



Latin American Weekly Spotlight

August 15, 2005



Dresdner Bank Lateinamerika AG
formerly Deutsch-Südamerikanische Bank AG



A company of the **Allianz Group**

Argentina: Unemployment decreases to 12 %
Brazil: Government suffers defeat over minimum wage
Chile: CB hikes rates by 25 bps to 3.75 %
Colombia: External debt coming down
Ecuador: New minister of finance takes office
Mexico: Weak growth of industrial production
Venezuela: International reserves exceed US\$ 31 bn

Argentina

After two years of strong economic expansion, Argentina is increasingly feeling capacity bottlenecks which are putting a damper on economic growth. According to President Kirchner, the investment ratio of currently 21 % is too low for sustained economic growth. It is planned to overcome the capacity bottlenecks by means of specifically targeted subsidies on investments, particularly in the infrastructure segment. In this context, the government announced tax allowances for companies which are reinvesting their profits. Besides, initiatives have been planned to foster foreign direct investments in Argentina as well as to repatriate foreign capital investments. ----- According to official sources, the unemployment rate for the second quarter stood at 12 %. Regarding the third quarter, the government is expecting employment to grow further, the jobless rate thus decreasing another percentage point. ----- We continue to view critically the government's prospects to conclude an agreement with the IMF prior to 2006. This year, there are still maturities due to the tune of US\$ 4.8 bn; we therefore project additional public-sector issuance.

Brazil

The political crisis took an unexpected move, as Lula's marketing manager, Duda Mendonca, spoke before Congress last week. Duda's testimony, in which he admitted having received BRL 11 mn earmarked for the PT's 2002 presidential campaign from an offshore company, brought the crisis closer to the government and to Lula himself, which should increase market tension more than we had been expecting. Overall, however, we would reaffirm our call that an outright impeachment against Lula is not in the opposition's interest, even though the "i-word" has been mentioned several times last week in the opposition's ranks. ----- In a negative move, the Senate approved a huge 47 % increase in the minimum wage, taking it to BRL 384.3. This compares to a government proposal of hiking the minimum wage by 15.4 % to BRL 300. According to preliminary estimates, the fiscal costs of the higher increase amount to some BRL 12 bn, around 0.6 % of

GDP. In order to become effective, however, the bill has to be approved by the Lower House, and if the government does not manage to overturn it there, President Lula can still veto the bill. Whereas such a veto would be costly in terms of political capital ahead of the 2006 elections, we still expect the government to find a way out of this mess. Against this backdrop, however, there is still a huge potential for further political noise, which might rattle the markets in the weeks ahead. ----- Inflation releases provided broadly good news last week: at 0.25 % mom in July, the IPCA consumer price index rose in line with market consensus. Compared to July 2004, the index rose by 6.59 %, a slight decline compared to the 7.27 % yoy increase last month. The bulk of last month's rise in the IPCA was due to seasonal and once-off factors, such as telephone costs and higher fuel prices. Core inflation as measured using trimmed means with smoothing rose by 0.45 % mom, slightly lower than June's figure (0.49 %). Meanwhile, the Fipe and IGP-M indices surprised on the downside, with the Fipe increasing a lower-than-expected 0.19 % mom in the first week of August, and the IGP-M falling by a higher-than-expected 0.36 % in the first preview of August. This compares with expectations of -0.08 % mom. ----- Against this backdrop, there is increasing speculation in the market that the CB may start monetary easing already this month, even though consensus is still for no change. On Tuesday, the CB starts its two-day Copom meeting, and we expect the CB to err on the side of caution and stay put at 19.75 %. As we expect the positive inflation news flow to continue in the coming weeks, however, the CB should be more convinced of a sustained downturn in inflation on its September meeting, and begin gradually cutting the key interest rate then.

Chile

As expected by us and the market, the Central Bank increased its key interest rate by 25bps to 3.75 %. In its communiqué the CB stated that, in a setting of dynamic economic activity, annual inflation surpassed 3 % sooner than anticipated and that inflation tendency continues to point upwards. As a result, the CB announced

that it will continue to remove the monetary stimulus present in the economy. We expect the CB to continue its gradual tightening move and hike interest rates three more times in the coming four months, taking the key interest rate to 4.5 % at year-end ----- The peso continued its recent appreciation trend, closing the week slightly below 540 CLP/US\$. In the first half of August, the peso appreciated 4 % against the dollar. While some further appreciation is definitely in the cards, we would expect the peso to trade range-bound in the next weeks, supported by high copper prices and rising domestic interest rates, which are partly counterbalanced by rising imports, rising dividend payments abroad, and continued strong investment abroad on part of Chilean pension funds. ----- The trade balance registered a surplus of US\$ 584 mn in July, some US\$ 100 mn lower than in July 2004. While exports posted a still healthy increase of 22.8 % yoy, imports hiked by 35 % yoy on the back of solid economic activity. According to preliminary figures, the increase in imports was driven by rapidly increasing capital goods imports, underlining the perception that investment is expanding strongly.

Colombia

The government continues with its target of reducing the external debt and increasing financing on the domestic market. External debt in April declined to US\$ 37.8 bn (31.6 % of GDP), when it was still at US\$ 39.6 bn in December last year. The public external debt declined by 5.5 % mom to 22.2 % of GDP and private debt, at 11.4 % of GDP, was 0.5 % lower than in March. However, we will have further issuance in foreign currencies in the next month in order to pre-finance the 2006 budget. ----- The Peso broke through the psychologically important border of COP 2300/US\$ last week and reached shortly its three-year low at COP 2284/US\$. The central bank, which already bought US\$ 1.84 bn this year, intervened strongly and achieved a slight depreciation of the Peso towards the end of the week. In October, there will be an inflow of US\$ 1.4 bn due to the sale of the Bavaria brewery so that we have to expect a strong Peso and further interventions of the central bank in the coming months. The strong increase of market liquidity due to the only partially sterilized interventions of the central bank did still not have any impact on inflation because of strong money demand. That is why inflation came in at a mere 4.9 % yoy in July.

Ecuador

After the resignation of Rafael Correa, President Palacio announced Magdalena Barreiro as new minister of finance and economy. While her economic policy orientation remains unclear, we are expecting her to winning

back the confidence of international investors and trying to improve the tense relationship of Ecuador with multinational lenders. ----- Ecuador is planning to place US\$ 500 mn in the external market probably by September. The government of Venezuela is expected to buy US\$ 300 mn.

Mexico

There will be a close race of the leading presidential candidates of the PRI. The latest poll of a national newspaper among PRI sympathizers showed that Arturo Montiel, former governor of Mexico State, is in the lead with 44 % of voting intentions, leaving hitherto favorite Roberto Madrazo (41 %) behind. However, everything is still possible, as the majority of PRI sympathizers still think that Madrazo is going to be the PRI candidate. ----- In June, industrial production grew by only 0.7 % yoy, far lower than the market consensus of 2.3 %. The weak growth reflects the problems of the car industry, where production declined 13.2 % yoy in June. Meanwhile, construction (+3.5 %), electricity (+2.3 %) and mining (+2.0 %) showed moderate growth. ----- High capital investment in machinery and equipment (+11 % yoy) contributed to the 8.3 % growth of gross investment in May. The highest investment growth was registered in imported goods (+16.1 % yoy), whereas investment in national products only grew by 2.2 %. ----- After a minor deflation in May (-0.25 %) and June (-0.1 %), there was a seasonal increase in inflation of 0.39 % mom (4.47 % yoy) in July. Prices of agricultural products rose by a very strong 2.06 % mom. For year-end, we are expecting that the decline of inflation seen in the first half of the year is going to continue and that, at the end of the year, inflation is going to stand at 3.7 % yoy

Venezuela

In a move that increases the tensions between the US and Venezuela, President Chávez announced the suspension of the longstanding cooperation between the US Drug Enforcement Administration and the country's National Guard. ----- According to industry sources, the Venezuelan oil production significantly lags its OPEC production quota of 3.2 mn b/d. Meanwhile, Energy and Mining minister Ramírez, who is acting as PDVSA President, insists that the country is producing 3.3 mn barrels per day. Given the increasing intransparency in Venezuela's public and external accounts, we find it hard to evaluate the issue. Against a backdrop of the increasing politization of PDVSA's staff policies, the diversion of PDVSA funds to social spending projects, and ongoing private-sector harassment on part of the government, we think a figure close to the industry sources could be reasonable. ----- The lower oil production does not have, however, negative effects on international reserve



accumulation: At the middle of last week, international reserves (incl. gold and FEM) surpassed the mark of US\$ 31 bn. With international oil prices solidly above the mark of 60 US\$/b – and the Venezuelan oil basket exceeding the US\$ 50-mark last week, thereby taking the ytd-average solidly above 40 US\$/b, reserve accumulation is likely to continue. Note, however, that during the current month US\$ 6 bn will be handed over to the government-administrated FONDEN, and that President Chávez had been handing out investment announcements at full speed on his tour through the Southern Cone last week. ----- In order to further tighten its grip on the country's international reserves, the government plans to reform the legal framework of the FEM stabilization fund, handing the fund's administration over to

the BANDES National Development Bank. Should the government succeed with its plan – which is to be expected –, the CB will continue to lose the freedom to accumulate funds during oil bonanza periods and thereby shield the economy against external shocks. --- -- Despite the ongoing medium-term weakening of the country's stability due to government intervention, S&P upgraded Venezuela's long-term foreign currency debt rating to B+, citing strong oil prices leading to a large current account surplus, high international reserves, and improving external debt figures. While this may be true in the short term, there are significant challenges to the country's economic stability looming at the horizon.

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

"Latin American Weekly Spotlight" is published in addition to our "Latin American Spotlight" and our "Latin American Spotlight Update". All three are published in English and in German. The information contained in this issue has been carefully researched and examined by Dresdner Bank Lateinamerika AG or reliable third parties. But neither Dresdner Bank Lateinamerika AG nor such third parties can assume any liability for the accuracy, completeness and up-to-datedness of this information. The authors' opinions are not necessarily those of Dresdner Bank Lateinamerika. Statements do not constitute any offer or recommendation of certain investments, even if individual issuers and securities are mentioned. Information given in this issue is no substitute for specific investment advice based on the situation of the individual investor. For personalized investment advice, please contact your Dresdner Bank Lateinamerika branch.



Exchange rate	date	last	one week	one month	one year	end 2004	ytd-change, %	end 2005f
Argentina	15.08.2005	2.88	2.87	2.86	3.02	2.97	3.1	2.9
Brazil	15.08.2005	2.37	2.33	2.34	3.00	2.66	11.9	2.4
Mexico	15.08.2005	10.66	10.65	10.61	11.37	11.15	4.6	11.0
Chile	15.08.2005	537	546	577	638	556	3.5	580
Colombia	15.08.2005	2307	2309	2333	2614	2355	2.1	2356
Peru	12.08.2005	3.25	3.25	3.25	3.41	3.28	0.8	3.3
Venezuela	15.08.2005	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	15.08.2005	415	394	420	5214	4707	-4292	
Brazil	15.08.2005	399	386	402	561	383	16	
Mexico	15.08.2005	153	145	158	194	167	-14	
Ecuador	15.08.2005	712	703	728	828	691	21	
Colombia	15.08.2005	308	304	317	436	333	-25	
Peru	15.08.2005	160	157	186	369	220	-60	
Venezuela	15.08.2005	417	412	435	561	412	5	

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	12.08.2005	4.25	4.38	4.94	2.50	2.31	1.9	5.0
Brazil Selic	15.08.2005	19.76	19.76	19.72	15.88	17.75	2.0	18.5
Mexico Cetes 28 days	12.08.2005	9.60	9.63	9.68	8.19	8.61	1.0	9.5
Chile 90 days, PDBC	11.08.2005	3.96	3.19	2.79	1.63	2.24	1.7	4.3
Colombia Overnight	10.08.2005	6.59	6.40	6.43	6.87	6.24	0.4	7.1
Peru Overnight	12.08.2005	3.03	na	3.00	2.60	3.03	0.0	2.5
Venezuela deposits 30 days	09.08.2005	10.75	10.92	10.86	11.15	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	12.08.2005	25.1	24.6	23.8	18.2	19.6	5.4	21.5
Brazil	11.08.2005	54.9	54.8	59.6	49.7	52.8	2.1	62.0
Mexico	05.08.2005	70.5	70.5	70.0	68.8	71.6	-1.1	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.)	11.08.2005	31.1	30.9	29.2	21.5	24.2	6.9	28.5

Economic activity				Inflation				GDP 2003, US\$ bn
GDP (yoy, %)	2003	2004	2005f	%, year end	2003	2004	2005	
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