Latin American Weekly Spotlight
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A company of the **Allianz Group**

Argentina: Solid EMAE growth in May
Brazil: Lower unemployment in June
Chile: Peso strenght in reaction to yuan revaluation
Colombia: Weaker industrial production growth
Mexico: Monetary easing expected
Venezuela: Central bank reform approved

Argentina

With a 10.5 % yoy increase in May, the EMAE economic indicator is showing a growth rate of 9% in the first five months of the year. The highest contributions to growth came from exports and private investment. Exports rose 14% and investment rose 19% yoy. Strong import growth (35% yoy) likewise suggests an acceleration of the economy. Yet we expect that the expansion of the industrial production will slow down in the second half of the year; in June already, it fell to 6.4% yoy from 8.5% yoy in May. Thus we keep our growth forecast for the year unchanged at 6%. ----- The central bank continues with its interventions in the foreign exchange market, trying to contain the peso strength against the US$ by dollar purchases. While the central bank's foreign exchange reserves meanwhile stand at more than US$ 24 bn, the strong increase in peso circulation makes it difficult to meet monetary targets set for the year. The inflation target of 5 to 8% will probably be missed; we expect a rate around 12%.

Brazil

The Brazilian Treasury announced last week the completion of the swap of US$4.4 bn C-Bonds into a new bond, the A-Bonds 2018. The new bond carries a 8% coupon, is not callable and extends amortization payments by 3.75 years as compared to former C-Bonds. The new bond matures on January 15th, 2018. Besides the improvement in the debt profile, the exchange paves the way for the symbolically important withdrawal of bonds which originated from the Brazilian default in the 80's. We expect that Brazil will retire the remaining US$ 1.2 bn in C-Bonds on the October 15th call date. ----- Despite the ongoing political scandal, President Lula's approval rating, at 54%, remains high in absolute and relative terms (June 2005: 55%, March 2005: 58%). --- President Lula made three further changes to his cabinet, yet which may do little, if anything at all, to reduce the current political noise. --- Two inflation indices released recently, Fipe and IGP-M, reinforced the view that inflation remains well under control. Whereas the Fipe index (consumer price changes in Sao Paulo) remained stable during the four-week period ending in the second week of July, the IGP-M fell by a higher than expected 0.25% mom in the second preview of this month. The downturn in the CPI component of the IGP-M continued; it rose by 0.03% mom compared with a rise of 0.05% mom previously. Moreover, the latest central bank survey brought another decline in end-2005 inflation expectations, which fell to 5.67% compared with 5.72% previously. --- In a widely expected and unanimous decision, the central bank left its overnight benchmark interest rate unchanged at 19.75%. The market will now look for the COPOM minutes, to be released on Thursday, for further guidance with respect to the course of monetary policy. We expect the CB to stay put in August, and to ease the monetary reins from September on. --- Two confidence surveys were released last week showing a mixed picture. While the CNI business confidence survey showed a fall in business confidence to 55.7 points in July from 60.6 points in April, consumer confidence in Sao Paulo (ICC) rose by 0.2 percentage points in July, to 133.3, following four consecutive monthly declines. --- Tax revenues, at BRL 31.6 bn, reached a record high for the month of June. This represents an increase of 10.8% yoy in real terms, bringing the YTD tax revenue figure to BRL 175.7 bn, or up 6.2% yoy in real terms. The rise in tax revenues is a reflection of solid economic activity: Corporate tax collection rose by 34.8% yoy in June while the CSLL tax (an additional tax on profits) rose by 31.7% yoy. Moreover, the IPI tax on cars rose by 19% yoy. --- The unemployment rate, which had been 11.7% a year earlier, fell to 9.4% in June, against a consensus forecast of 10.1%. The sharp decline was led by a fall in the number of people looking for work as well as increased job creation. Meanwhile, real wages fell by 0.3% yoy while rising by 1.5% mom.

Chile

Following China's decision to slightly revalue the yuan last week and increase the number of the peg's reference currencies, the Chilean peso rose slightly last week, closing the week at 568 CLP/US$. Copper prices reached new highs at almost US$ 1.55 per pound, driven by expectations of continued strong demand

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from China. Given that the yuan's revaluation is comparatively small, we do not expect significant changes to our exchange rate forecast scenario and continue to see the peso at 580 CLP/US$ by year-end. ----- We expect that the industrial production, driven by solid domestic demand, will show strong growth in June, too (to be published on Friday; the yoy rate should remain more or less unchanged fromMay, at +6.8 %. Mining production, however, may continue its rather weak performance in June as well (May 2005: +1 % yoy).

Colombia

Following a decline in the first quarter of the year, industrial production seemed to pick up in the second quarter (April: +11% yoy), yet figures published by the national statistic institute DANE now show that growth was only 2.1% yoy in May. This information is contradictory to data published last week by the national employers association ANDI, which puts growth at 10.4% yoy in May. One reason for the difference could be the missing report from the state-owned oil company Ecopetrol. ----- The government announced it will not ask congress for an additional budget this year. This is due to higher than expected tax revenues, which were up 13% ytd until May. Should the positive trend of higher tax revenues not continue in the second half of the year, the government will cut investment expenditure rather than consider an additional budget.

Mexico

International reserves as reported by Banco de Mexico fell by USD 3.3 bn over the week ending July 15. At USD 57.3 bn, reserves are now at their lowest level since September 2004. However, the decline in reserves is almost entirely accounted for by the recent purchase by the government of foreign currency from the central bank (USD 2.9 bn). This latter operation was consistent with the government's goal of ensuring that resources are in place to cover all external market debt amortizations through to the end of 2007. --- There were small decreases in interest rates across the Cetes yield curve at last week's auctions. The general tendency towards a flattening of the curve witnessed in recent weeks was also again in evidence. Rates on benchmark 28-day Cetes eased by 1 bp to 9.60% at Tuesday's (July 19) auction. However, there were bigger decreases in rates on 91-day Cetes (7 bps down to 9.66%) and 182-day Cetes (3 bps down to 9.62%). This is in line with the continued fall in inflation expectations and perception that the next move by the central bank will be towards monetary easing after it left the corto unchanged at MXN 79mn last Friday. --- According to the new series produced by Inegi, unemployment increased to 3.63% in June, from 3.27% in the previous month. However, much of the increase appears to be explained by an increase in the number of persons previously excluded from the formal labor market which are now looking for a job.

Venezuela

With respect to recent investigations into the accounts of private oil companies operating in Venezuela (see last weekly Spotlights), the national tax authority SENIAT announced it will seek around US$ 250 mn in unpaid taxes from the first three companies under investigation. Note that another 19 foreign companies are subject to ongoing SENIAT investigations as well. Given the tax hikes and higher royalties, we see an increasing probability that SENIAT's tough stance will negatively affect private investment in the oil sector. As moreover PDVSA is obliged to hand over cash to the government instead of investing in the maintenance of its activities, this would imply declining oil output levels for years to come. ----- Last week, the National Assembly (NA) approved the bill that allows the government to dispose of "excess" international reserves. The bill, which will come into effect next month, would force a one-off transfer of US$ 6 bn worth of international reserves (out of around US$ 29 bn in total reserves incl. gold). The NA also approved the clause that modifies USD sales from PDVSA to the central bank, allowing the monies to be channelled into a special fund (FONDEN). The government has the exclusive spending authority over this fund, which further contributes to rising concerns over inflationary pressure due to very expansive fiscal policy. Additionally, it implies a further weakening of Venezuela's financial situation in times of lower oil prices (although they admittedly appear distant at the moment). From a markets' perspective, the law might fuel some speculation over potential debt buy-backs. ----- The NA approved the Foreign Exchange Offenses Law which specifies sanctions on activities on the parallel foreign exchange market. As expected, the law allows for the purchase and trading of foreign exchange-denominated domestic issuances of government bonds, which has been a means in recent months to acquire hard currency without having to refer to the CADIVI foreign exchange administration. As the law, somewhat surprisingly, also excludes ADR trading operations from the punishable activities, we would not expect major effects on the parallel exchange rate, which currently is around 2600 VEB/US$. ----- In line with the government's recent activities of chasing allies in the region, President Chávez announced that the government was interested in investing public monies in Ecuadorian public debt. After the recent ousting of President Gutiérrez, the cash-strapped new government of President Palacio is desperately searching for means to enhance the country's liquidity situation. First speculations called for around US$ 500 mn to be invested by Venezuela, while later declarations lowered expectati-

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ons somewhat to a range of US$ 150-250 mn. While not relevant in terms of Venezuela's short-term liquidity and long-term solvency, the approach of investing public monies due to political reasoning – the government already invested US$ 300 mn this month in Argentina's Boden 12s – appears questionable.

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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

Exchange rate	date	last	one week	one month	one year	end 2004	ytd-change, %	end 2005f
Argentina	25.07.2005	2.86	2.86	2.89	2.98	2.97	3.8	2.9
Brazil	25.07.2005	2.42	2.34	2.38	3.08	2.66	9.8	2.4
Mexico	25.07.2005	10.67	10.62	10.81	11.49	11.15	4.5	11.0
Chile	25.07.2005	569	571	580	642	556	-2.3	580
Colombia	25.07.2005	2314	2317	2325	2647	2355	1.8	2356
Peru	25.07.2005	3.25	3.25	3.25	3.43	3.28	0.8	3.3
Venezuela	25.07.2005	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	25.07.2005	419	423	889	5046	4707	-4288
Brazil	25.07.2005	416	401	424	615	383	33
Mexico	25.07.2005	153	153	177	197	167	-14
Ecuador	25.07.2005	734	723	831	915	691	43
Colombia	25.07.2005	327	320	333	442	333	-6
Peru	25.07.2005	185	179	204	408	220	-35
Venezuela	25.07.2005	445	427	468	614	412	33

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	22.07.2005	5.13	5.50	5.38	2.50	2.31	2.8	5.0
Brazil Selic	25.07.2005	19.72	19.73	19.74	15.75	17.75	2.0	18.5
Mexico Cetes 28 days	25.07.2005	9.68	9.68	9.71	7.03	8.61	1.1	9.5
Chile 90 days, PDBC	21.07.2005	3.16	2.96	2.99	1.78	2.24	0.9	4.3
Colombia Overnight	21.07.2005	6.39	6.38	6.37	7.11	6.24	0.1	7.1
Peru Overnight	22.07.2005	3.00	na	3.00	2.60	3.03	0.0	2.5
Venezuela deposits 30 days	19.07.2005	10.69	10.96	11.27	10.95	11.92	-1.2	14.5

Foreign exchange reserves								
US$, bn	date	last	one week	one month	one year	end 2004	ytd-change	end 2005f
Argentina	22.07.2005	24.7	23.9	22.9	18.0	19.6	5.0	21.5
Brazil	21.07.2005	59.8	59.6	59.4	50.1	52.8	7.0	62.0
Mexico	15.07.2005	69.1	70.2	67.6	70.0	71.6	-2.5	66.1
Chile	31.05.2005	17.4	na	17.0	16.1	16.1	1.2	16.7
Colombia	30.06.2005	13.7	na	13.4	11.6	13.5	0.2	16.0
Peru	30.04.2005	13.6	na	13.6	10.5	12.6	1.0	13.5
Venezuela (FEM&Gold incl.)	21.07.2005	30.0	29.6	28.6	23.6	24.2	5.9	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	12.5	127
Brazil	0.5	4.9	3.4	9.3	7.6	5.7	506
Mexico	1.4	4.4	3.3	4.0	5.2	3.7	626
Chile	3.7	6.1	5.4	1.1	2.4	3.6	74
Colombia	4.1	4.1	4.0	6.5	5.5	5.4	80
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	126	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	2.1	13	12	0.8	0.8	1.1	-1.2
Colombia	-2.7	-1.2	56	52	10.6	10.0	12.8	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	397	35	32.3	75	2.2	3.3	13.3	3.9	5.8
Brazil	203	12	65.6	59	1.9	11.7	33.7	18.2	6.2
Mexico	78	21	37.5	18	-1.2	-7.9	-8.6	15.0	3.3
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