarket sales over the first 10 months were 2.2 % higher and car sales were 13.8 % up, but there was a mixed trend for the month of October (supermarket sales 6.6 % higher but car sales 2.8 % down).

The October fiscal deficit, at U\$ 1 bn, was stable, accumulating a 10-month total of U\$ 10 bn (- 52.4% down on last year, and equal to 2% of GDP). A point to watch is the fact that, though the 10-month interest bill (U\$ 37 bn) was 14 % down on last year, the figure for October alone (U\$ 3.9 bn) is up again (+ 12.5%). This must reflect the effect of the rise in interest rates, not fully compensated by the stronger Real (only 11.2% of the securitised debt is in U\$ whereas 54.2% is based on the SELIC). The authorities are actually intervening to stop the Real from rising further.

It remains to be seen, particularly if economic and fiscal statistics go into reverse again, whether Lula will be allowed to get away with turning his back on the principles, which brought him to power.

CHILE

The APEC leaders' meeting was a public relations' apotheosis for the Chilean authorities who managed to overcome the linguistic, logistical and security threats and host the world's high, mighty and wealthy around a cozy and virtually trouble-free meeting, whilst scheduling parallel "official" visits some of which lasted only slightly longer than a session on a New York shrink's couch. They even got brownie points by politely and firmly putting GWB's security detail in its place. Preventing the Secret Service men from entering a venue exclusively under Chilean police protection, the English-speaking carabinieri, in

response to the gunslinger's protest "but this is my president", replied "and this is my country". Santiago's surplus hotel capacity got a much-needed injection, as did some restaurant and nightspots.

Back to reality, and the presidential pre-campaigning is in full swing 12 1/2 months before the polls. As the Right's bloody-nosed hopeful thinks of new campaign ideas, the coalition's four official pre-candidates will have to wait until early 2005 at least. Three of them are Christian Democrats, though Ms Alvear seems to be in the lead, after which it has to be decided between her and Socialist Ms Bachelet. The latter is flagging a bit, and having earlier had a mild brain aneurysm, is now in hospital with severe pneumonia. Acts of God are rarely factored-in by political analysts but they happen: people get ill, are run over by buses or get shot. The whole shape of Brazilian politics was changed when Tancredo Neves died on the eve of becoming the first democratic post-military president as a result of a botched up abdominal operation (diverticulitis) performed by a duty surgeon during the weekend in Brasilia. Alvear is this month's candidate in front for the wise money. The military regime and its fellow travelers will soon be put even more to shame with the publication on a detailed report on torture during the Pinochet years.

Growth statistics look good (GDP grew by 6.8 % in the third quarter), and claims that it will soon be reflected in employment statistics abound. Let us see. I still maintain that the export boom and credit-financed consumer bubbles make up the bulk of the growth and could easily go into reverse. If things are so good, why is capital not staying in the country? How come external reserves actually fell by US\$ 54 million in the first 10 months of the year, despite a US\$ 7.32 bn trade surplus and a 9-month current account surplus of US\$ 2.27 bn? There was a net US\$ 5 bn investment outflow during the period.

COLOMBIA

On his way back from the APEC summit, GWB stopped over in Colombia and (literally) gave a pat on the back of his protégé president Alvaro Uribe, the beneficiary of the third largest US military aid budget. Several peace initiatives there have been blowing hot and cold (as usual). There is supposedly some progress in disarming the paramilitary, but they are not a cohesive lot with whom you can deal en block. Furthermore, they have switched their policy to include political power in the regions, controlling several governorships and mayor posts. On November 10, President Uribe changed all the top military command.

The economy continues to tick in a fairly dynamic fashion, with the Finance Minister saying that growth this year will exceed 4%, and inflation be kept within a 5 to 6% range. Multiplier-effect sectors such as construction (up 7% in September) are helping to spread the jam. The IMF is expected to extend by a few months its program maturing next January.

MEXICO

In the previous report I mentioned that Mexico City mayor and 2006 presidential hopeful AMLO appeared unsinkable in the polls, but this may be changing. Though he still has a 74% backing in the Federal District in relation with the good job he has done there, he and his PRD party are weakening nationally. A most recent poll actually shows him behind the PAN's Santiago Creel with just 28% of presidential voting intentions vs. Creel's 29%, and the PRI's Madrazo at 26%. The PRD did not do very well in recent regional elections, and its lack of a dynamic national power base has always been one of AMLO's strong handicaps. The PRI on the other hand did particularly well, whereas the PAN's Creel is getting advice from Bill Clinton's electoral guru Dick Morris, said to be the main cause of his advance in the polls, contrary to his party's decline in local voting booths. He is still not the PAN's official candidate (in fact nobody is as yet nobody's official candidate), and in the case of the PAN, it seems the decision will be in the hands of the party's most conservative wing.

Chinese competition notwithstanding, the struggling in-bond maquiladora sector is making a bit of a comeback of late. Its performance helped push September's industrial production up 5.5% to a 9-month total of 4%, whereas overall economic activity that month grew by 4.4% (which is also the official GDP forecast for the full year). However, the recovery is not creating that many jobs. We are to expect a new more realistic unemployment measure in the near future. Despite an increase of 23.6% in oil exports and 21.4% in non-oil products, Mexico's trade is still in deficit, and in fact a growing one (+ 11.5% to US\$ 3.36 bn). The average price of Mexican oil was US\$ 31.23 per barrel in the first 10 months (+ 25.5%), when 1.85 million b/d were exported.

The Fox administration is still drifting from conflict to conflict. Congress adopted divergent budgetary measures for 2005, which the president is trying to veto, and there are fears that this dispute may lead to government paralysis (an aggravation of the arthritis it has been suffering from the beginning). Another two years of feeble administration is what awaits us. Thanks heavens for the oil price, which brought in US\$ 17.6 bn in exports during January-October.

PERU

As the politically embattled Toledo administration somehow manages to float along on a sea of rather good economic statistics, there are vacuums left to amuse the gallery. Among these were a declaration by former president Alan Garcia and a potential candidate for a comeback, praising the Chinese model of government, and the trial of the Senderista leadership possibly turning into farce due to procedural mistakes.

The fiscal deficit during the third quarter was stable at 2.3% of GDP, with the cumulative 9-month total at 0.1% (vs. 1.1 % in 2003). Growth reached 4.5% in September, accumulating 4.4% over the 9 months, helped by exports and investment components. The trade balance continues to be healthy, with exports up 34.7% in the first 10 months. Even the current account moved into surplus during the third quarter, for the first time in 15 years

Controversial fiscal proposals ranging from a corporate asset tax to mining royalty are not endearing the administration to the business sector, but interestingly there is less talk nowadays of Toledo not finishing his term (which still has until August 2006 to run). It might be another case of "good economy, pity about the politics".

VENEZUELA

The full results of the October 31 local and regional elections showed another clean sweep for the pro-Chávez candidates, who captured 18 out of 20 states and 83% of municipalities. The wind is definitely blowing in the president's favor, with the opposition in disarray and the oil price holding high. A press-gagging law recently passed has been very controversial, but it just shows in whose favor the cards are stacked. There was a cabinet reshuffle in mid-November when the Foreign and Health ministers were replaced, and this might eventually extend to the economic team.

His position will be further strengthened by the publication of CIA documents which show that the USA at least knew about the failed coup attempt against him, an accusation which he had made at the time and afterwards. The killing by a bomb (the first political murder in the country for 47 years) of the prosecutor investigating the coup, if proved to be a last act of revenge by the conspirators, can also be fully exploited by Chávez.

The economy is also looking good. Inflation fell under 1% a month in September and October for the first time in 18 months, and third quarter GDP jumped by 15.8%. September unemployment, at 14.5%, was 2.2 points below the year ago level. Still, resources are always needed for the social programs that sustain the administration's popularity among the lower classes. Still pressuring the Central Bank to

hand over "currency gains" to the Treasury, the government finally increased the price of controlled products in the second week of November, and made the 0.5% financial transaction tax a permanent feature.

Chavez appears one of the survivors in the region, and despite all he went through in recent years, including many mistakes, he is still on top. There must be a morality there somewhere.

SMALLER COUNTRIES

With protests, bombings and other pressure, the government in **Bolivia** is once again with its back against the wall and the usual talk of military coup is reviving. **Ecuador's** president managed to escape the impeachment process but is not yet out of the woods. In **Paraguay** pressure is strong on the government to do something about land invasions. In **Uruguay** the president-elect is trying to form a reassuring broadly-based government, and has obtained the majority in both congresses, being just one vote short of the numbers needed to reform the constitution.