Latin American Weekly Spotlight

July 4, 2005

Dresdner Bank Lateinamerika AG
formerly Deutsch-Südamerikanische Bank AG

A company of the **Allianz Group**

Argentina: IMF board calls for reforms
Brazil: Inflation down, trade surplus up
Chile: Unemployment rate falls sharply in May
Colombia: First quarter GDP growth at 3.6% yoy
Mexico: Decoupling from US interest rates
Venezuela: Central Bank reform may be approved this week

Argentina

The IMF board issued its statement concerning the recent Article IV consultations, broadly confirming the critical tone of the staff report published on June 20. In its statement, the board urged Argentina to carry out further reforms; among other things, the statement calls for a reliable set of rules and regulations for the privatized companies and a reform of the banking sector to be implemented. Besides, this year the targeted primary surplus (budget surplus before interest payments) is to be raised above the original target of 3.8 % of GDP. Additionally, the Fund is pressing for an arrangement concerning the non-restructured bonds. Roughly 25 % of the bondholders did not accept the exchange offer. This year, Argentina's repayment obligations with the Fund amount to US$ 1.6 bn, and in 2006, to US$ 3 bn. An agreement with the IMF would be an important prerequisite for stretching the maturities. However, we assume negotiations to become difficult. The relationship between the Fund and the Argentine government is damaged, and in October, parliamentary elections will be held in Argentina. ----- Moody's, the rating agency, has lifted its foreign exchange long-term rating of Argentina by one notch to B3, catching up with S&P. In its statement, the agency cited substantially lower debt and debt service levels as the main drivers of the upgrade. ----- Supermarket sales increased substantially in May (+11.7 % yoy). At a monthly rate of +4.8 %, the weak trend of the first four months of 2005 has been inversed. We would expect a weakening domestic demand in the months ahead, as rising interest rates and increasing inflation will hit consumer confidence. ----- The trade balance posted a solid surplus in May (US$ 1.2 bn), taking the surplus to US$ 4.8 bn ytd. On the back of weakening export growth and dynamic imports we expect the overall 2005 trade surplus to decrease to US$ 10.8 bn (2004: US$ 13.3 bn).

Brazil

The latest central bank survey brought further good news as it showed that inflation expectations for 2005 fell sharply to 6.05% from 6.16% previously. Expectations for accumulated inflation over the next 12 months declined to 4.96% from 5.07% previously. Meanwhile, expectations for 2006 remained unchanged at 5%. However, the top five most precise forecasting institutions that take part in the survey are now forecasting inflation of 4.88% in 2006. However, we do not believe that the ongoing decline in inflation expectations will lead the central bank to bring the easing cycle forward (to July/Aug as opposed to Sept/Oct-05). --- The trade balance posted a surplus of US$4 bn in June, the highest monthly surplus ever. This brought the surplus to US$ 19.7 bn (+31.1%) ytd, which compares with a surplus of US$ 15 bn in the first semester of last year. Exports rose by 9.4% yoy in June registering an all time high of US$ 10.2 bn (Jan-Jun-05: US$ 53.7 bn; +23.9% yoy. Meanwhile, imports rose by 11.7% yoy to US$ 6.2 bn (Jan-Jun-05: US$ 34 bn; +20.2%), also on the back of a strong across-the-board performance. --- Despite the lower than expected central government primary surplus, the consolidated public sector - which includes regional governments - posted a record high primary surplus of BRL 6.3 bn in May (May 2004: BRL 5.8 bn). The primary surplus stands now at BRL 50.3 bn ytd, or 6.57% of GDP, another all-time high since records began. This compares with a surplus of BRL 38.3 bn in the same period of last year, equivalent to 5.64% of GDP. The improvement over the central government figures was driven by a large turnaround in the fiscal performance of state companies. The latter posted a surplus of BRL 1.4 bn in May, compared to a deficit of BRL 735 mn in May 2004. As expected, there was a slight deterioration (in absolute terms) in the nominal deficit on the back of higher interest payments. The nominal deficit reached BRL 7.4 bn in May 2005 compared with a deficit of BRL 4.8 bn in May 2004. Nevertheless, the debt-to-GDP ratio remained relatively stable at 50.4% of GDP. --- The declining trend of inflation rates has been confirmed by the recently released price indexes. The Fipe index, which measures consumer price changes in Sao Paulo, fell by 0.15% mom in the four week period ending by the third week of June 2005. This compares with expectations of no change (0%) and follows an increase of 0.07% mom in the previous four-week period. The decline in the index was led by a renewed fall in food and transport prices. Core inflation fell to 0.26% mom in the third week of this month from 0.28% mom previously. Moreover, the IGP-M inflation Index fell by 0.44% in June 2005 following a

economics@dbla.com

decline of 0.22% in May. All in all, these factors are likely to lead to a renewed decline in inflation expectations.

Chile

After a 5.4 % drop in production in April and an average ytd growth of just 1.1 % in the first four months of 2005, mining production only expanded slightly in May (+1 %). Stagnating copper production accounts for the sector's slack. Overall, however, the sector is well positioned to benefit from the current high commodity prices. ----- On the back of robust production in the chemical industry, industrial production surpassed expectations and grew by 6.8 % in May. Average 2005 growth amounts to 5.6 % ytd. ----- Good news from the labor market: As in recent months, solid job creation (+3 % yoy) reduced the unemployment rate further, from 9.4 % in May 2004 to 8.3 % this May. The increase compared to April (+0.1 percentage points) is due to the upcoming southern hemisphere winter.

Outlook: Consumer prices in June are likely to have increased by 0.2 %, taking the yoy rate to 2.5 % (Tuesday). ----- On the back of solid industrial production, we expect the IMACEC economic indicator to post growth of 6.8 % in May (Tuesday).

Colombia

The economy grew by 3.6% yoy in the first quarter of 2005. Especially the construction sector (+10.6%), retail sales (+7.3%) and mining (+5.1%) contributed to this positive result, while industrial production declined slightly (-1 % yoy). For the second quarter we expect industrial production to recover and the economy to grow by over 4% yoy. This has thus far been confirmed by monthly data. In April industrial production recovered and grew by 11% yoy. ----- The increase in money supply due to the central bank's interventions on the foreign exchange market did not lead to a rise in inflation so far: at 0.4% mom in June (4.8% yoy), inflation was 0.2 percentage points lower than in June 2004. Food prices showed the strongest rise at 0.7% mom. ----- The strong growth of exports continued in March, taking export revenues to US$ 1.7 bn, 41.9 % higher than in March 2004. In the first quarter exports amounted to US$ 4.6 bn, resulting in a trade surplus of US$ 0.35 bn.

Mexico

Banxico signaled a formal de-linking of its monetary policy from changes in Fed funds. At the same time it left the corto unchanged on Friday, June 24. The decoupling was widely expected by financial markets, given the recent downturn in inflation – what brought the tightening cycle to an end after the rates had risen by around 450 bps since Feb-04. We do not expect a near-term reduction in the overnight rate since the central bank will ensure that inflation expectations are kept low. However, it is clear that Banxico is also keeping a wary eye on economic activity, referring to a possible "fall in the dynamism" of manufactured exports. As a result, if the central bank starts to perceive this as an increasing risk it would strengthen the case for preemptive action – particularly given the current strength of the exchange rate and the extra headwind that this creates for manufactured exports. If such a scenario materializes, a 25 bps cut in the overnight rate could be contemplated by August/September. --- The monthly GDP proxy, IGAE, increased by a lower-than-expected 4.8% yoy in April. The market had been expecting a rise of 5.3%, helped by positive calendar effects after a weak March (when the IGAE rose by just 0.3% yoy). The latest 3-month period spanning Feb-Apr 05 reveals an average monthly increase of 2.7% yoy. This compares with 4.7% in the previous 3-month period. --- Congress, which is currently in the midst of an extraordinary legislative session, has approved the long-awaited reform of the Pemex tax regime. The bill, which now awaits President Fox's signature to become law, will save Pemex an estimated MXN 25 bn (USD 2.3 bn) in taxes in the first year. It will become effective from the start of 2006. Although the annual savings for Pemex will rise to an estimated MXN 94 mn (USD 8.7 bn) by 2010, the reduction in oil income for the treasury will be gradual. This will leave time for the authorities to boost non-oil revenues. Around 60% of Pemex's revenues are collected by the government in taxes. As a result, Pemex was obliged to more than double its debt over the last four years – to USD 46 bn at the end of 2004 – in order to finance its investment programme. Nonetheless, it is clear that the political consensus for a much bigger energy reform is still lacking. The Fox government has been trying desperately for over four years to get backing for a reform that would have removed the constitutional ban on joint ventures in the energy sector. Oil experts, as well as Pemex officials, are unanimous in the view that foreign participation is vital if Mexico is to be in a position to harness its large offshore hydrocarbons reserves. However, it is apparent that if anything is to happen on this front it will have to wait until 2007 at the earliest - i.e. after the installation of a new government.

Venezuela

According to local press reports, the planned reform of the central bank's legal framework may bring a new fund to accumulate what the government deems „excess" reserves otherwise held at the central bank. While similar to the existing, but currently defunct FEM fund, this fund would be entirely at the discretion of the government, with the central bank having no say on the

economics@dbla.com

use of these monies. The reform, which does not count with an economic impact study with respect to its consequences on inflation and the country's vulnerability to external shocks, may be approved in Congress as early as this week. ------ Close to approval as well is the law which will introduce sanctions on activities on the parallel foreign exchange market. If approved as planned, the private sector will have to recur to the CADIVI foreign exchange authority for all its needs of hard currency. At +0.6 % mom (15.9 % yoy), consumer price inflation surprised on the downside in June, following a hefty increase in May (+2.5 % mom). We expect inflationary pressure to prevail, taking year-end 2005 inflation to 18 %.

Dresdner Bank Lateinamerika AG
Neuer Jungfernstieg 16
20354 Hamburg
Germany

Economics Dept.
Chief economist: Dr. Heinz Mewes
Tel.: (+49 40) 3595 3494
Fax: (+49 40) 3595 3497
E-Mail: economics@dbla.com
http://www.dbla.com

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

Exchange rate	date	last	one week	one month	one year	end 2004	ytd-change, %	end 2005f
Argentina	04.07.2005	2.89	2.89	2.89	2.95	2.97	2.9	2.9
Brazil	04.07.2005	2.34	2.38	2.45	3.02	2.66	13.5	2.5
Mexico	04.07.2005	10.73	10.81	10.88	11.44	11.15	3.9	11.4
Chile	04.07.2005	580	580	594	629	556	-4.1	580
Colombia	01.07.2005	2362	2325	2335	2670	2355	-0.3	2389
Peru	04.07.2005	3.25	3.25	3.25	3.47	3.28	0.8	3.3
Venezuela	01.07.2005	2147	2147	2147	1918	1918	-10.7	2150

EMBI+ Spread							
bps	date	last	one week	one month	one year	end 2004	ytd-change, bps
Argentina	01.07.2005	451	889	6599	5145	4707	-4256
Brazil	01.07.2005	401	424	425	642	383	18
Mexico	01.07.2005	158	177	168	203	167	-9
Ecuador	01.07.2005	797	831	879	941	691	106
Colombia	01.07.2005	322	333	359	494	333	-11
Peru	01.07.2005	202	204	210	443	220	-18
Venezuela	01.07.2005	453	468	505	641	412	41

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	01.07.2005	5.38	6.00	3.25	2.63	2.31	3.1	5.0
Brazil Selic	01.07.2005	19.74	19.74	19.75	15.81	17.75	2.0	18.8
Mexico Cetes 28 days	01.07.2005	9.71	9.71	9.73	6.66	8.61	1.1	9.5
Chile 90 days, PDBC	30.06.2005	2.87	2.90	2.71	1.56	2.24	0.6	4.3
Colombia Overnight	29.06.2005	6.35	6.36	6.43	6.84	6.24	0.1	7.1
Peru Overnight	01.07.2005	3.00	na	3.00	2.60	3.03	0.0	2.5
Venezuela deposits 30 days	28.06.2005	10.93	11.63	10.45	10.07	11.92	-1.0	14.5

Foreign exchange reserves								
US$, bn	date	last	one week	one month	one year	end 2004	ytd-change	end 2005f
Argentina	01.07.2005	23.1	23.0	22.2	17.5	19.6	3.5	21.5
Brazil	30.06.2005	59.9	59.3	61.0	49.8	52.8	7.1	62.0
Mexico	24.06.2005	69.3	68.4	67.3	68.3	71.6	-2.3	65.0
Chile	30.04.2005	17.0	na	15.4	16.0	16.0	1.0	16.7
Colombia	31.05.2005	13.4	na	13.3	11.4	13.5	-0.1	14.0
Peru	30.04.2005	13.6	na	13.6	10.5	12.6	1.0	13.5
Venezuela (FEM&Gold incl.)	30.06.2005	28.8	28.8	28.2	23.3	24.2	4.6	28.5

Economic activity				Inflation				
GDP (yoy, %)	2003	2004e	2005f	%, year end	2003	2004	2005	GDP 2003, US$ bn
Argentina	8.8	9.0	6.0		3.7	6.1	10.2	127
Brazil	0.5	4.9	3.4		9.3	7.6	6.9	495
Mexico	1.3	4.4	3.3		4.0	5.2	3.7	626
Chile	3.7	6.1	5.3		1.1	2.4	3.1	74
Colombia	4.0	4.0	4.0		6.5	5.5	5.4	79
Ecuador	2.5	7.0	3.5		6.1	1.9	2.7	27
Peru	3.8	5.1	5.0		2.5	3.5	2.0	61
Venezuela	-7.7	17.9	6.0		27.1	19.2	18.0	84

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	4.2	140	121	19.8	19.8	19.1	16.1
Brazil*	-5.2	-2.7	56	52	94.2	84.3	72.1	68.4
Mexico**	-0.6	-0.3	28	27	23	30	26	32
Chile***	-0.4	2.8	13	12	0.8	0.8	1.1	-1.2
Colombia	-2.7	-1.2	56	52	10.6	10.0	12.7	11.2
Peru	-1.9	-1.3	48	46	1.1	1.3	2.3	2.2
Venezuela	0.2	0.0	46	39	10.8	9.0	10.7	9.0

* 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	403	36	32.3	77	2.0	3.0	13.3	3.9	5.8
Brazil	203	12	65.6	59	2.0	11.7	33.7	18.2	6.2
Mexico	79	21	37.5	18	-1.2	-7.9	-8.6	15.0	3.2
Chile	128	18	7.2	21	1.5	1.4	9.0	6.7	5.6
Colombia	205	11	7.3	39	-1.3	-1.2	1.0	2.6	6.8
Ecuador	17	9	1.4	3	0.3	0.9	6.8	1.1	1.1
Peru	195	10	3.7	25	-0.2	-0.1	2.7	1.8	9.3
Venezuela	111	22	8.3	21	12.7	13.8	21.4	1.3	9.0