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Latin America Advisor

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Featured Q&A *With Our Board of Advisors*

Q Market reaction to heightened political tensions in Mexico involving the legal case against Mexico City Mayor and presumed presidential candidate Andres Manuel Lopez Obrador (AMLO) have thus far been relatively muted. Are you surprised? Can Mexico's markets and economy survive a prolonged period of political noise?

A Guest Comment: Benito Berber: "The reaction of the market has not been muted. In fact, it has appropriately priced in a low risk of violence following AMLO's speeches. Indeed, AMLO's two speeches—one in the Zocalo in front of approximately 180,000 people, the other in the lower house—clearly communicated two things: 1) that the PRD will not use violence to respond to the PRI and the PAN, which brought much relief to investors; and 2) that the accusations by the PRI and the PAN were aimed at stymieing AMLO's chances of becoming a presidential candidate. I don't believe the increase in the political noise could seriously affect the economy at this moment. Furthermore, the risk to the economy seems contained, given that the macro fundamentals are anchored in NAFTA, a flexible exchange rate, a prudent fiscal policy, and the timely intervention of an independent central bank. However, this type of political development has a life of its own and could deteriorate very fast at any moment, thus affecting all markets. Indeed, the immunity trial is not the end, but the beginning of political noise that will only subside with the election of the new president in July of 2006."

A Guest Comment: Jose Barrionuevo: "While financial volatility will likely grow over the coming year, we see periods of sharp weakness associated with AMLO's presidential candidacy as representing strong investment opportunities. The Mexican peso will be particularly vulnerable during such periods, experiencing bouts of depreciation pressure of as much as 2.5 percent or so. Still, the global credit

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PHOTO OF THE DAY

Will continued demonstrations, like this one in Mexico City's *Zocalo* last Thursday, upset investors?

Photo: Mexico City government.

Inside This Issue

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NEWS BRIEFS

In Shake-Up, Heineken Appoints Young New Chief Executive

Dutch brewer **Heineken** on Tuesday appointed a young new chief executive as part of a shake-up to energize the company amid sluggish growth and shrinking profits. Forty-three year-old Belgian Jean-Francois van Boxmeer will replace Anthony Ruys, 57, on October 1, Heineken said. Heineken's global operations include control of Chile's largest brewer, **CCU**, and a 20 percent stake in money-losing Brazilian brewer **Kaiser**. Heineken has been named as one of several companies interested in acquiring Colombia's **Bavaria**, Latin America's largest independent brewer.

Source: company statement.

Nortel to Expand, Upgrade Haitian Wireless Network

Canadian telecommunications equipment supplier **Nortel** announced Tuesday that it had been hired by **Haiti Telecommunications International** (HaiTel) to expand and upgrade HaiTel's wireless network, and enable the introduction of 3G mobile data services. The expanded network is expected to reach more subscribers in a country with a teledensity of about 4.8 percent—one of the lowest rates in the Western Hemisphere.

Source: Nortel statement.

Brazil's TAM to Sell Shares

TAM, Brazil's second-largest airline, plans to sell shares in an offering to Brazilian and US investors. The offering will include the sale of preferred shares, TAM said in a filing with Brazil's securities regulator. It will disclose details of the offering, including sale dates, in a later filing.

Source: Bloomberg News.

Economic News

Donor Nations Pledge Renewed Support for Latin America

Donor nations and Japan, Latin America's biggest creditor, on Tuesday renewed pledges to support the region's development, stressing that economic reforms are vital to ensure continued growth and attract more investment from Asia, Reuters reported Tuesday. At the Inter-American Development Bank's annual meeting in Okinawa, Japan, Asian economic officials said their decisions on whether or not to invest in the region would hinge on the countries' improved overall environment of debt management, public-sector reform, and technological advancements. Some risk-averse Asian investors, particularly in Japan—one of the IDB's biggest shareholders—are concerned about rising interest rates and stalled structural reforms in the region. In addition, on Sunday Japanese Finance Minister Sadakazu Tanigaki criticized Argentina's handling of its controversial debt restructuring and urged the country to act in good faith with its creditors. Many Latin American nations, such as Mexico, Brazil and Colombia hope to continue building on their recent economic stability by issuing debt in Asia to tap the region's large pool of savings. IDB President Enrique Iglesias said higher interest rates and oil prices could dampen the outlook for Latin American economies. "For the time being, the situation is generally (one of) cautious optimism," Iglesias said. He expects the region's economic growth to slow to 4.0-4.5 percent in 2005 from last year's record 5.5-6.0 percent expansion.

Some risk-averse Asian investors, particularly in Japan, are concerned about rising interest rates and stalled structural reforms in the region.

Uruguay Aims to Slash Public-Sector Debt Over Five Years

The 42 day-old government of Uruguayan President Tabare Vazquez plans to reduce its public debt from 90 percent of gross domestic product to 60 percent of GDP over the next five years, Economy Minister Danilo Astori said Tuesday. "The government proposes to reduce the debt-to-GDP ratio to around 60 percent over the course of the next five years," Astori said at the Inter-American Development Bank's annual meeting in Okinawa, Japan, according to a text of his speech posted on the Uruguayan presidential Web site (www.presidencia.gub.uy). "This will only be possible if we manage to substantially increase investment and achieve a sustained rate of growth higher than the one the country has been exhibiting," Astori added. In 2003, Uruguay restructured half of its debt to avoid default, according to Reuters. The government is close to reaching a new agreement with the International Monetary Fund, although it is not clear whether the deal will include fresh loans. The government forecasts growth of 6 percent this year after expansions of 12.3 percent in 2004 and 2.5 percent in 2003, according to Reuters. It emerged from a four-year recession in 2003 brought on by economic woes in neighboring Argentina.

Company News

Wachovia Offers Foreign Remittance Card

US bank **Wachovia Corp.** announced Tuesday that it is offering a foreign remittance card for customers to send money home to relatives in Latin America and the Caribbean. Wachovia said customers with a checking or savings account can fund the "Dinero Directo" card with money from their accounts and then use the card at any automated teller machine (ATM) in the Visa/PLUS network, which consists of more than 950,000 ATMs in 160 countries. "We've seen the amount of money sent from the United States to Latin America increase dramatically over the past several

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years to $36 billion, indicating a real need for a remittance product," Jorge Moller, director of Wachovia's Hispanic Segment Strategy, said in a press release. "Fifty percent of the Hispanic households within Wachovia's footprint are from countries other than Mexico. For this reason, we expanded the capabilities of our Wachovia Dinero Directo Card so customers can send money to friends and family throughout Latin American and Caribbean countries, as well as Mexico." Moller said Wachovia was the first major bank to issue such a card. The increasing involvement of banks in facilitating remittances through the offering of products specifically targeting senders is one factor expected to drive continued growth in remittances to Latin America, according to analysts and industry officials [Editor's note: see related Q&A in the April 1, 2005 issue of the *Latin America Advisor*.]

Coca-Cola Helps Start Foundation for War Victims in Colombia

Coca-Cola Co., whose partners in Colombia have been accused of hiring right-wing death squads to murder union activists at Coca-Cola bottling plants, has helped start a foundation to assist victims in Colombia's civil war, the new foundation announced Tuesday, according to Reuters. The Colombia Foundation for Education and Opportunity said it received $10 million in seed money from the Coca-Cola Foundation, the charitable arm of the US beverage maker. The Colombian foundation plans to work with non-governmental groups to provide education and other opportunities to people affected by Colombia's four decade-old civil war, Reuters reported. The creation of the Colombian charitable entity comes a week before Coca-Cola's annual meeting. At last year's meeting, senior executives were forced to defend the company's business practices in Colombia, where more than half a dozen union activists employed at Coca-Cola bottling plants have been murdered since 1989. In a March 29 statement, Coca-Cola said an internal investigation and two different judicial inquiries in Colombia had found no evidence of wrongdoing by the company or its bottling partners.

By the Numbers

The Inter-American Dialogue's Claudio Loser comments on the latest data from Latin America

WASHINGTON—In recent weeks, Argentina emerged after somewhat more than three years from its public debt default, effectively paying some 35 cents on the dollar.

Some politicians in Latin America view the tough debt strategy of Argentina as the example to follow in the region. They observe a sharp decline in the debt burden and an economy that has grown at an average rate of more than 8.5 percent in the last two years, while in Brazil, Mexico, and even Chile, the growth rate has been much more modest.

However, if we compare the experience of Argentina—the largest sovereign default in recent history—with that of Brazil and Mexico, which did not default, or even with Ecuador, we get a more sobering picture.

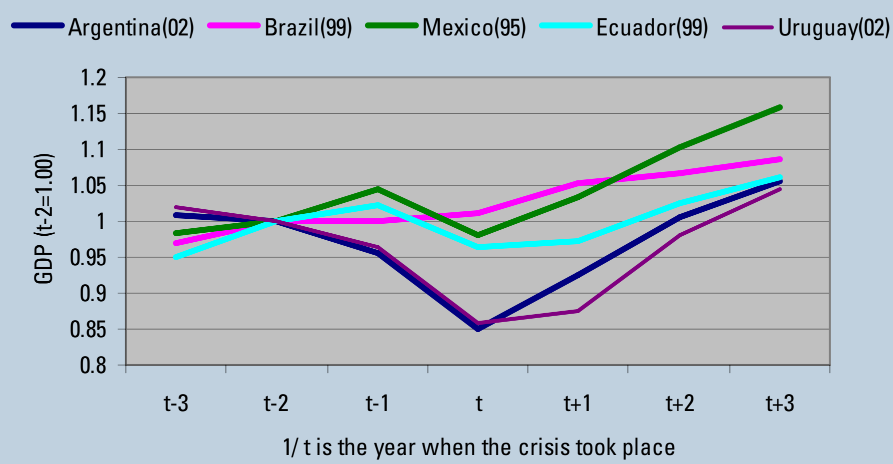
The chart below compares the level of GDP (defined as 1.00 for two years prior to the crisis (t) for five countries that experienced serious financial crises. Even with the spectacular recovery of Argentina, it remained behind that of the other countries after three years, with a clear loss of output compared to the other countries.

This is to a large degree the effect of the debt crisis and the ensuing default. Only Uruguay did as badly as Argentina, because of contagion. Brazil and Mexico, with a more traditional restructuring approach, were better off than Argentina.

Clearly, those trying to emulate Argentina need to do their homework and realize the devastating effects of a default of the magnitude experienced in Argentina. It would be the equivalent of wrecking a car in order to reduce your debt on the vehicle."

Claudio Loser is a Senior Fellow at the Inter-American Dialogue and former Head of the Western Hemisphere Department at the International Monetary Fund.

GDP Levels Before and After Financial Crises in Latin America



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Featured Q&A
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environment, and the performance of the US economy and, in particular, the US Federal Reserve will remain, as in the past, a much more critical driver of investment opportunities and peso pressures. In the near term, should AMLO succeed in advancing his presidential bid, which is likely in our view, downside pressures on the peso will likely push the currency toward 11.3-11.4 per dollar. However, should the US Fed continue its gradual tightening, and there is a sense that most of the Fed tightening will be behind us sometime in the third quarter, the peso will likely rally markedly, plausibly through 11.0 per dollar on the upside. Local investors are likely to remain wary of Mexico's financial prospects through at least early 2006 and probably through all of 2006, should AMLO win the election. Foreign investors will likely take advantage of periods of sharp peso pressures to build positions in Mexico's fairly attractive local peso bonds. The leading concern under an AMLO victory would be capital flight pushing the peso well below 12.0 per dollar in 2006, ahead of the presidential election. While this scenario is plausible, it would hinge on the ability of the PRI to come up with a sharper contender than the present candidate. Should a new candidate emerge, which is still likely in our view, the PRI would capture the PAN's loss of popular support and the PRI would be in a strong position to win, thus limiting capital outflows and peso weakness."

A Guest Comment: Tapen Sinha: "The Mexican stock market had a dream run until February 2005. It kept setting record after record. In the past few years, the market has practically doubled in value. Given the close alignment of the Mexican economy with the US economy, this performance has surprised some, given that the US stock market has been languishing since 2000. However, the movements of the stock market have much to do with the deepening capital markets in Mexico—not just the stock market but other ancillary markets as well (such as the derivatives markets, which has exploded in the past three years in Mexico). It has also a lot to do with the developments in the privatized pension markets and investment grade authorized by various bond rating agencies for Mexican government bonds. A decade ago, the biggest segment of the bond market was 28 day CETES. Now, the average maturity of a UMS (Mexican Treasury Bond) has a maturity of seven years. These developments have made Mexico much less vulnerable to short term shocks—political or otherwise. *Hacienda* is already actively reducing the value of bonds that will mature in 2006—the election year. A positive surprise has been the total absence of any violence following the *desafuero*. Even if Lopez Obrador manages to become the president next year, he will have to preside over a divided legislature. He will be in the same boat as the current president. Thus, the market will take into account that any president will not be able to bring about radical changes and therefore, current policies will broadly continue."

Benito Berber *is a Vice President and Latin America Economist at HSBC.*

Jose Barrionuevo *is Director of Emerging Markets Strategy for the Americas at Barclays Capital.*

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