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**Argentina:** Industrial production stagnates in July

**Brazil:** Corruption scandal takes its toll

**Chile:** Strong GDP growth in Q2-05

**Colombia:** Deficit of central government at 2.3% of GDP in H1-05

**Ecuador:** Government came to an agreement with the protesters

**Mexico:** Current account almost balanced in Q2-05

**Venezuela:** VAT likely to be lowered by 1pp

## Argentina

In July, industrial production expanded by only 0.1 % mom, sa, significantly below market consensus. On an annual basis, the seasonally-adjusted growth rate stood at 6.7 % with the strongest growth impetus emanating from the automotive sector. ---- In July, capacity utilization of the industrial sector rose to 72.1 %, the highest figure in twelve months. ---- In July, the primary surplus in the public-sector budget came to ARS 1.8 bn (US\$ 632 mn). For the first seven months of the year, it stands at ARS 13.4 bn; consequently, the budgetary goal set by the government for fiscal 2005 (primary surplus of 15.3 bn pesos), has already been fulfilled to an 88 %.

## Brazil

Data released by the latest IBOPE poll showed further negative opinion trends for President Lula. For the first time since 2002 Lula would not win the presidential elections in the second round, since 44% of people interviewed preferred Sao Paulo's mayor José Serra, against 35% for Lula. Nevertheless, Lula would win against any other possible candidate. Also according to the poll Lula's approval ratings fell from 55% in June, when the political crisis began, to 45% in August. Those disapproving Lula jumped from 38% to 47% and for the first time the number of people considering the government as "bad" (31%) was higher than those responding for "good" (29%, from 36% previously). The poll shows that the opposition's strategy of weakening Lula through the political crisis has been working out. --

- The strong primary fiscal performance continued in July. The primary surplus (before interest payments) reached R\$ 8.8 bn, the highest for a month of July ever (R\$ 6.6 bn in July 2004). This brought the primary fiscal surplus to 6.3% of GDP in ytd terms (same period last year: 5.4% of GDP) and to 5.2 % of GDP in the last 12 months (R\$ 97 bn), as compared to the year-end target of 4.25% of GDP. Interest payments reached R\$ 12.1 bn in July, a drop against the amount of R\$ 15.2 bn registered in June. Considering the last twelve months, interest payments reached 7.9% of GDP, resulting in a nominal fiscal deficit of 2.7% of GDP. The stock of net public debt was 51.3% of GDP in July, increasing slightly in comparison with the previous month (51%). --

- The consumer price index IPCA-15, which has the same methodology of the IPCA index used for the inflation targeting, was 0.28% in August, above the previous rate of 0.11% and at the upper end of expectations. However, core inflation remained well under control and most of the rise is explained by one-off factors, as the seasonal increase in phone tariffs. Positive news concerning the inflation outlook was released by the COPOM minutes, from which the sentence meaning that rates would be kept unchanged for a "sufficiently long period of time" was removed. We reaffirm our expectation of gradual interest rate cuts to begin in September. --- The total credit volume in the Brazilian financial system increased to R\$ 533.4 bn in July (+1.5% mom; +18.8% yoy), reaching 28.2% of GDP, against 25.3% of GDP a year ago. Most of the recent rise is due to the positive performance of personal loans, especially the modality where installments are directly withdrawn from wages (+109.7% yoy). These loans are cheaper than other loans and have been supporting the recent growth of durable goods sales. --- The unemployment rate remained stable mom in July at 9.4%, but decreased significantly against a year ago, when the rate was at 11.2%. According to the IBGE, real wages in July rose in both mom (+2.5%) and yoy (+1.6%) terms and informal employment data showed a decreasing trend.

## Chile

GDP expanded by a stronger-than-expected 6.5 % yoy in Q2-05, taking overall growth in H1-05 to 6.3 %. Expansion was driven by soaring investment, which increased by an impressive 26 % yoy. Growth dynamics eased somewhat, however, with qoq-growth (sa) at 1.1 %, which compares to a rate of 1.6 % in Q1-05. We expect growth dynamics to stabilize at the current level, and adjust our overall 2005 GDP forecast to 5.7 %. ---- The current account posted a surplus of US\$ 303 mn in Q2, down by more than half compared to the second quarter of last year. This notwithstanding, robust goods exports where significantly outpaced by import growth, and the services deficit widened on the back of higher profit remittances abroad. On a very positive note, net FDI increased almost fourfold in the quarter to US\$ 1.9 bn.

## Colombia

In the first half of the year, the central government's budget deficit reached 2.3 % of GDP and was therefore lower than in the same period of last year (2.5 %). The lower deficit comes on the back of a 14.2 % yoy increase in revenues, with tax revenues up 13 % due to strong economic growth and the improvement in tax collection. Expenditures of the central government only grew by 11.2 %. But as the lion's share of expenditures is concentrated in the second half of the year, the deficit is expected to reach 6.1 % of GDP by year-end. Nevertheless, the strong peso and the high tax revenues could contribute to a lower-than-expected deficit. We expect the consolidated public-sector deficit to reach 2.5 % of GDP as agreed with the IMF. ---- Robert Renchanck, chief of the IMF economic team visiting Colombia, welcomed the plan of the Central Bank to transfer international reserves to the government, as the government would then be able to prepay external debt and to improve its debt profile. The government plans to buy up to US\$ 1mn from the central bank, but it is still not clear which will be the government's definitive use of these reserves. Details of the transaction will probably be announced on the next central bank's board meeting scheduled for September 16. ---- The Mexican telecommunication company Telmex is going to buy the majority stake in Telecom, the state-owned phone company, for US\$ 350mn. Therefore, forex inflows amounting to US\$ 260mn will be entering the country by the end of the year or during the first months of 2006.

## Ecuador

Last week, the government came to an agreement with the protesting population of the Amazon provinces Orellana and Sucumbio. After the demonstrators almost disrupted oil production, it is now increasing fast so that it will be at the pre-demonstration level at the beginning of September. The government promised to improve local infrastructure and to recruit local workers for the planned constructions; it also promised to transfer 16 % of income taxes from the oil companies directly to the regional governments. The costs of the strike are estimated by the government to reach US\$ 150mn, with part of the fiscal damage alleviated by the higher-than-expected oil price.

## Mexico

Both headline and core inflation rates were lower than expected in the first half of August. Headline inflation for the period increased only 0.07 %, bringing the yoy rate to 4.1 %, its lowest level since 2003. Given the moderate inflation rates and sluggish economic growth (see below), we expect the Central Bank to promote a Corto reduction soon. On its last meeting on Friday, the CB

left the corto unchanged, but signaled that it would accept a 25 bps reduction in the overnight rate, to 9.5 %. ---- Following the weaker than expected GDP growth in the second quarter, the Finance Ministry revised down its economic growth forecast for the second time this month. FM is now expecting a GDP growth of 3.5 % for this year (3.8 % previously). Meanwhile, another indicator of economic activity – the IGAE, which is a monthly proxy of GDP – increased by just 1 % yoy in June, showing a mom (sa) decrease of 1.19 %. We expect a GDP growth of 3.3 % this year. ---- July's trade deficit came in at a higher-than-expected US\$ 619 mn (consensus: US\$ 449 mn). While this means an improvement as compared with the same month last year, it resulted mainly from rising oil exports (+39 % yoy). ---- The current account deficit of only US\$ 19 mn in the second quarter of 2005 showed a better performance as compared with the result of the same quarter last year (-US\$ 200 mn), based on the strong growth of remittances from abroad (+15 % yoy to US\$ 5.3 bn).

## Venezuela

Last week, Congress approved a reform proposal to lower the VAT by 1pp to 14 %. If approved in the second round, which seems to be a done deal as early as this week, this would be the second VAT reduction in less than one year. While the government may succeed in the short term with its goal to stimulate private consumption with this VAT reduction, we do not expect any significant moderating effect on consumer price increases, which is the second goal apparently strived for by the government. Previous reductions in the VAT rate lowered inflation only in the very short term, and the government's foremost expansive fiscal policy stance continues to be the key driver of inflation in Venezuela. According to rough estimations, fiscal costs amount to around US\$ 200 mn, which is negligible against the current background of high oil prices. ---- The long-announced internal debt exchange, estimated to go ahead with the issuance of domestic debt worth more than VEB 3 trillion, has not been executed yet. The deal, which has been expected by the market for two weeks now, is intended to shift the heavy amortizations coming due in 2006 and 2007 into the more distant future. It is not clear whether the swap will take place in the current week. ---- The current account surplus in Q2-05 came in at US\$ 5.8 bn, almost double the amount registered in the same period of 2004. FDI inflows almost halved compared to Q2-04, which has to be seen against the background of growing harassment of foreign companies by the government and an increasingly interventionist economic policy stance. In a similar vein, Royal Dutch Shell plc announced the halt to three-year-long talks with the government on the Mariscal Sucre natural gas project.



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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

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Exchange rate	date	last	one week	one month	one year	end 2004	ytd-change, %	end 2005f
Argentina	29.08.2005	2.91	2.91	2.86	3.01	2.97	2.1	2.9
Brazil	29.08.2005	2.40	2.37	2.38	2.94	2.66	10.6	2.5
Mexico	29.08.2005	10.86	10.74	10.59	11.41	11.15	2.7	11.0
Chile	29.08.2005	546	541	560	627	556	1.9	570
Colombia	26.08.2005	2306	2304	2308	2541	2355	2.1	2337
Peru	26.08.2005	3.26	3.26	3.25	3.36	3.28	0.7	3.3
Venezuela	29.08.2005	2147	2147	2147	1918	1918	-10.7	2150
<b>EMBI+ Spread</b>								
bps	date	last	one week	one month	one year	end 2004	ytd-change, bps	
Argentina	29.08.2005	441	429	413	5188	4707	-4266	
Brazil	29.08.2005	419	409	401	524	383	36	
Mexico	29.08.2005	153	150	152	185	167	-14	
Ecuador	29.08.2005	723	735	735	825	691	32	
Colombia	29.08.2005	308	302	315	403	333	-25	
Peru	29.08.2005	162	154	172	350	220	-58	
Venezuela	29.08.2005	435	421	427	537	412	23	
<b>Benchmark interest rates</b>								
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	26.08.2005	4.50	4.31	4.63	2.56	2.31	2.2	5.0
Brazil Selic	26.08.2005	19.74	19.74	19.73	15.88	17.75	2.0	18.5
Mexico Cetes 28 days	26.08.2005	9.48	9.58	9.67	7.44	8.61	0.9	9.5
Chile 90 days, PDCC	18.08.2005	4.03	3.96	2.96	1.57	2.24	1.8	4.5
Colombia Overnight	24.08.2005	6.37	6.37	6.41	6.88	6.24	0.1	7.1
Peru Overnight	26.08.2005	3.10	na	3.00	2.73	3.03	0.1	2.5
Venezuela deposits 30 days	23.08.2005	10.55	10.68	10.72	10.52	11.92	-1.4	14.5
<b>Foreign exchange reserves</b>								
US\$, bn	date	last	one week	one month	one year	end 2004	ytd-change	end 2005f
Argentina	26.08.2005	25.2	25.2	24.8	18.0	19.6	5.5	21.5
Brazil	25.08.2005	54.9	54.7	54.7	49.3	52.8	2.2	62.0
Mexico	19.08.2005	71.9	70.6	69.1	68.7	71.6	0.3	66.1
Chile	30.06.2005	16.6	na	17.4	15.8	15.8	0.8	16.7
Colombia	31.07.2005	13.9	na	13.7	11.8	13.5	0.3	16.0
Peru	30.04.2005	13.6	na	13.6	10.5	12.6	1.0	13.5
Venezuela (FEM&Gold incl.)	25.08.2005	31.8	31.4	30.4	21.3	24.2	7.6	28.5
<b>Economic activity</b>								
GDP (yoY, %)	2003	2004	2005f	Inflation %, 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	5.6	506
Mexico	1.4	4.4	3.3		4.0	5.2	3.8	626
Chile	3.7	6.1	5.7		1.1	2.4	3.5	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
<b>Public sector</b>								
Budget balance, % of GDP		2003	2004	Public debt, % of GDP	2003	2004	Amortization, US\$ bn	Gr. financing needs, US\$ bn
				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 % of exports	Debt service s.t., % of total	US\$ bn	Debt service % of exports	Current account % of GDP	Trade Balance US\$ bn	FDI (net) US\$ bn	Import cover months
Argentina	397	35	32.3	75	2.2	3.3	3.9	5.8
Brazil	203	12	65.6	59	1.9	11.7	33.7	18.2
Mexico	79	21	37.5	18	-1.2	-7.9	-8.6	17.4
Chile	112	18	7.2	18	1.4	1.3	9.0	6.7
Colombia	205	11	7.3	39	-1.3	-1.2	1.0	2.6
Ecuador	17	9	1.4	3	0.3	0.9	6.8	1.1
Peru	195	10	3.7	25	-0.2	-0.1	2.7	1.8
Venezuela	111	22	8.3	21	12.7	13.8	21.4	1.3