



# Latin American Weekly Spotlight

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A company of the **Allianz Group**

<b>Argentina:</b>	Bond swap has begun
<b>Brazil:</b>	We expect a 50 bps interest rate hike
<b>Chile:</b>	CB hikes key interest rate by 25 bps
<b>Colombia:</b>	CB meets 2004 inflation target
<b>Ecuador:</b>	World Bank pledged US\$ 200mn for 2005
<b>Mexico:</b>	Solid growth of industrial production
<b>Peru:</b>	Mounting pressure on President Toledo
<b>Venezuela:</b>	Increasing legal uncertainty

## Argentina

On Monday the Argentine government received the approval of the German BAFIN to tender the restructuring proposal in Germany. At the same time the approval from Luxembourg was received. ---- Japan, where 4% of eligible debt is held, is the only market in which the transaction is not going ahead until now, due to the lack of a local institution willing to perform the required roles in the transaction. ---- As expected, the first presentations of the Ministry of Economy on the debt swap brought no news regarding the details of the offer already known. The tender period started on January 14. It will end on February 25. The early tender period, during which investors are guaranteed the swap into par bonds up to the equivalent of US\$ 50,000, will end on February 4. The result of the swap will be announced on March 18. ---- Due to strong economic growth and high temperatures, energy consumption grew 9.9% yoy in December. Should the hot climate persist, energy shortages cannot be ruled out.

Outlook: Presentations on the debt swap will be held this week in Europe followed by presentations in the U.S. next week. At the early stages Argentine authorities are likely to convey the picture of a successful start to the transaction. Although it will not be possible to verify such statements, it is not unlikely that the beginning of the swap could see a high initial response from bondholders, as the Argentine pension funds – following talks with the government – declared their intention to participate; besides, Argentines holding bonds abroad might be shy to enter into legal battles over these investments. What the participation ratio will be in the end remains difficult to tell. Economy Minister Lavagna stated he would view a participation of 50% as a success because this would mean that two thirds of the entire public debt would be performing. The IMF and most market participants seem to see 75% as a minimum. The 75% mark was mentioned last week by the Italian IMF director and member of the IMF Board Pier Carlo Padoan. Previously it had seemed the IMF would view 80% as the minimum participation ratio.

## Brazil

Industrial production fell from a very high level by 0.4% mom in November, which corresponds with an 8% yoy increase, which underlines the solid state of the sector. - --- The Minister of industry and foreign trade criticized in an interview the concept of the inflation targeting (and the interest rate hikes done on the basis of this concept), as inflation was influenced above all by adjustments in administered prices. We do not share this view. The administered prices, which account for about 30% of the IPCA-basket of goods, are not randomly set prices. Instead, a big part of them (e.g. gasoline and transport tariffs) depend on the international oil price. In addition, the concept of inflation targeting has been very successful in the past couple of years. ----- Rating agency Moody's has left Brazil's rating unchanged, but lifted the outlook to "positive". Moody's rating of B1 is one notch below the BB minus rating of S&P and Fitch.

Outlook: The central bank will hike the interest rate by 50 basis points to 18.25% on Wednesday, given inflation expectations above the inflation target and the higher than expected IPCA inflation rise (Dec: 0.86% mom, 7.6% yoy). Afterwards, the Central Bank might take a wait-and-see position for the next couple of months. ----- Balance of payment figures on Thursday: The current account should show a comfortable surplus of around US\$ 1bn on the back of a record result in the trade balance. This would take the overall 2004 current account to a surplus of US\$ 11.5bn, or 2% of GDP. For this year we expect a surplus of 1.3% of GDP. FDI should amount to over US\$ 1bn for the third month in a row. ----- The retail sector's mood had suffered a little bit from the latest interest rate hikes. However, we expect that Christmas season led to an increase of sales of 6% in real terms in November (Tuesday).

## Chile

As we expected, the CB lifted the monetary policy interest rate by 25 bps to 2.5%. The decision is based on the assessment that a robustly growing economy renders further monetary stimulus redundant, and on the notion that core inflation accelerated somewhat in re-

cent months. We expect a measured tightening over the year, taking the key interest rate to 3.75% by year-end.

### Colombia

Colombia is going to place US\$ 1.5bn in bonds on international capital markets and will contract multilateral monies to an amount of US\$ 2bn. ----- The government reaffirmed its very optimistic outlook for 2005 and forecasts GDP growth of 4%, a 2.4% budget deficit and a level of public debt below 50% of GDP. We expect GDP growth at 3.8%, a budget deficit of 2.4% and public debt at 55%. ----- As expected, the 2004 year-end inflation came in at 5.5% yoy, taking average inflation to 5.9%. For 2005 we expect a slightly decreasing inflation rate (average: 5.7%).

### Ecuador

Boosted by the overall strong growth in the economy last year, largely driven by the oil sector tax, government revenues were up 11.7% yoy in December resulting in a full-year increase of 12.2% ---- The World Bank announced loans to Ecuador of US\$ 200mn this year. This comes on top of an equal amount promised by the IADB, and an expected US\$ 80mn from the CAF. With this promised multilateral funding, financing constraints have eased considerably.

Outlook: President Gutiérrez and Economy Minister Yépez are preparing their forthcoming visit to New York. The focus will be on the government's proposal to swap the 2012 global bonds, as well as a possible new bond issue (the first since the 1999 default).

### Mexico

After Moody's had raised its rating for Mexican foreign currency bonds one notch to Baa1, S&P's indicated that it has no immediate plans to upgrade its Mexico rating. Currently, Mexico is rated BBB- at S&P's, two notches below the new Moody's rating. In its risk assessment, S&P's has a somewhat bigger focus on structural reform issues (tax system, energy sector, labor market). Nevertheless, should macroeconomic data in 2005 develop as solid as in the recent past (this depends on the continuation of high oil prices and robust demand growth from the US), an upgrade by S&P's becomes highly likely prior to the presidential election in July 2006, even if structural reform will not take place. ---- Following the unexpectedly sharp drop of inflation in December to 0.2%, the central bank left its monetary policy unchanged on its bi-weekly Friday policy meeting. In case that inflationary pressure continues to ease in the coming months, the probability will grow that the Banxico can stop tightening by raising the "corto". Money market rates (Cetes, 28-days) have stabilized

recently after having reached a cyclical high of 8.6% in mid-December. ----- In November, industrial production grew 5.4% y/y, slightly more than the consensus forecast of 4.8% (DBLA-forecast: 5.5% y/y). The robust expansion in the industrial sector is still in place and is set to continue for the time being. The strong increase of industrial production in the US in December of 0.8% m/m is a strong indicator that the Mexican industry will benefit from continuing high demand. ----- In October, gross fixed investment grew by 6.5% y/y. This means that the rather hesitant recovery of investment demand continued, after the share of investments fell substantially over the past years.

Outlook: This week's only publication of relevance is the labor market statistics for the month of December. We expect a relatively sharp drop of the unemployment rate from 3.8% to 3.2%, mostly due to seasonal factors.

### Peru

Despite the resignation of Interior minister Javier Reátegui, President Toledo is still under significant pressure. The opposition has announced its intention to censure Prime Minister Carlos Ferrero and Defense minister Roberto Chiabra next Tuesday, which, if successful, could force Toledo to rearrange his cabinet. We do not, however, expect nervousness on international markets, as Finance minister Kuczynski is likely to remain in office. ----- Industrial production grew 10.8% yoy in November, mainly due to higher demand for consumer goods (10.9%) and intermediate goods (11.7%), while capital goods underperformed (2.8%). 2004 total growth in this sector will probably amount to 6.1% yoy.

### Venezuela

President Chávez has signed a decree to facilitate the expropriation of allegedly unused land. On the same occasion, he praised the provincial governors enacting expropriations in their regions. The consequences for the investment climate are fatal, which in turn further increases Venezuela's dependency on oil. Additionally, we would not rule out social unrest. ----- The alleged kidnapping of a high-ranking FARC terrorist in Caracas, which Chávez argues was paid for by the Colombian authorities, weighs on anyway tense bilateral relations. - ---- Central government expenditure rose 60% yoy nominally in November. This takes the ytd-increase to 62% yoy. ----- The CB has announced to hand over to the government close to VEB 700bn (around US\$ 365mn) in exchange rate profits. The government had been claiming a total of US\$ 1.2bn. We expect the government to get its will, as the CB's new president, who is to be named by the end of January, will be very

close to the government. ----- The recently announced new management of the state-owned PDVSA oil company tightens the government's grip on the company. Energy minister Ramírez, who heads PDVSA's management as well, underlined the intention to increase the company's social activities. In other words, the current practice of supplementary budgets, which blurs fiscal transparency and accountability, is here to stay.

Outlook: We expect the devaluation of the official exchange rate (1918 VEB/US\$) in the coming weeks. While there is talk of a rate of 2150 VEB/US\$, a more

substantial devaluation is clearly on the cards, as price controls appear fairly effective. In reaction to the devaluation speculation, the unofficial exchange rate weakened significantly, reaching a five-months low at 2800 VEB/US\$ last week. ----- The government asked national and international banks to elaborate proposals for public debt operations on international markets (Deadline: January 19). It seems that the government intends to continue its efforts to improve its external debt maturity profile.

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Abbreviations:

mom = month-on-month  
qoq = quarter-on-quarter  
yoy = year-on-year  
ytd = year-to-date  
s.a. = seasonally adjusted  
n.s.a. = not seasonally adjusted

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Exchange rate	date	last	one week	one month	one year	end 2004	ytd-change, %	end 2005f
Argentina	14.01.2005	2.94	2.97	2.98	2.88	2.97	1.2	3.1
Brazil	17.01.2005	2.70	2.70	2.71	2.84	2.66	-1.7	2.9
Mexico	17.01.2005	11.23	11.25	11.22	10.81	11.15	-0.7	12.0
Chile	17.01.2005	573	567	574	570	556	-2.9	600
Colombia	17.01.2005	2368	2381	2357	2739	2355	-0.5	2650
Peru	14.01.2005	3.26	3.27	3.27	3.46	3.28	0.6	3.3
Venezuela	17.01.2005	1918	1918	1918	1598	1918	0.0	2150

EMBI+ Spread								
bps	date	last	one week	one month	one year	end 2004	ytd-change, bps	
Argentina	14.01.2005	4926	4842	5472	5549	4707	219	
Brazil	17.01.2005	433	431	396	436	383	50	
Mexico	14.01.2005	171	167	169	188	167	4	
Ecuador	14.01.2005	689	713	733	739	691	-2	
Colombia	14.01.2005	362	360	359	393	333	29	
Peru	14.01.2005	251	240	226	277	220	31	
Venezuela	14.01.2005	447	439	434	612	412	35	

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	14.01.2005	2.25	2.25	2.38	1.44	2.31	-0.1	5.0
Brazil Selic	17.01.2005	17.74	17.74	17.74	16.30	17.75	0.0	16.0
Mexico Cetes 28 days	14.01.2005	8.54	8.56	8.54	4.66	8.61	-0.1	8.2
Chile 90 days, PDBC	13.01.2005	2.53	2.17	2.36	1.79	2.24	0.3	3.8
Colombia Overnight	13.01.2005	6.41	6.52	6.93	7.48	6.24	0.2	7.5
Peru Overnight	14.01.2005	3.03	3.03	3.00	2.50	3.03	0.0	4.0
Venezuela deposits 30 days	11.01.2005	11.68	10.98	13.40	12.30	11.92	-0.2	12.0

Foreign exchange reserves								
US\$, bn	date	last	one week	one month	one year	end 2004	ytd-change	end 2005f
Argentina	06.01.2005	19.7	19.6	19.3	14.3	19.6	0.0	21.5
Brazil	13.01.2005	53.2	52.6	50.4	49.9	52.8	0.4	58.2
Mexico	07.01.2005	73.4	71.6	70.7	65.1	71.6	1.8	63.5
Chile	30.09.2004	15.8	na	15.8	15.7	15.9	0.0	17.3
Colombia	30.11.2004	13.0	na	12.3	10.7	10.9	2.1	13.3
Peru	30.09.2004	11.2	na	11.0	9.8	10.2	1.0	13.0
Venezuela (FEM&Gold incl.)	05.01.2005	24.4	23.8	23.8	21.3	24.2	0.3	20.8

Economic activity				Inflation				
GDP (yoy, %)	2003	2004e	2005f	% , year end	2003	2004	2005	GDP 2003, US\$ bn
Argentina	8.8	7.5	4.0		3.7	5.6	7.5	127
Brazil	0.5	4.9	3.9		9.3	6.9	5.9	495
Mexico	1.3	3.9	3.0		4.0	5.1	3.6	626
Chile	3.3	5.7	5.3		1.1	2.4	3.0	72
Colombia	3.7	3.6	3.8		6.5	5.8	5.4	79
Ecuador	2.5	5.8	2.8		6.1	2.0	0.9	27
Peru	4.0	4.5	4.0		1.8	3.8	3.9	61
Venezuela	-7.6	17.0	4.5		27.1	18.7	16.4	86

Public sector	Budget balance, % of GDP		Public debt, % of GDP		Amortization, US\$ bn		Gr. financing needs, US\$ bn	
	2003	2004e	2003	2004e	2003	2004e	2003	2004e
Argentina	1.3	4.1	140	128	19.8	19.8	19.1	15.5
Brazil*	-5.2	-2.9	58	52	94.2	84.3	72.1	68.4
Mexico**	-0.6	-0.3	28	28	23	30	26	32
Chile***	-0.4	2.4	13	12	0.8	0.8	1.4	-0.8
Colombia	-2.8	-2.5	62	58	10.6	10.0	8.4	7.5
Peru	-1.9	-1.3	48	46	1.1	1.3	2.3	2.2
Venezuela	0.2	0.5	45	34	10.8	9.0	10.7	8.5

\* Amortisations only federal debt, including short term debt

\*\* Amortisations without Cetes

\*\*\* debt, amortization and financing needs: central government only

External Sector 2004e									
	External debt		Debt service		Current account		Trade Balance	FDI (net)	Import cover
	% of exports	s.t., % of total	US\$ bn	% of exports	% of GDP	US\$ bn	US\$ bn	US\$ bn	months
Argentina	364	39	32.3	77	3.3	4.7	13.3	0.0	6.3
Brazil	203	12	65.6	59	2.0	11.6	33.7	14.5	5.9
Mexico	79	28	33.3	16	-1.3	-8.5	-6.1	15.0	3.4
Chile	113	19	7.2	19	2.8	2.6	9.0	3.4	5.2
Colombia	242	12	6.9	41	-1.3	-1.3	0.9	2.0	6.5
Ecuador	17	9	1.4	3	0.0	0.5	6.8	-0.1	1.1
Peru	218	16	3.6	25	-1.2	-0.8	2.6	2.0	9.3
Venezuela	83	10	8.3	21	14.6	15.2	22.6	1.3	8.9