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# Inter-American Dialogue

LATIN AMERICA ADVISOR



## Featured Q&A *With Our Board of Advisors*

**Q** **Amid concerns about accelerating inflation, Argentine President Nestor Kirchner last week called for a national boycott of Royal Dutch/Shell Group after the company hiked gasoline prices for the second time in seven months. Will Kirchner be able to keep a lid on inflation? How will multinationals respond to government pressure to hold prices down?**

**A** **Guest Comment: Federico Thomsen:** "It is good that the Argentine population is so mindful of the country's inflationary past that it demands price stability from its politicians. Having said this, the significance of the recent uptick of inflation should not be exaggerated: it is no more than a yellow light. It would not require much from the Central Bank to stop it. With the economy growing at an 11 percent annualized clip in the last quarter of 2004, a slight monetary tightening, which is what is needed, could hardly be called recessionary. However, if Kirchner out of ignorance or demagoguery decides to stabilize prices by bullying companies into submission, then Argentina, which sorely needs new investment, will be headed for trouble. The positive news is that while the president postures before voters the monetary authorities are working quietly on more suitable measures. The negative news is that Royal Dutch/Shell may have been singled out for punishment not for hiking its prices, but because it decided not to sell its assets in Argentina (yet?) In doing this, it frustrated the plans of President Kirchner and Venezuela's President Chavez to create a binational, state-owned gasoline distribution network in Argentina through a partnership between PDVSA and Argentina's asset-less Enarsa."

**A** **Guest Comment: Vladimir Werning:** "CPI inflation, potential energy rationing during winter, and crime are the issues with the highest potential political repercussion ahead of October elections. Actual and expected inflation has breached the Central Bank's 5-8 percent target, and multiple pol-

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**PHOTO OF THE DAY**

Guatemalan President Oscar Berger on Monday vowed to sign the Central American Free Trade Agreement despite popular protests. See related story, page 2.

*Photo: Guatemalan government.*

## Inside This Issue

## NEWS BRIEFS

### Mexico's Industrial Production Grew 3.1 Percent in January

Industrial production in Mexico grew 3.1 percent in January compared to the same month of 2004, led by 5.2 percent growth in construction amid a housing boom. Manufacturing grew 2.9 percent year-on-year, while output by *maquiladora* plants rose 6.6 percent. Production in the mining sector and in the electricity, gas, and water sector rose 2.9 percent and 0.8 percent, respectively. Industrial output in Mexico grew 3.8 percent in 2004 after three straight years of declines.

*Source: INEGI.*

### Judge Allows House Arrest for Ex-Costa Rican President

A Costa Rican judge ruled Monday that former President Miguel Angel Rodriguez could leave prison and remain under house arrest while he awaits trial on corruption charges. Prosecutors allege Rodriguez sought $1.2 million in kickbacks from France's Alcatel in exchange for a government contract in 2001. Rodriguez was forced to resign as secretary general of the OAS in October after just two weeks in the post because of the allegations.

*Source: Associated Press.*

### Brasil Telecom Had Highest Rate of Complaints in February

**Brasil Telecom** had the highest rate of complaints among mobile users in February, telecommunications sector regulator Anatel said in a report Monday. Anatel said it received 2.617 complaints per 1,000 Brasil Telecom mobile subscribers last month. The next-highest complaint rate was by **Telefonica-Portugal Telecom** joint venture **Claro**, which had 0.353 complaints per 1,000 customers.

*Source: Anatel.*

# Political News

### Blockades Continue in Bolivia, Threaten Food Supply

Bolivian indigenous groups demanding an increase in royalties paid by foreign oil and gas companies continue to block highways critical to the supply of food and water in the country, Bolivian daily *La Razon* reported Monday. The nationwide blockades are preventing goods from eastern agriculture-producing areas from reaching the capital, La Paz, and from being exported abroad, according to Reuters. President Carlos Mesa said the government might not be able to pay public salaries in as soon as two weeks because of the blockades. Mesa said the demand by protesters—led by Movement Toward Socialism (MAS) party head Evo Morales—that the government raise royalties from 18 to 50 percent is unacceptable. Mesa is trying to rally support in Congress for his version of a new hydrocarbons law, whereby oil and gas companies would be charged 18 percent in royalties and 32 percent in taxes. "The blockades are a path that Bolivians today do not accept," Mesa was quoted as saying by the *Toronto Star*. "I want to advise the road blockers that they don't waste their time and energy in something that is unnecessary. The hydrocarbons law is going to pass." Labor unions, demanding the nationalization of the hydrocarbon sector, plan a 48-hour strike starting today. A proposed meeting between Mesa and opposition leaders on Monday fell apart after Mesa said he would not attend, citing a lack of participation by various groups.

*President Carlos Mesa said the government might not be able to pay public salaries in as soon as two weeks because of the blockades.*

### Nineteen Guatemalans Hurt in Clashes Over CAFTA Approval

Nineteen people were injured in Guatemala on Monday during clashes between police and demonstrators protesting a regional free trade agreement with the United States, the Associated Press reported. Police guarding the presidential palace used tear gas and water cannons to disperse some 4,000 protesters throwing rocks and bottles. Elsewhere in the country, protesters reportedly closed schools and blocked highways to denounce lawmakers' approval last week of the Central American Free Trade Agreement. Despite the protests, President Oscar Berger vowed to sign the trade agreement "as soon as Congress sends it to me." Guatemala is the third of the seven parties to the proposed trade deal to ratify the agreement. El Salvador was the first to ratify the pact, followed by Honduras, while it awaits ratification in Costa Rica, the Dominican Republic, Nicaragua, and the United States, according to the *Financial Times*. The US Congress, where CAFTA is expected to face difficult passage, is expected to take up the trade deal this spring.

# Company News

### Shell Station Sales in Argentina Fall 70 Percent Amid Call for Boycott

Sales at **Shell** service stations in Argentina have fallen 70 percent since President Nestor Kirchner called for a nationwide boycott of the company last week, the Argentine Federation of Fuel Businesses said Monday, according to Reuters. "The company is doing a survey comparing sales this past weekend with the previous one. The vendors of Shell fuels are talking of more or less a 70 percent drop in sales," Federation President Carlos Calabro was quoted as telling local radio. Last week, the **Royal Dutch/Shell Group** raised prices for gasoline and diesel fuels 2.6 percent and 4.2 percent, respectively, prompting Kirchner to urge Argentines to boycott the company's service stations. Calabro said the decline in sales at Shell stations could be more a result of motorists' fear of violent confrontations with picketers that have blocked access to the stations than to popular approval of Kirchner's call for a boycott. "This doesn't do anybody any good, and it is worrying. If this is the government's methodology, we believe it is inappropriate." Shell is the third-biggest gasoline distributor in Argentina. Kirchner said Shell's two biggest competitors in Argentina—Spain's **Repsol YPF** and Brazil's state-owned **Petrobras**—would not raise prices. However, the Uruguayan government said it plans to sell its chain of 172 **Sol Petroleo** gas stations in Argentina due to losses in the sector, Bloomberg News reported yesterday. Industry and Energy Minister Jorge Lepra said at a press conference Sunday that the Argentine unit of Sol Petroleo, which last week raised gas prices but later reversed the increase, is losing $1.7 million a month. Lepra said it is not yet clear how much Uruguay has invested and lost through its energy operations in Argentina. He said Petrobras, Venezuelan state-owned oil company **PDVSA**, and Argentina's state-run energy company **Enarsa** are interested in buying the unit. Kirchner, fresh off the success last month of a debt swap offer that repays holders of billions of dollars in defaulted bonds just 25 percent of the value of their original investments, said prices would become a central focus now that the debt exchange issue has been resolved. The government is intent on taking strong measures to prevent a resurgence of inflation after the country's 2002 default depleted the savings of many Argentines. After two years of low inflation, consumer prices jumped 2.5 percent in the first two months of 2005 alone. [Editor's note: see related Q&A on page 1.]

# The Dialogue Continues

*A continuation of the March 11, 2005 Q&A*

**Q Brazil's National Monetary Council earlier this month approved the unification of the country's foreign exchange markets in a move the Central Bank said is aimed at simplifying currency transactions and making them more efficient. What impact will unity of Brazil's foreign exchange markets have on investment in the country? Will it affect the exchange rate?**

**A Guest Comment: Roberto Teixeira da Costa:** "Steps recently taken by our Central Bank to simplify and eliminate unnecessary bureaucracy in foreign exchange transactions were a long-time demand by different sectors of the economy. Rules had to be updated, taking into consideration several changes in our country and elsewhere in a well-known scenario of many more transnational operations. It is important to remark that Brazil in the 12 months through February 2005 reached a spectacular total of $100 billion in exports. Without creating the risk of providing excessive facilities for money laundering, certainly other measures could be considered to unify foreign exchange markets, which increase transparency and will have a positive effect on Brazil risk. The measures adopted, plus the presence of the Central Bank in the market as a buyer (more than $10 billion were bought during Jan-Feb 2005) made the dollar react, to the pleasure of the exporting sector, which was afraid of losing competitiveness."

**Roberto Teixeira da Costa** *is a member of the Board of Banco Itau in Brazil.*

## Copper Miners SPCC, Antofagasta Report Strong 2004 Profit Growth

Two of South America's largest copper miners on Monday reported strong profit growth in 2004 amid high global prices for the metal, according to Reuters. **Southern Peru Copper Corp.** (SPCC) said its 2004 profit rose five-fold to $596.8 million, helped by a 60 percent increase in the average price of copper in New York last year, while Chile's **Antofagasta** said its net income tripled to $558.3 million. Antofagasta, which said it expects the price of copper to remain strong this year, announced a special dividend of $0.40, making the total dividend for the year $0.79. SPCC, majority-owned by **Grupo Mexico**, said sales more than doubled to $1.72 billion in 2004. However, SPCC predicted copper production, which rose 6.1 percent to 876 million pounds last year, would fall 8 percent in 2005 due to a decline in ore grades at its Cuajone mine. In related news, lawyers for local and international mining companies on Monday said Peru's Constitutional Court, the country's highest judicial body, should strike down a royalty on mining sales because it was improperly rushed through Congress and violates the terms of the concessions granted to the mining companies, Reuters reported. Last June, Peru's Congress approved a 1-3 percent royalty on mining sales to raise money for reinvestment in poor mining regions, sparking an outcry among mining companies who warn the royalty threatens investment in future projects. Mining companies account for more than half of Peru's annual exports. SPCC is one of the companies most affected by the royalty because it did not sign a stability contract with the government that locks in tax rates. If the six-member Constitutional Court, which is expected to issue its ruling next month, decides that the royalty is illegal, mining companies will still be required to make the 10 monthly payments levied before the Court's ruling, according to Reuters. Peru is the world's third-largest zinc producer, fifth-largest copper producer, and sixth-largest gold producer.

**Featured Q&A**
*Continued from page 1*

icy objectives alongside limited policy tools suggest Kirchner's administration is not going to rein CPI back into that range in 2005. While unit labor costs appear under control, the challenge is that inflation is responding to a mix of demand pull, capacity constraints, relative price adjustments, and excess monetary stimulus. Stepping up sterilization of FX intervention will help limit monetization, but private consumption will remain strong as long as short-term real interest rates remain negative. Unfortunately, fiscal policy will not constrain demand this year (it will shift from a drag to a thrust); policy actions cannot contain pricing power arising from capacity constraints near term (although imports will partially help); service price pressure will not fade while the peso is kept nominally weak; and export taxes that isolate the economy from higher international prices are already in place. Thus, the realistic goal has become avoiding a double-digit CPI. Kirchner's call for a boycott on purchases from companies that hiked gasoline prices is not surprising: first, Kirchner relies on an image of unwavering personal authority (to contrast with ex-President De La Rua who was pushed to resign); second, it reflects Kirchner's economic schooling as a provincial governor (price setting in Santa Cruz's economy—consisting of oil/gas, construction contractors, and public employment—relied more on bargaining strength and government involvement than on competitive market forces); and third, concern over income distribution is boiling in Argentina. Of course, verbal antagonism is unsupportive of the business climate. But a more relevant observation for corporates is that business groups that have publicly challenged the president's vision or his specific policies have had to endure open, strong, and ongoing pressure from the administration, while those that kept a low profile or a conciliatory tone (while publicizing their investment commitments) have ultimately been able to maneuver better and at times even received favorable treatment from the government—that is, after the public's eye was drawn to alternative issues."

**A** **Guest Comment: Liliana Rojas-Suarez:** "Having just reached an agreement with a majority of its creditors, Argentina's policymakers are now facing a central policy dilemma: the authorities would like to prevent the exchange rate from appreciating in order to continue their export-led growth path. But keeping a 'weak peso' has implied an expansionary monetary policy, that is now pushing inflation up as output growth has not kept up with the expansion of aggregate demand. The Kirchner government will not be able to reach the 8 percent inflation limit established by the monetary program with selective price controls or a boycott of foreign gas suppliers such as the Royal Dutch/Shell Group. Under the current circumstances, reaching the inflation goal requires a tightening of monetary policy and therefore higher interest rates. While this policy would most likely result in an appreciation of the real exchange rate, this adjustment is needed to restore equilibrium in the foreign exchange market and should not be considered bad news. The markets are already signaling the Argentine peso is one of the most undervalued currencies in the world and are forcing an appreciation. It would not be a smart move for the Kirchner government to 'fight the markets,' at least this one time."

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**Federico Thomsen** *is head of E.F. Thomsen economic consultancy in Buenos Aires.*

**Vladimir Werning** *is Vice President at J.P. Morgan Chase & Co.*

**Liliana Rojas-Suarez** *is a Senior Fellow at the Center for Global Development.*

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