



Inter-American Dialogue

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Featured Q&A With Our Board of Advisors

Q Recent months have seen currencies strengthen in several Latin American countries, including Brazil, Mexico, Argentina, Chile, and Colombia. Should these countries be concerned that their currencies are too strong and pose a risk to exports? To what extent should authorities in these countries intervene to control their currencies' rise?

A **Guest Comment: Fernando Losada:** "The appreciation of most exchange rates, both in real and in some cases even in nominal terms, observed during recent weeks across Latin America, is probably related to the perception that the US dollar's weakening against other major currencies is a phenomenon that will stay with us for quite some time. It is also due to technical considerations of markets in the region, as new fund inflows as well as reinvestment of coupon and principal redemption payments into these countries have been substantial. In some cases, however, country-specific considerations appear to be playing a major role, such as in Mexico, for instance, because of its dollar-auctioning mechanism to slow down reserve accumulation. While currency stability has been a boon to consolidate anti-inflation plans, the process of exchange rate appreciation has overshot those plans and many of these currencies appear by now to be overvalued. Typically, bilateral trade flows are more sensitive to changes in income levels than

to variability in relative prices. Therefore, in the short term it is not clear that the stronger exchange rates will make a dent on trade flows, especially considering that US demand for Latin American exports is expected to be strong in the months to come. But a protracted process of currency overvaluation would eventually take its toll on export performance. Thus, current concerns about the extent of the ongoing currency strengthening process are justified. While intervention could be a temporary

Continued on page 4

PHOTO OF THE DAY



Peruvian President Alejandro Toledo addresses the nation in a nationally televised speech Saturday night, in which he denied involvement in a corruption scandal involving friend and former aide Cesar Almeyda. See related story on page 2.

Photo: El Peruano.

Inside This Issue

FEATURED Q&A: Should Some Countries Worry Their Currencies Are Too Strong?.....1	Aristide Agrees to Measures Aimed at Defusing Haiti's Political Crisis2
Embattled Bolivian Leader Announces Economic Measures2	Argentina Denies Collapse of Bank Bidding to Advise on Debt Talks3
Toledo Denies Involvement in Scandal, Condemns Corruption2	Chavez Continues to Pressure Central Bank to Back Farm Program3

NEWS BRIEFS

Mexico Names Special Prosecutor to Probe Killings

The Mexican government has appointed a special prosecutor to investigate the mostly unsolved murders of over 300 women during the past 10 years in the border city of Ciudad Juarez. The prosecutor, Maria Lopez, said she will look at the conduct of local police, who human rights groups have accused of bungling the investigations into the murders.

Consumer Prices in Ecuador Post 0.41 Percent Increase in January

Consumer prices rose 0.41 percent in Ecuador in January, according to the government's National Statistics Institute. The figure compares with a 2.48 percent increase in prices in January 2003. The government has an inflation target of 4 percent for this year.

AES Makes \$90 M Debt Payment

US energy giant AES on Friday made a \$90 million debt payment to Brazil's national economic and social development bank (BNDES). The payment was made by a deadline set according to the terms of a deal made with the BNDES last month to restructure AES' \$1.2 billion in debt to the bank.

Colombian Joblessness 14.7 Percent in December

Unemployment in Colombia's largest cities was 14.7 percent in December, up from 14.1 percent the previous month, the government reported. The number of unemployed totaled 1.41 million in December, versus 1.48 million in December 2002.

Source: Reuters.

Political News

Embattled Bolivian Leader Announces Economic Measures

Bolivian President Carlos Mesa on Sunday announced a series of economic measures designed to close the country's \$414 million budget deficit and at the same time stave off the threat of violence that led to the downfall of his predecessor, *The Miami Herald* reported. In a nationally televised address, Mesa, who took office in October after Gonzalo Sanchez de Lozada was forced to resign amid violent street protests, called for a 5 percent cut in government spending. He proposed to raise \$95 million for government coffers through an 18 percent tax on oil companies and \$100 million through a financial transaction tax. However, Mesa retreated from plans to immediately increase fuel taxes and eliminate cooking gas subsidies for the poor. He proposed instead a gradual end to government price controls. Before last night's speech, some radical opposition leaders, who when Mesa took office gave the president 100 days to show results, promised to take to the streets again to force Mesa's ouster. However, Evo Morales, an indigenous coca farmer who is Bolivia's most well-known opposition leader, said it was important for Mesa to stay in power "for questions of stability."

Toledo Denies Involvement in Scandal, Condemns Corruption

Peruvian President Alejandro Toledo on Saturday attempted to distance himself from a corruption scandal involving a friend and trusted advisor, Reuters reported. The president denied having knowledge of a December 2001 meeting between his friend and former intelligence chief, Cesar Almeyda, and Oscar Villanueva, a principal operative in a corruption and bribery network led by jailed former spy-master Vlademiro Montesinos, and said he was disappointed by his former confidante. "I am profoundly pained that Cesar Almeyda acted behind my back, and I regret having placed my confidence in someone who has shown he did not deserve it," Toledo said in a nationally tel-

vised address. "It is clear this is an isolated incident which does not involve the government. I reiterate that anyone who is corrupt is my enemy and the enemy of my government." During the meeting with Villanueva, which took place five months into Toledo's five-year term, Almeyda discussed pressuring and bribing judges, efforts to control a television station, and how to help Montesinos escape drug trafficking charges. Toledo's administration has been battered by allegations of corruption in recent months. Four ministers, including the prime minister, have been fired or resigned within the past three months amid allegations of influence peddling. On Friday, Raul Diez Canseco resigned as Toledo's vice president due to charges he signed a decree granting the father of a girlfriend a tax waiver on his business. The allegations had already forced Diez Canseco to step down as foreign minister in November. The corruption allegations and cabinet resignations have not helped Toledo's dismal popularity. Nine out of ten Peruvians disapprove of his presidency, according to polls.

Aristide Agrees to Measures Aimed at Defusing Haiti's Political Crisis

Under pressure from neighboring countries and the international community to defuse Haiti's political crisis, Haitian President Jean-Bertrand Aristide on Saturday agreed to give opponents a greater role in his government, *The Miami Herald* reported. After talks in Jamaica led by Jamaican Prime Minister P.J. Patterson, Aristide agreed to replace his prime minister with someone seen as neutral by both his Lavalas Family party and by the country's opposition. He also committed to rescinding a decree restricting protests to certain areas and said he would work with the Organization of American States to create clear rules for demonstrations. In addition, Aristide accepted proposals to disarm armed guns, publicly destroy illegal weapons, release in a week's time all those being detained arbitrarily, and to process demonstrators who have been arrested within 48 hours. The Haitian president's

compliance with the commitments will be monitored by the OAS and by leaders of the 15-member Caribbean Community. He is expected to issue a progress report by early next month. Aristide and his Lavalas Family party have been locked in an often violent dispute with Haiti's opposition, which accuses the president and his party of rigging parliamentary and presidential elections in 2000. More than 50 people have died in violent street clashes between the country's police, Aristide's opponents, and his supporters.

Castro Vows to Die Fighting in Defense Against Feared US Invasion

Cuban President Fidel Castro on Friday promised to die "with a gun in my hand" were the US to invade Cuba to overthrow his government, Reuters reported. "I don't care how I die, but for sure, if they invade us, I will die fighting," the 77-year-old Castro told a group of anti-free trade activists. Castro, who dodged CIA assassination attempts throughout the 1960s, exhorted the Bush administration to explain its policy on assassinating foreign leaders, made murky when the US named Saddam Hussein a target before last year's invasion. The Bush administration recently accused Cuba and Venezuela of planning to destabilize Latin America's democratic governments. President Bush last year established a commission to plan a post-Castro transition to democratic rule, which has fueled Havana's worries of a potential "regime change." Castro said Cuba would resist invasion with "hundreds of thousands" of guerrilla-trained soldiers. Cuban authorities have been preparing the population for invasion with training drills, said Western diplomats.

Economic News

Argentina Denies Collapse of Bank Bidding to Advise on Debt Talks

The Argentine government on Friday acknowledged that several of the seven investment banks competing to advise Argentina during debt restructuring talks with creditors had dropped their bids, but

The Dialogue Continues

A continuation of the January 28, 2004 Q&A

Q In what a Nicaraguan government spokesman called the "best economic news in the last 25 years," the International Monetary Fund (IMF) and World Bank on January 23 approved \$4.5 billion in debt relief for the impoverished Central American country under their Initiative for Heavily Indebted Poor Countries (HIPC) program. What is Nicaragua's short- and long-term economic outlook as a result of the debt relief?

A **Guest Comment: Carlos Roberto Perez:** "For Nicaragua the the announcement by the International Monetary Fund and World Bank to cancel approximately 70 percent of its external debt, which in 2002 amounted to \$6.362 billion, represents a great

opportunity to use financial resources for the country's economic recovery, given that the \$4.5 billion is equivalent to 1.2 times the country's total production and 7.5 times the value of exports last year. The above, added to the completion of a free trade agreement with the United States, creates great expectations for the Central American country in the short and medium term. It is important to note also that the cancellation of the debt is tied to Nicaragua's commitment to apply measures that strengthen macroeconomic stability and fight corruption, as well as to implement an antipoverty program. The task now is a challenge for all Nicaraguans."

Carlos Roberto Perez is a Program Coordinator at the Central American Secretariat of Economic Integration.

denied earlier reports that all seven had withdrawn, according to Reuters. Economy ministry spokesman Armando Torres said it was not true that all the banks had pulled out and that the government would continue negotiating with those remaining. "Other big international banks are perfectly capable of overseeing the negotiations," Torres stated. "They have contacted the economy ministry, interested in joining the short list of organizing banks." Earlier in the day, an unnamed source close to the country's contentious debt restructuring said that all seven banks applying to manage the restructuring of Argentina's \$88 billion in defaulted debt had dropped their bids due to the government's low commission offer. Argentine newspaper *La Nacion* reported earlier in the week that **Goldman Sachs** and **Morgan Stanley** had pulled out of the bidding, leaving **ABN Amro**, **Barclays**, **UBS**, **Dresdner Kleinwort Wasserstein**, and **Lehman Brothers** still in the running. **JP Morgan** and **Salomon**

Smith Barney withdrew as candidates last year.

Chavez Continues to Pressure Central Bank to Back Farm Program

Venezuelan President Hugo Chavez demanded Sunday that the Central Bank and private sector fulfill their commitments to finance state programs to revitalize the Andean country's struggling agriculture sector, Reuters reported. "The country must keep pressing the Central Bank to make sure it really guarantees financing for agriculture and not only with promises as they have done before," Chavez said on his Sunday broadcast. "We can't leave the game just in the hands of the Central Bank and the private banks." The Bank has thus far avoided the populist president's threatened takeover of the bank to use over \$1 billion in international reserves for state farming projects, calling such a use of the \$22.2 billion reserves unconstitutional.

Featured Q&A*Continued from page 1*

solution, it is doomed to fail if the appreciation is due to a systemic factor. There is plenty of evidence in the region showing that the exchange rate is a poor trade policy instrument. Countries in the region would be better advised to deepen their structural reform agendas to ensure continued gains in productivity."

A Board Comment: Geoffrey Milton: "Any strengthening of the Latin currencies can only be against the US Dollar, where we have seen a material and overdue correction against the euro and yen. With oil priced in dollars, there is no real impact on energy costs. Similarly, commodity export prices should remain competitive in Europe and Asia. Any modest appreciation on the dollar should not have a significant impact on exports to the United States and could actually have a positive impact on domestic inflation. It also becomes less of a burden to service dollar debt from local currency sources. Central banks must concentrate on domestic money supply and inflation, leaving the exchange rate to market forces. Witness the example of Brazil over the last year—an appreciating real is a reflection of strength in the economy and a more stable monetary policy, permitting a reduction in interest rates and the beginning of a virtuous cycle."

A Guest Comment: Suhas Ketkar: "The short answer is 'no,' with the exception of Chile and Mexico. At their current levels, the Argentine peso, Brazilian real, and Colombian peso are still quite competitive. Furthermore, the global economy and commodity prices are likely to be stronger this year than last year, enabling these countries to maintain healthy trade surpluses. In view of this, there is no reason why monetary authorities in Argentina, Brazil, and Colombia should be encouraged to resort to market intervention to engineer depreciation of their currencies. Chile and Mexico face somewhat different challenges. The Chilean peso's appreciation since August 2003 has been driven by a sustained run-

up in copper prices. In the process, the currency has come close to losing its international competitiveness. In my judgment, the Central Bank has responded appropriately by cutting interest rates and relaxing capital controls. This leaves Mexico, whose market share in the United States has been eroded by an up to 20 percent overvaluation of the peso and China's admission to WTO. In the absence of structural reforms, Mexico needs a substantially weaker peso to improve its export and growth performance. I would encourage Mexico to ease monetary policy."

A Guest Comment: Sidney Weintraub: "There is no exchange-rate system that is ideal for all countries under all circumstances. Many Latin American countries paid a heavy price in the last few decades with so-called fixed but adjustable rates, or near fixed rates, or rates fixed within a narrow band, expending foreign reserves to protect these rates. Mexico and Brazil come to mind. Argentina suffered an immense collapse by trying to maintain a rate fixed to the dollar long after its useful time. The general conclusion was that floating rates, with little intervention to control the rate, did the least damage. Some rates have become overvalued as a consequence—Mexico is an example of this in recent years, but this is slowly correcting itself—but a policy of direct intervention on a regular basis might be more costly over time than a currency that is temporarily overvalued."

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