Latin American Weekly Spotlight
September 19, 2005
Dresdner Bank Lateinamerika AG
formerly Deutsch-Südamerikanische Bank AG
A company of the **Allianz Group**

Argentina: Robust GDP growth in the second quarter
Brazil: Interest rate easing has begun
Chile: Peso strong even despite lower copper prices
Colombia: Budget surplus of 0.8% of GDP in the 1st half of the year
Mexico: Low industrial production in July
Venezuela: Foreign exchange law published

Argentina

GDP expanded by 9.1% yoy in the first half of the year, with higher growth rates in the second quarter (+10.1%) in comparison to the first (+8%). GDP grew by 2.4% (quarter-on-quarter, seasonally adjusted) following 0.8% in the first quarter. Consumption saw solid growth in the second quarter, at 10.6% yoy in the private sector and 5.4% in the public sector. Expansion was also significantly export-driven (+ 17.9 % yoy), though net exports are decreasing with rising import pressure. Investment activities expanded by 24.4% yoy in the second quarter, recovering from low Q1 figures. The second half of the year will see a slight growth slowdown, yet at a high level. Overall economic growth is expected to reach 8% this year. ----- The 2006 budget bill of the government contains a primary surplus target of 3% of GDP (following a target 3.2 % of GDP for 2005). Expenditure is expected to increase by 12%, to reach ARS 93.7 bn. Revenue is assumed to rise by 12.2% to ARS 100 bn, with government assumptions being based on a forecast of 4 % for economic growth and 9.1% for inflation. President Kirchner is thus neglecting the IMF's recommendations to increase the primary surplus and reduce procyclical effects. We estimate that the surplus of the consolidated public sector will reach just over 4 % of GDP only, whereas the IMF is recommending a primary surplus of 4.5 % or more.

Brazil

The political scandal took its first official toll at Congress. With 315 votes (minimum necessary was 257) the Lower House impeached Deputy Roberto Jefferson last week. This was the first of a series of 18 impeachments of deputies involved in the cash-for-votes scandals suggested by the Congress' ethics commission, which includes also the President of the Lower House, Deputy Severino Cavalcanti. We expect most of the accused to be expelled, including former Lula's chief of staff Jose Dirceu. The expelled deputies get their political rights suspended for eight years. --- The central bank cut the benchmark interest rate Selic by 25 bps to 19.50% in last week's Copom meeting. The recent downward trend for both inflation and inflation expectations, combined with matched growth for aggregate demand and supply has created the conditions for the easing. However, given the still low spare capacity in industry and inflation pressures from high oil prices, we believe that the central bank will keep cautious and cuts will be moderate. The move was in line with our expectation, so that we keep our year-end interest rate forecast of 18.5%. Meanwhile, three inflation figures released last week show further deflation of between 0.11 and 0.69% mom. --- According to data released by IBGE, retail sales were 4.5% higher yoy in July. In mom seasonally adjusted terms the increase was 0.31% in July. Despite strong sales of furniture and electronic goods (+17.4% yoy), the monthly (sa) figure showed a drop of 1.9%, which could signal the beginning of a certain slowdown of credit. Nevertheless, there was a significant recovery in sales related to the recent rise in real wages. Sales of clothing and footwear increased 7.2% in July as compared to June.

Chile

At 535 CLP/US$, the Peso strength continues even though copper prices, usually one of the most important determinants of the currency's external value, dropped by some 5 % since the beginning of September. The peso strength is likely to be driven by continuing inflows of international capital on the back of the solid economic growth outlook and a robust trade surplus. While we expect the peso to weaken slightly during the next months as weaker copper prices should finally take their toll and growth prospects cool down somewhat, it should be supported by the ongoing monetary tightening, which should take the benchmark interest rate from its current 4 % to 4.75 % by year end. At the end of the year, we expect the peso to trade around 560 CLP/US$.

Colombia

The consolidated public sector had a surplus of 0.8 % of GDP in the first half of the year, up from a deficit in the same period of last year. This surplus is due to higher tax revenues as a consequence of stronger domestic demand, higher revenues of the state-owned oil company, and the positive effect of the peso apprecia-

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tion on external debt interest payments. With spending in check, the government decided to cut its public sector deficit targets for 2005 from a maximum of 2.5 % of GDP to 1.6 % of GDP and the central government deficit target from a maximum of 5.8 % to 5.5 % of GDP. Yet as the biggest share of the expenditures is executed in the second half of the year, it might have been too early to adjust the budget. But the positive results of the first half of the year are still a very good sign that public finances are kept in check. ----- The government bought back US$ 700 mn in external bonds with maturities between 2007 and 2033, but did not buy back bonds maturing next year as we had expected. At the same time, the government also sold US$ 500 mn of the reopened "Global 2024". It is still not clear how the government will use these funds, to which up to US$ 3 bn will be added by a transfer of foreign exchange reserves from the central bank to the government. ----- The central bank continues to intervene against the peso appreciation and cut the repo rate to 6% from 6.5% in its meeting last Friday. As inflation continues to be surprisingly low, further interventions in the foreign exchange market should be expected. This means additional liquidity for the economy, which could endanger the medium- to long-term inflation targets.

Mexico

In the PAN's first primary election to choose the party's presidential candidate, former Energy Secretary Felipe Calderon got surprisingly 46% of the vote, reaching the first place and beating Interior Minister Santiago Creel, who is very close to President Fox and up to now considered the favorite. --- Another disappointing economic indicator was released last week. The industrial production unexpectedly dropped 1.1% yoy in July. The drop can be explained by the decrease in the manufacturing sector (-2.1% yoy), which reflects mainly the decline in the car industry in July (-13.2% yoy). Nevertheless, we expect a slight recovery in the coming months, since August data already released by the Mexican Automobile Industry Association show a production increase of 7.2% yoy. --- According to data released by the Finance Ministry the aggregate demand increased by 4.8% yoy in the 2nd quarter, remaining nearly flat in qoq (sa) terms. The increase is mainly a result of robust growth in gross fixed investment, which reached 8.5% yoy and 3.05% qoq (sa), while private consumption showed a rise of 4.4% yoy, led by demand for durable goods (+6.2% yoy). Given the satisfactory growth in private consumption and especially in gross fixed investment, we expect a slight recovery in economic activity in the second half of the year, in line with our GDP growth forecast of 3% for 2005.

Venezuela

According to US government sources, Venezuelan crude oil exports to the US increased by 2.7 % mom in July. Compared to July 2004, exports were up 8.1 %, while year-to-date, export volumes are flat. The figures may suggest some pragmatism in the country's oil policies even despite President Chavez' continuous attacks against the northern neighbor, but the diversification of export destinations away from the US is clearly a central goal of the government. ----- The law which regulates activities related to foreign exchange transactions was published last week. As expected, heavy fines are imposed on individuals and companies engaged in illicit foreign exchange activities, and the sole authority to distribute hard currency remains at the central bank and its agents. Public sector domestic debt issues denominated in foreign currency, but payable in Bolivares, are not affected by the new law. ----- In line with recent activities to gather support in Latin America, President Chávez announced the government's intention to buy up to US$ 1 bn in Argentine public debt. This amount apparently comes on top of the around US$ 550 mn in Argentine debt already purchased by Venezuela in recent months. While clearly motivated by political reasons, from an economic perspective it would be preferable for the government to first use its transitory oil wealth to reduce the country's external obligations.

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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	19.09.2005	2.91	2.92	2.91	2.99	2.97	2.1	3.0
Brazil	19.09.2005	2.30	2.32	2.45	2.87	2.66	15.3	2.5
Mexico	19.09.2005	10.88	10.69	10.77	11.46	11.15	2.4	11.0
Chile	19.09.2005	535	538	545	612	556	3.8	570
Colombia	19.09.2005	2299	2306	2309	2541	2355	2.4	2304
Peru	16.09.2005	3.30	3.29	3.25	3.35	3.28	-0.6	3.3
Venezuela	16.09.2005	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	19.09.2005	389	408	431	5540	4707	-4318
Brazil	19.09.2005	366	383	419	467	383	-17
Mexico	19.09.2005	131	134	152	177	167	-36
Ecuador	19.09.2005	665	705	733	792	691	-26
Colombia	19.09.2005	241	271	305	388	333	-92
Peru	19.09.2005	152	145	151	304	220	-68
Venezuela	19.09.2005	352	387	424	482	412	-60

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2004	%-points	end 2005f
Argentina, Overnight	16.09.2005	4.56	4.50	4.31	2.56	2.31	2.3	5.0
Brazil Selic	19.09.2005	19.49	19.74	19.74	16.23	17.75	1.7	18.5
Mexico Cetes 28 days	19.09.2005	9.21	9.36	9.62	7.26	8.61	0.6	9.5
Chile 90 days, PDBC	13.09.2005	4.24	4.25	3.96	2.42	2.24	2.0	4.8
Colombia Overnight	15.09.2005	6.19	6.42	6.37	6.88	6.24	0.0	7.5
Peru Overnight	16.09.2005	3.00	na	3.10	2.65	3.03	0.0	2.5
Venezuela deposits 30 days	14.09.2005	10.54	10.59	10.80	10.94	11.92	-1.4	14.5

Foreign exchange reserves								
US$, bn	date	last	one week	one month	one year	end 2004	ytd-change	end 2005f
Argentina	16.09.2005	25.7	25.6	25.1	18.3	19.6	6.0	21.5
Brazil	15.09.2005	56.0	55.3	54.8	49.1	52.8	3.2	62.0
Mexico	09.09.2005	73.9	72.8	70.5	70.3	71.6	2.3	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	15.5
Peru	31.07.2005	15.3	na	13.8	11.1	12.6	2.7	15.6
Venezuela (FEM&Gold incl.)	15.09.2005	32.1	32.2	31.1	21.3	24.2	7.9	28.5

Economic activity				Inflation			
GDP (yoy, %)	2003	2004	2005f	%, year end 2003	2004	2005	GDP 2003, US$ bn
Argentina	8.8	9.0	8.0	3.7	6.1	11.9	127
Brazil	0.5	4.9	3.4	9.3	7.6	5.4	506
Mexico	1.4	4.4	3.0	4.0	5.2	3.8	626
Chile	3.7	6.1	5.7	1.1	2.4	3.6	74
Colombia	4.1	4.0	3.8	5.5	5.2	4.8	97
Ecuador	2.5	7.0	3.5	6.1	1.9	2.7	27
Peru	4.0	4.8	5.6	2.5	3.5	2.0	61
Venezuela	-7.7	17.9	6.0	27.1	19.2	17.4	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	2.2	13	12	0.8	0.8	1.1	-1.2
Colombia	-1.2	-2.5	52	51	10.0	11.2	11.2	14.2
Peru	-1.6	-1.2	48	45	1.1	1.3	2.1	2.1
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	396	35	32.3	75	2.2	3.3	13.3	3.9	5.8
Brazil	200	12	65.6	58	1.9	11.7	33.7	18.2	6.1
Mexico	79	21	37.5	18	-1.2	-7.9	-8.6	17.4	3.3
Chile	112	18	7.2	18	1.4	1.3	9.0	6.7	5.0
Colombia	178	7	7.4	33	-0.2	-0.3	2.1	2.8	7.1
Ecuador	17	9	1.4	3	0.3	0.9	6.8	1.1	1.1
Peru	212	9	3.8	25	-0.1	-0.1	2.7	1.8	9.3
Venezuela	111	22	8.3	21	12.7	13.8	21.4	1.3	9.0