Latin American Weekly Spotlight
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Dresdner Bank Lateinamerika AG
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Argentina: Inflation fears apparent in the domestic FI market
Brazil: Ongoing political crisis
Chile: Industrial production posts strong growth in June
Colombia: Moreno elected new IADB President
Mexico: Growth slowdown
Venezuela: Local debt swap around the corner?

Argentina

Concerned about the recent inflationary spike and rising inflation expectations, both the Treasury and the CB last week announced the intention to halt the issuance of ARS-denominated inflation-linked paper in the future to reduce the number of the indexation mechanisms in the economy (and curb the Treasury's cost of funding). At last week's auction, however, the CB was not able to place the long-term options on fixed-rate ARS- and US$-denominated paper that it was aiming to issue as alternative to inflation-linked notes. The uncertainties of inflation outlook and the expansionary monetary policy stance are drivers behind this behavior. From an investor's perspective, the announcements made by both the Treasury and the CB clearly led to a perceived scarcity value of inflation-linked paper that fuelled the ongoing rally on these bonds. We expect the government to re-open once again the US$-denominated Boden 2012, which should meet considerable demand. With respect to the goal of reducing the issuance of ARS-denominated inflation-linked paper, we are skeptical whether this goal coincides with investors' perception of inflationary risks in Argentina. ----- Construction went up another 10% yoy in Jun-05, in line with the better-than-expected performance seen in the previous two months. On a seasonally adjusted basis, construction rose by 1.7% mom following a 2.2% mom increase in May. Construction averaged a growth of 13.2% yoy in Q2-05, a compelling comeback after the disappointing 3.7% yoy increase observed in Q1-05. Infrastructure projects led the way in Q2 with a 18% yoy surge, together with road works (+18.4% yoy) both boosted by an increasing public investment spending. ----- The trade surplus in Jun-05 declined to US$ 692mn, as imports continue to expand strongly (+34% yoy). On a positive note, however, once again exports growth in volumes delivered a strong performance (+21% yoy) in a context of falling soft commodity prices that drove overall export prices down by 4% yoy. While primary products shipped to China remain the main driver (+37% yoy in volume terms), agriculture and industrially manufactured exports continue to perform well. ----- Retail sales performed weak in Jun-05. Supermarket sales fell by 1.9% mom sa after a substantial 5.4% mom sa surge in May-05. Similarly, shopping center sales decreased 0.1% mom sa in June following a jump of 3.4% mom sa the previous month. Despite evidence that private sector consumption is somewhat loosing steam, it is doing so from a very high level. In fact, year-on-year growth rates are still impressive 7.8% for supermarket sales and 10.5% for shopping center sales.

Brazil

Brazilian financial markets were volatile last week as investors started to shift to more defensive positions due to the ongoing political crisis. Meanwhile, leading politicians of opposition parties, including former PSDB governor of Minas Gerais state Azeredo, are getting involved in the corruption scandals. Anyway, Lula's popularity remains still high, although with a declining trend, and finance minister Palocci has not been involved in the corruption accusations against the ruling party PT, so we do not expect any relevant economic policy change. According to polls, Lula is still the clear favorite to win next year's elections. ----- The public sector posted a primary surplus of R$ 9.6bn in Jun-05, a 22% yoy increase. In the first half of this year, the primary surplus reached R$ 60bn (6.4% of GDP), the best result since 1991. Nevertheless, interest payments reached also a record of R$ 80.1bn in H1-05 (8.6% of GDP) as a result of the Selic rate increase, so that the nominal deficit increased to 2.2% of GDP in H1-05 against 1.9% of GDP in the same period last year. ----- National Treasury Secretary Levy announced changes on the external debt policies, informing that only 76% of maturities will be rolled over in the next two years (roll over of ca. US$ 9bn against maturities of US$ 11.8bn). The other 24% of maturities will be amortized in an effort to reduce external debt and exposure to exchange rate fluctuations. ----- Inflation expectations for 2005 (IPCA) fell to 5.55% from 5.67% last week. For the accumulated inflation over the next 12 months the expectation fell to 4.90% from 4.97%, while it remained stable at 5% for 2006. Markets have also grown more optimistic about the scope for interest rate cuts by the end of the year. Analysts are now forecasting an end-2005 Selic rate of 17.88%, down from 18.0% in the previous survey and a current rate of 19.75% (DBLA forecast: 18.5 %). For the end of 2006, the forecast remains unchanged at

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15.75% (DBLA: 16.5%). --- Fipe inflation accelerated slightly in the third week of this month (0.17% mom). Meanwhile, the IGP-M fell 0.34% in July, its third consecutive mom deflation. ----- The current account surplus narrowed to US$ 1.3bn in June as compared to a surplus of US$ 2.02bn in the same month of last year. The decline is partly accounted for by a sharp increase in profit and dividend remittances, which doubled in yoy terms. There was also an increase in service expenditures, including higher tourist spending. Nevertheless, despite the oya-weakening in June, the accumulated current account surplus still amounted to an impressive US$ 5.3bn in the 1st half of the year. FDI inflows increased to US$ 1.3bn in June. Moreover, the central bank is forecasting a further increase in July, to US$ 1.5bn. So far this year, FDI inflows amounted to US$ 8.6bn (1st half of 2004: US$ 4.0bn).

Chile

Following the positive performance of recent months, industrial production expanded by 7.4% in June. Capital goods production grew especially strongly (+23.9%), which bodes well for the sustainability of current growth dynamics. ----- Further support for the economic upturn comes from the labor market: at 8.7%, the unemployment rate in June was almost a percentage point lower than in June 2004. Compared with last June, employment increased by a very strong 4.2%. ----- Mining production posted another month of disappointing activity figures in June, contracting by 7.7%. Mining activity in June was affected by machinery retooling, but the sector's weak performance during the first half of this year points to significant investment demand in order to maintain current production levels. ----- Against the backdrop of a stronger peso, which is counterbalanced by high oil prices and solid economic activity, we expect consumer prices to increase by 0.3% mom in July, taking the annual inflation rate to 2.7% (Thursday).

Colombia

Luís Alberto Moreno, former Colombian ambassador in Washington, was elected new president of the Inter-American Development Bank with 20 out of 28 votes. He was backed up by the US, Canada, Central America and the Caribbean States, whereas most of the South American countries supported the Brazilian candidate João Sayad or the Peruvian Finance Minister Pedro Pablo Kuczynski. ----- Consumer confidence rose in June again and is now at 18.7 points (with a bandwidth from -100 to +100 points). Low interest rates and positive growth expectations bolstered consumer confidence. There is a strong correlation of consumer confidence and private consumption, so we assume consumption to have resumed its expansionary path in the second quarter of the year after a slight slowdown in the first quarter. ----- The government continues to be successful in increasing the share of Peso-denominated public debt and is therefore able to diminish the negative effects of potential exchange-rate fluctuations on public debt. Last week, the government managed to sell COP 267bn (US$ 115mn) in TES bonds by placing a new bond on the domestic market with a maturity until 2020 and a nominal coupon of 11% pa. ----- The government presented its budget for 2006. Despite its attempt to contain public spending, the budget is 13.1% higher than in the current year due to the fiscal burden of interest payments, pensions, and transfers to the regions. However, the deficit is not supposed to exceed the 2% of GDP agreed with the IMF. The pension reform will start to ease the fiscal pressure not before 2010, and also the transfers to the regions are making it hard for the central government to cut down the budget. That is why President Uribe is still pressing ahead with a structural tax reform and why he wants to change the current system of transfers to the regions. Anyway, this is probably not feasible before the general elections next May.

Mexico

The IGAE economic activity indicator showed an increase of 3.7% yoy in May. There was a continued good performance on the part of the services sector (+4.3% yoy). This contrasted with a more sluggish performance on the part of industry (+3.0%). There was also a meaningful jump in mom terms. The increase of 0.79% in mom seasonally-adjusted terms was in fact the highest since March of last year. However, this comes after a disappointing run of figures with respect to the seasonally-adjusted series. Over the first four months of this year, the IGAE decreased by an average of 0.18% per month. ----- Furthermore, retail sales, as reported by Inegi, rose by 3.7% in May, thus remaining below the market forecast of a 5.5% rise. Indeed, the May result is the lowest yoy increase since June 2004. It suggests that consumer spending is finally starting to come off the boil. Further evidence of the slowdown is apparent in the seasonally adjusted series, which revealed a 0.16% decline in retail sales in mom terms. ----- Banco de Mexico has lowered its forecast for growth this year to between 3.25% and 3.75% from between 3.5% and 4.0% previously (DBLA: 3.3%). According to Banxico chief economist, Manuel Ramos Francia, the downward revision takes into account lower external demand for Mexican exports and a loss of market share in the US. ----- The trade deficit in June was a lower-than-expected US$ 22mn (Consensus: US$ 454mn). In terms of exports (+9.4% yoy), the contribution of oil remains very strong. In yoy terms, revenues from oil exports grew by nearly 45%, accounting for almost 15% of total export earnings in June. In contrast, the 4% yoy rise in manufactured exports in June was

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much more sluggish, given positive industrial production results from the US in that month. In terms of imports (+6.2%), the deceleration in the pace of growth is consistent with signs of an overall slowdown in the economy.

Venezuela

The Organization of American States confirmed that it will send staff to witness the August 7 municipal elections. Due to the complexity of electoral issues, however, it refused to offer a full-fledged election-observing mission. We expect the pro-Chávez forces to significantly strengthen its position in the elections. ----- At US$ 30.5bn, the country's international reserves reached another record at the middle of last week (latest figure available). Year-to-date, this implies an increase in the economy's FX cushion by almost US$ 6bn. This is, however, almost exactly the amount that will be transferred in August to the new FONDEN fund following the approval of the modification of the CB regulation in July. We do not expect markets to be frightened by the upcoming transfer, as the FX liquidity situation remains very comfortable, with oil prices north of US$ 60 per barrel. In the medium term, however, Venezuela is significantly weakened by the government's latest move, and inflation is likely to increase further despite the government's pledge to spend the FONDEN monies only abroad. While we definitely expect the government to use part of the FONDEN monies to bolster domestic populist activities, part of the funds may be used in a voluntary debt swap on the external markets. ----- According to CB figures, in the first five months of the year, the central government expenditure increased by more than 40% yoy. While the budget still exhibits a significant surplus due to high oil-related revenues and solid non-oil tax revenues, we expect significantly rising expenditure in the second half of the year and confirm our central government budget deficit forecast of 3.9% of GDP. Additionally, it is important to note that huge amounts of public money are channeled via opaque parallel budgets, which contributes to rising inflationary pressure. We expect consumer prices to increase by 1.5% mom in July, taking annual inflation to 16% (Tuesday). ----- According to the wires, the government is planning to issue public debt within the next few days. While an external debt operation seemed to be in the cards, more recent reports point to a domestic Bolívar-denominated debt operation in order to absorb abundant liquidity and swap maturities upcoming until 2007.

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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	01.08.2005	2.86	2.86	2.89	2.98	2.97	3.9	2.9
Brazil	01.08.2005	2.38	2.49	2.36	3.05	2.66	11.6	2.4
Mexico	01.08.2005	10.60	10.75	10.73	11.41	11.15	5.1	11.0
Chile	01.08.2005	562	567	580	644	556	-1.1	580
Colombia	29.07.2005	2308	2315	2327	2605	2355	2.0	2356
Peru	01.08.2005	3.25	3.25	3.25	3.41	3.28	0.8	3.3
Venezuela	01.08.2005	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	01.08.2005	411	428	451	5013	4707	-4296
Brazil	01.08.2005	399	421	401	591	383	16
Mexico	01.08.2005	149	157	158	199	167	-18
Ecuador	01.08.2005	732	765	797	852	691	41
Colombia	01.08.2005	313	332	322	436	333	-20
Peru	01.08.2005	171	188	202	410	220	-49
Venezuela	01.08.2005	425	447	453	580	412	13

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	29.07.2005	4.56	5.13	5.63	2.50	2.31	2.3	5.0
Brazil Selic	29.07.2005	19.73	19.72	19.74	15.82	17.75	2.0	18.5
Mexico Cetes 28 days	29.07.2005	9.67	9.67	9.71	7.16	8.61	1.1	9.5
Chile 90 days, PDBC	26.07.2005	3.25	3.05	2.90	1.87	2.24	1.0	4.3
Colombia Overnight	27.07.2005	6.39	6.41	6.37	6.81	6.24	0.1	7.1
Peru Overnight	28.07.2005	3.00	na	3.00	2.50	3.03	0.0	2.5
Venezuela deposits 30 days	25.07.2005	10.93	10.38	11.00	10.26	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	29.07.2005	24.9	24.7	23.0	18.0	19.6	5.3	21.5
Brazil	28.07.2005	54.7	59.8	59.9	49.7	52.8	1.9	62.0
Mexico	22.07.2005	69.9	69.1	68.4	68.5	71.6	-1.7	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.)	28.07.2005	30.4	30.0	28.8	23.7	24.2	6.3	28.5

Economic activity				Inflation				
GDP (yoy, %)	2003	2004	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	2004	2003	2004	2003	2004	2003	2004
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 2004	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