**Argentina:** Speculation regarding improved debt offer
**Brazil**: Depreciation of the real expected to be short-lived
**Chile**: Industrial production should maintain solid growth impetus
**Colombia**: Stable upswing
**Ecuador** : IMF negotiations continue
**Mexico**: Q1 GDP growth surprises on the upside – we raise our 2004 forecast from 2.8% to 3.2%
**Peru**: Weak employment figures and social unrest challenge governability
**Venezuela**: After GDP growth of 30 % yoy in Q1-04, we raise our growth forecast

## Argentina

Industrial production shrank an astonishing 3.9% in April (mom, s.a.), due to the energy rationing and plant retooling, which had been delayed to April in response to the boom experienced by the sector in recent months. In yoy terms production was up 9.3% in April. ---- The monthly GDP proxy EMAE grew by 11.9% (yoy) in March (+1%, mom, s.a.), taking preliminary GDP growth to 10.7% (yoy) in Q1-04. ---- The primary surplus again came in higher (ARS 1.7 bn) than market expectations of ARS 1 bn. The IMF target of ARS 5.55 bn for H1-04 thus has already been more than achieved in the first four months of the year (ARS 5.66 bn). ---- According to official estimates public revenues in 2004 will exceed budgeted figures by ARS 7.8 bn (US$ 2.7 bn). Economy minister Lavagna stressed that nothing of these extra monies will be spent as part of the debt restructuring. Instead it will be used to cover increased public spending. ---- The main bondholder committee GCAB criticized that the talks with government officials agreed upon in April so far have not taken place.

Outlook: At the end of last week Economy Minister Lavagna presented to President Kirchner the new debt offer, details of which will presumably be released in June. The local newspaper Ambito Financiero claims to have had access to the offer, which allegedly calls for net present value losses of 80%. The latter compares to net present value losses in excess of 90% in the first offer made in Dubai in September last year. We find it hard to judge the accuracy of the above mentioned article. However, we believe the new offer will show some improvements. Still we regard the present quotations of defaulted bonds in the high twenties as overoptimistic.

## Brazil

The central bank did not cut the Selic interest rate by 25 basispoints, but let it constant at 16 % instead. The decision was not unanimous (6:3), what we consider a signal that the central bank will resume the process of interest rate cuts as soon as the nervousness at the financial markets has calmed down. ----- The balance of payments data for April were in line with expectations: The current account showed a significant deficit (-US$ 735 mn), as interest payments were extraordinarily high that month. Foreign direct investments came in even lower than our already low forecast (US$ 381 mn). For the current month the central bank expects inflows of only US$ 600 mn (2004 forecast: US$ 11.5 bn). There was better news in terms of the roll-over rate, which rose from below 50% for private sector debt (medium and long term) in March to 67% in April. ----- Retail sales increased by 11.4% yoy in March leading to first-quarter growth of 7.5% yoy. This is another signal that the economic upturn is getting broader. An improving consumer climate is being confirmed by the consumer confidence index ICC for Sao Paulo, which recovered from its low March level to 124.4 points. This is significantly higher than the 2003 average of 111.5 points (on a scale ranging from 0 to 200 points).

Outlook: GDP should have increased in the first quarter by 1.1% yoy and 0.7% mom (Thursday). We expect a more pronounced upturn in the current quarter and GDP growth of 3.5% for the year as a whole. ----- Given positive economic activity data, we expect that unemployment, which stood at 12.8% in March, slightly decreased in April (Tuesday). ----- Fiscal data on Friday: The public sector's primary surplus amounted to BRL 7 bn in April, corresponding to a ytd primary surplus of 5% of GDP (the IMF primary surplus target is 4.25% of GDP). Net public debt should have increased slightly in April due to the BRL depreciation in that month (in March net public debt was at 57.4% of GDP). ------ The minutes of the latest central bank meeting (Thursday) may contain signals as to whether further rate cuts may be expected in the next few months (we are expecting that). ----- Short-term outlook for the foreign exchange rate: After the decision of the central bank to leave the Selic rate at 16% (what might have been interpreted by some investors as a signal that the central bank is really worried about the increase in spreads) the real depreciated significantly to over 3,20 BRL/US$. Yet this weakness was not provoked by a lack of capital inflows (indeed, the latest foreign exchange flow data show a significant increase of inflows in the first 10 days of May), but by the fact that banks absorbed the dollar inflows and built up large long USD positions, currently at an all-time high of US$ 3.4 bn, in expectation of an interest rate increase in the United


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States. We stick to our forecast for the end of the year of 3.10 BRL/US$ as we expect that banks will unwind their positions in the coming months. However, the BRL could depreciate further in the short term, above all if corporate hedging (subdued until now as they expect the depreciation to be only temporary) would increase.

## Chile

As expected, central government finances posted a considerable surplus in March. In Q1-04, the surplus now amounts to 0.4% of total 2004 GDP. For 2004 as a whole, the surplus should increase to 0.7% of GDP, driven by growth acceleration and higher copper prices. ----- Retail sales increased by 7% yoy in April. This should alleviate concerns regarding the strength of the economic growth acceleration, sparked by a weaker consumer sentiment in April and mixed employment figures in March.

Outlook: According to preliminary IMACEC data, GDP should have expanded by 4.6% yoy in Q1-04. We expect significant export growth, but domestic demand should have posted solid growth as well (today). ------ We expect growth acceleration to be reflected in solid industrial production figures for April (forecast: 4.9% yoy), a significant expansion of mining production, and robust employment figures (Thursday). ----- Driven by stronger goods exports, the current account should post a solid surplus of US$ 0.9 bn in Q1-04. We expect a surplus of US$ 1.6 bn (1.8 % of GDP) for 2004 as a whole (today).

## Colombia

Industrial production showed a surprisingly strong increase in March (just under 9% yoy). We stick to our assessment of a continuing upswing and count on industrial production growth of around 7% over the year as a whole. ----- The central bank started selling foreign currency reserves with the intention to use the proceeds for buying local government bonds (TES) and thus reducing outstanding public debt. So far US$ 160 mn have been used for debt buybacks. Even though we are generally skeptical about the selling of foreign currency reserves, a total amount of US$ 500 mn seems justifiable against the backdrop of a current foreign currency reserves level of more than US$ 11 bn. ----- In the first four months of this year, tax revenues increased by 23% yoy (in nominal terms). Most notably VAT and income tax revenues rose stronger than expected. Even though we expect the trend of strong tax revenue increases to continue, higher military and social spending as well as the delay of planned political reforms (with a fiscal impact) should get in the way of a further reduction of the budget deficit.

Outlook: The economic upswing should be reflected in higher retail sales (March) and lower unemployment figures (April). We expect GDP to have grown by more than 4.5% yoy in the first quarter of this year.

## Ecuador

IMF agreement: In contrast to earlier statements, there are government considerations to alter the nature of the currently negotiated precautionary IMF Staff-monitored program (SMP) into a traditional Stand-by arrangement (SBA). The latter would allow for a draw-down of IMF monies, albeit only under certain conditions. We expect the government to have realized that under current market conditions, original plans to raise money on international financial markets are no longer feasible, leading to the necessity of drawing IMF money. Independently, the national procurator has given his approval to government plans to hire the Andean Development Corp. (CAF) to be the manager of any sovereign debt operation on external capital markets. ----- Around 30% of funds accumulated in Q1-04 in the FEIREP oil stabilization fund (in total around US$ 200 mn) have been transferred to the government. Under original rules, only 10% of FEIREP deposits are supposed to be used for current spending. A further 20% of the monies are allocated to a “rainy day” oil stabilization fund, while the remaining 70% are reserved for debt reduction. However, government has argued that the temporary closing of the OCP oil pipeline earlier this year (due to landslide damage) justifies dipping into the 20% “rainy day” component of the fund. The use of the FEIREP monies in this way is another sign of the cash flow pressures that the government is continuing to experience.

## Mexico

The first of 14 state elections scheduled to take place this year delivered a slight success for the PAN, as it could win 36 out of 106 mayoral contests in southern Yucatan, including that in the capital Merida. --- GDP growth for the first quarter surprised positively, reaching 3.7% yoy or 1.3% qoq in seasonally adjusted terms. Contrary to that, we were expecting a negative surprise. Apparently, the economic upturn especially gathered speed in March. This leads us to increase our 2004 GDP forecast from 2.8% to 3.2%. Nevertheless our basic economic forecast remains unchanged: we expect the economic upturn to lose some steam in the second half of the year based on the fact that the stimulus from US demand will recede. In addition, real interest rates should continue to rise. Given the lack of structural reforms this should be enough to change the currently bright mood among investors and consumers. The Mexican Central Bank has a completely different outlook. According to Governor Ortíz it is thinking about raising its 2004 GDP growth forecast to more than 3.5%.-----The decrease in unemployment in April was somewhat stronger than expected, as the rate dropped from 3.86% to 3.58%.

Outlook: In the first two weeks of May consumer prices presumably fell by 0.4% due to seasonal factors (electric fee subsidies). Nevertheless, the annual rate of inflation should increase to 4.3% (Monday). The central bank should keep its monetary policy steady for the time being on its Friday meeting.---- Exports should have continued to rise strongly in April (+15% yoy). The trade balance should post a smaller deficit than last year in April (US$ 450 mn vs. US$ 805 mn), mainly due to higher oil prices (Tuesday).----The current account deficit should have fallen slightly in the first quarter of 2004, mainly due to higher remittances (Tuesday). ----- In March, retail sales should have increased by 7.5% in real terms (Tuesday).

## Peru

Surprisingly strong GDP growth in March was not reflected in recent labor market data. The unemployment rate reached 10.7% in April (March 04: 10.2%; year-end 2003: 9.7%) and the fraction of underemployed remains high (56%). ----- After social unrest near the border to Bolivia going on for weeks, the government decided to call the state of emergency in the region. In April the mayor of the small town Ilave was lynched. At the same time the resistance of coca growers in the amazon region against government plans to reduce the cultivation of coca rises. ----- The government's budget showed a surplus of 0.4% of GDP in the first quarter of this year (Q1 2003: -0.6% of GDP). Given growing demands of various political groups for higher government spending, we expect government expenditures to increase drastically in the coming months. The 2004 consolidated public-sector deficit (DBLA forecast: 1.6% of GDP) should be slightly higher than the upper limit agreed upon with the IMF (1.4%).

Outlook: We perceive a high risk of President Toledo stepping down in the next months. According to latest opinion polls just 6% of the public stand behind president Toledo. Still disenchantment with politics is not confined to the government. The work of the congress as a whole is insufficient in the opinion of more than 80% of the interviewees.

## Venezuela

GDP grew by 29.8% yoy in the first quarter of 2004; we had anticipated an increase of 20% due to a huge basis effect (GDP Q1, 2003: -27.8% yoy). As the general strike in December 2002 and January 2003 had affected oil production in particular, this sector's growth now has likewise been much more elevated than that of the remaining sectors (72.5% vs. 18.9%). Given the performance of the first quarter and a fiscal policy that is more expansionary than expected, we have lifted our 2004 growth forecast to 10.5% in spite of ongoing private sector investment restraint. ----- The current account had a surplus of almost US$ 3.5 bn in the first quarter, above all due to unexpectedly high oil prices. At the same time, there was a deficit of US$ 1.8 bn in the capital balance, so that the central bank was able to build up further reserves. ----- Bank lending increases strongly: In April, credit volume was 66% higher than a year before (+35% in real terms).

Outlook: The verification of the 1.19 million signatures for the presidential referendum that are suspected to be invalid will take place next week-end (May 28 to 30) and be monitored by the OAS (Organization of American States) and by the Carter Center. Last week, a corresponding verification had been made with respect to the referendums against government (1) and opposition (13) representatives. In the process, signatures already given may revoked for "repentance". It seems possible, yet not certain that the opposition may be successful in the verification process. The result is to be known on June 4.


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Abbreviations:

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

| Exchange rate | date | last | one week | one month | one year | end 2003 | ytd-change, % | end 2004f |
|---|---|---|---|---|---|---|---|---|
| Argentina | 21.05.2004 | 2.94 | 2.91 | 2.83 | 2.84 | 2.84 | -3.6 | 2.9 |
| Brazil | 24.05.2004 | 3.19 | 3.12 | 2.91 | 3.03 | 3.03 | -5.3 | 3.1 |
| Mexico | 24.05.2004 | 11.57 | 11.52 | 11.28 | 10.24 | 10.24 | -11.5 | 11.9 |
| Chile | 21.05.2004 | 642.10 | 642.50 | 611.55 | 705.10 | 705.10 | 9.8 | 600 |
| Colombia | 21.05.2004 | 2774.70 | 2720.80 | 2615.70 | 2856.50 | 2856.50 | 2.9 | 2800 |
| Peru | 21.05.2004 | 3.49 | 3.48 | 3.48 | 3.49 | 3.49 | 0.0 | 3.5 |
| Venezuela | 21.05.2004 | 1917.60 | 1917.60 | 1917.60 | 1598.00 | 1598.00 | -16.7 | 2400 |

| EMBI+ Spread | | | | | | | |
|---|---|---|---|---|---|---|---|
| bps | date | last | one week | one month | one year | end 2003 | ytd-change, bps |
| Argentina | 24.05.2004 | 5038 | 4896 | 4474 | 5343 | 5739 | -701 |
| Brazil | 24.05.2004 | 742 | 722 | 597 | 789 | 463 | 279 |
| Mexico | 24.05.2004 | 200 | 209 | 179 | 238 | 199 | 1 |
| Colombia | 24.05.2004 | 878 | 843 | 815 | 1103 | 799 | 79 |
| Ecuador | 24.05.2004 | 538 | 507 | 369 | 470 | 431 | 107 |
| Peru | 24.05.2004 | 510 | 420 | 317 | 415 | 312 | 198 |
| Venezuela | 24.05.2004 | 672 | 648 | 650 | 1090 | 593 | 79 |

| Benchmark interest rates | | | | | | | ytd-change | |
|---|---|---|---|---|---|---|---|---|
| % | date | last | one week | one month | one year | end 2003 | %-points | end 2004f |
| Argentina, Overnight | 21.05.2004 | 4.25 | 2.56 | 1.31 | 5.25 | 1.50 | 2.8 | 4.0 |
| Brazil Selic | 21.05.2004 | 15.77 | 15.77 | 15.85 | 26.30 | 16.33 | -0.6 | 14.0 |
| Mexico Cetes 28 days | 21.05.2004 | 6.73 | 6.81 | 5.61 | 4.83 | 6.01 | 0.7 | 6.5 |
| Chile 90 days, PDBC | 18.05.2004 | 1.31 | 1.33 | 1.56 | 2.48 | 2.29 | -1.0 | 2.8 |
| Colombia Overnight | 19.05.2004 | 6.80 | 6.95 | 6.98 | 7.20 | 7.49 | -0.7 | 8.8 |
| Peru Overnight | 21.05.2004 | 2.55 | 2.55 | 2.43 | 3.80 | 2.50 | 0.0 | 2.6 |
| Venezuela deposits 20 days | 17.05.2004 | 10.40 | 10.19 | 9.58 | 17.05 | 13.20 | -2.8 | |

| Foreign exchange reserves | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| US$, bn | date | last | one week | one month | one year | end 2003 | ytd-change | end 2004f |
| Argentina | 19.05.2004 | 16.0 | 15.6 | 15.1 | 11.2 | 14.1 | 1.9 | 17.0 |
| Brazil | 06.05.2004 | 50.8 | 50.5 | 51.2 | 43.3 | 49.3 | 1.6 | 54.2 |
| Mexico | 30.04.2004 | 68.9 | 68.4 | 68.0 | 57.0 | 65.8 | 3.1 | 65.0 |
| Chile | 30.04.2004 | 16.0 | na | 15.96 | 15.89 | 15.89 | 0.1 | 16.6 |
| Colombia | 31.03.2004 | 11.33 | na | 11.29 | 10.62 | 10.62 | 0.7 | 11.5 |
| Peru | 29.02.2004 | 10.5 | na | 10.6 | 10.1 | 10.19 | 0.3 | 10.9 |
| Venezuela (FEM&Gold incl.) | 06.05.2004 | 24.6 | 24.354 | 23.43 | 24.35 | 21.30 | 3.3 | -6.8 |

| Economic activity | | | | Inflation | | | |
|---|---|---|---|---|---|---|---|
| GDP (yoy, %) | 2003e | 2004f | 2005f | 2003 | 2004 | 2005 | GDP 2003, US$ bn |
| Argentina | 8.7 | 6.5 | 3.8 | 3.7 | 8.0 | 8.0 | 127 |
| Brazil | -0.2 | 3.5 | 3.5 | 9.3 | 6.4 | 5.2 | 492 |
| Mexico | 1.3 | 2.8 | 2.6 | 4.0 | 3.9 | 3.5 | 614 |
| Chile | 3.3 | 4.8 | 4.5 | 1.1 | 2.2 | 3.0 | 72 |
| Colombia | 3.7 | 4.0 | 3.7 | 6.5 | 6.0 | 6.5 | 78 |
| Ecuador | 2.7 | 4.8 | 2.9 | 6.1 | 5.0 | 0.9 | 27 |
| Peru | 4.0 | 3.8 | 3.7 | 1.8 | 2.3 | 2.2 | 61 |
| Venezuela | -9.2 | 6.0 | 5.0 | 27.1 | 30.0 | 27.8 | 82 |

| Public sector | Budget balance, % of GDP | | Public debt, % of GDP | | Amortization, US$ bn | | Gr. financing needs, US$ bn | |
|---|---|---|---|---|---|---|---|---|
| | 2003e | 2004f | 2003e | 2004f | 2003e | 2004f | 2003e | 2004f |
| Argentina | 1.2 | 1.6 | 140 | 150 | 19.8 | 19.8 | 19.1 | 18.2 |
| Brazil* | -5.2 | -2.6 | 83 | 79 | 94.2 | 83.2 | 72.1 | 67.3 |
| Mexico** | -0.6 | -0.3 | 28 | 28 | 23 | 29 | 26 | 31 |
| Chile*** | -1.0 | 0.9 | 16 | 14 | 0.8 | 0.8 | 1.4 | 0.2 |
| Colombia | -2.8 | -2.8 | 60 | 60 | 6.2 | 5.3 | 8.4 | 7.9 |
| Peru | -1.9 | -1.6 | 47 | 46 | 1.1 | 1.5 | 2.3 | 2.5 |
| Venezuela | -3.6 | -4.5 | 42 | 47 | 4.7 | 6.1 | 7.7 | 10.0 |

* Amortisations only federal debt, including short term debt ** Amortisations without Cetes *** debt, amortization and financing needs: central government only

| External Sector 2004f | 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 | 374 | 30 | 32.3 | 82 | 2.2 | 3.3 | 11.5 | 0.0 | 5.6 |
| Brazil | 237 | 12 | 64.0 | 69 | 0.6 | 3.3 | 26.3 | 13.0 | 7.1 |
| Mexico | 83 | 28 | 33.3 | 17 | -1.8 | -11.0 | -7.8 | 14.0 | 3.5 |
| Chile | 135 | 18 | 6.8 | 21 | 1.8 | 1.6 | 6.0 | 1.5 | 6.3 |
| Colombia | 243 | 12 | 7.9 | 49 | -1.3 | -1.2 | 0.9 | 2.0 | 6.3 |
| Ecuador | 17 | 14 | 1.4 | 3 | -0.7 | 0.0 | 6.4 | -2.5 | 1.0 |
| Peru | 238 | 16 | 3.6 | 28 | 0.0 | 0.0 | 1.7 | 1.1 | 9.4 |
| Venezuela | 122 | 11 | 5.0 | 18 | 9.5 | 8.3 | 14.2 | 1.4 | 11.1 |