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FEATURED Q&A

What is the Outlook for Investment Banking in Brazil?

Q Swiss bank UBS is reportedly under pressure on various fronts to sell its Brazilian asset management and underwriting subsidiary, UBS Pactual. What would a sale mean for Pactual and who would the potential bidders be? What is your outlook for investment banking in Brazil?

A **Guest Comment: Jose Barrionuevo:** "My investment outlook for Brazil is bright, despite the understandable limitations that the US financial crisis may pose in the near term. Brazil is the most vibrant emerging market economy in the world. Brazil was always considered the country of tomorrow. Tomorrow is finally here today. Brazil's well managed economy, especially on the monetary front, gives the country a remarkable level of stability, and its continued convergence to international financial standards, including single-digit interest rates, appears more achievable than ever after reaching investment grade status—a status that recognizes the solid monetary policy foundations of the country that are finally yielding the stability that fosters sharp investment and a brighter growth future. Despite recent inflationary pressures, the likely further, marked appreciation of the real will help ease external inflation pressures and end the present tightening cycle as we enter the second half of the year. This would allow Brazil to continue building its

long-term yield curve and a vibrant domestic financial market. As Brazil becomes the next global financial hub, investment banking and, especially, brokerage and asset management services will remain a critical part of the growth strategy of any global firm. The unlikely sale of Pactual would be a major blow to UBS' efforts to strengthen its global franchise to improve its growth prospects, both of which are badly needed at this time. It would seriously raise questions over the bank's strategy and its efforts to position itself in the fastest-growing emerging markets in the world, of which Brazil is a critical part, at a time when these markets are becoming essential to the growth of the world economy. Pactual is a well-run, strong franchise that would have many

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Argentine Economy Minister Martin Lousteau (R), pictured here with President Cristina Fernandez, resigned on April 24. See story on page 5.

Photo: Casa Rosada.

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NEWS BRIEFS

Wachovia Caught Up in US Probe of Drug Money Laundering

US federal prosecutors are investigating Charlotte, NC-based **Wachovia Corp.** as part of a broad probe of alleged laundering of drug proceeds by Mexican and Colombian money-transfer companies, *The Wall Street Journal* reported on April 26.

Wachovia said it is in discussions with the US Justice Department about reforms to its compliance system and faces a possible deferred-prosecution agreement that would require extensive federal oversight, according to the report.

Equifax Posts 34 Percent Growth in Latin American Revenues

US-based credit reporting firm **Equifax** on April 21 posted first-quarter operating revenue from its Latin American operations of \$53.2 million, up 34 percent from the same period a year earlier in dollar terms and 18 percent in local currency terms. In a press release, Equifax said Latin America accounted for 11 percent of the company's total first-quarter operating revenue of \$503.1 million, up from 10 percent a year ago.

Brazilian Police Arrest Credit Suisse Banker

Brazilian police arrested a **Credit Suisse** banker on April 23 on charges of money laundering and tax evasion, Reuters reported. Christian Peter Weiss was arrested as part of a two-year probe into an irregular money transfer scheme at the Swiss firm. Weiss will be charged with 13 other bank employees and former employees. Last year, police arrested 20 people, including bankers at **UBS**, **Credit Suisse** unit **Clariden**, and **AIG Private Bank** on charges they helped wealthy Brazilians evade taxes.

Financial Services News**Costa Rica Ends 84-Year Insurance Monopoly**

Costa Rican lawmakers voted April 24 to break an 84 year-old monopoly on the insurance business, paving the way for local and foreign privately owned firms to offer their products in the Central American nation. After years of controversy and public demonstrations over proposals to break Latin America's last state-run insurance monopoly, the controversial bill was approved relatively quietly, Spain's *El Pais* reported. Private-sector groups praised the vote, which opens the market, establishes an insurance sector regulator, and brings Costa Rica one step closer to passing all the legislation required to implement the CAFTA free trade agreement with four other Central

AIG Raises \$692 Million for Latin America Equity Fund

Asset management firm **AIG Investments** said April 22 that **AIG Capital Partners** raised \$691.9 million for a private equity fund targeting companies in Latin America. In a press release, AIG Investments, a unit of insurance giant **AIG**, said the sum exceeded the target close for the "Brazil Special Situations Fund II," or BSSF II, a second-generation fund focused on investment opportunities in Brazil, as well as in Mexico, Colombia, and other Central and South American countries. "Brazil, Mexico, and Colombia have seen tremendous growth over the past several years driven by rising consumer purchasing power, increasing global trade, and economic stability. These

In a survey of 400 business leaders in Costa Rica, 80 percent said they believe the quality of insurance services will improve with the market opening.

American nations, the Dominican Republic, and the United States. A strong CAFTA supporter, Costa Rican President Oscar Arias has been a big advocate for making the state-run **National Insurance Institute**, or INS, compete with privately run firms. In a survey of 400 business leaders by polling firm **Pulsa Empresarial** and cited by local daily *La Prensa Libre*, 44 percent said the INS does not meet their companies' needs. Sixty-seven percent said the relationship between price and quality at the INS is regular or deficient, while 80 percent believe quality will improve with the market opening. Opposition party Accion Ciudadana, which opposes CAFTA, has campaigned heavily against the market opening. "There is not a single experience of a country that has followed a solidarity model while allowing openings that lead toward privatization," said Alberto Salom, an Accion Ciudadana deputy, according to *El Pais*. [Editor's note: see related Q&A in the March 12-25 issue of the *Financial Services Advisor*.]

strong fundamentals create attractive opportunities across the region, particularly for private equity investing, where the market is relatively underserved," Ana Vigon, managing director and head of Latin America private equity at AIG Capital Partners, was quoted as saying in the press release. The fund targets companies expected to capitalize on opportunities in the region in such areas as agriculture, natural resources, consumer products and services, retail, financial services, and manufacturing, AIG Investments said. To date, BSSF II has made three investment commitments worth a total of \$112.5 million, it said. AIG Capital Partners has a team of 15 investment professionals dedicated to Latin America with offices in Sao Paulo and Mexico City. It plans to open an office in Bogota.

Citigroup Posts 9 Percent Drop in Q1 Profit on Rising Bad Debt Provisions

US financial giant **Citigroup** on April 18 reported a \$453 million first-quarter net

profit at its Mexican unit **Banamex**, down 9 percent from the same period a year earlier largely due to higher credit costs from rising bad debt provisions in its credit card business, Dow Jones reported. Citigroup said first-quarter revenues rose 4 percent year-on-year to nearly \$1.70 billion, led by growth in consumer banking and wealth management. But "net income declined as higher revenues and an expense benefit related to a legal vehicle restructuring were more than offset by higher credit costs, primarily in the cards business," it said. In January, Citigroup cited Mexico as a key source of deteriorating credit quality in its consumer business, and Citigroup Chief Financial Officer Gary Crittenden said Mexico was one of a handful markets where the bank was closely monitoring credit exposure. Banamex's CEO for Latin America, Manuel Medina Mora, said in late February that Banamex's loan portfolio was in good shape, although he said the bank would be careful not to accumulate too much bad debt. In the first quarter, Banamex accounted for about 15 percent of Citigroup's international revenue and 39 percent of its international net profit, according to Dow Jones. By segment, net profit from Banamex's consumer banking business fell 9 percent to \$340 million in the first quarter, despite a 6 percent increase in revenue to \$1.46 billion. Net profit from the bank's capital markets and corporate banking operations fell 11 percent to \$101 million, while revenue declined 11 percent to \$203 million. Banamex, Mexico's second-largest bank, opened 16 retail bank branches during the first three months of this year, ending March with 1,619 branches. Citigroup said it closed 16 consumer finance offices in Mexico, ending the quarter with 410 offices.

Remittances to El Salvador Up 6 Percent in First Quarter

Salvadorans living abroad sent home a record \$912.2 million in the first quarter of 2008, the Central American country's Central Bank said April 16, according to Reuters. The figure was up from \$860.1 million for the first three months of 2007, and contrasted with remittance trends in

Q1 Earnings Roundup

Lending Growth Boosts Banco Bradesco Profit 23.3 Percent to 2.1 Bn Reais

Banco Bradesco, Brazil's largest private bank, on April 28 reported a 2.102 billion-real (\$US 1.26 billion) first-quarter profit, up 23.3 percent from the same three months a year earlier, on strong lending growth, according to Reuters. Bradesco's credit portfolio rose 38.5 percent year-on-year in the first quarter to 169.41 billion reais, but expanded only 5 percent from the previous quarter, suggesting lending is beginning to slow after years of fast growth spurred by increased consumer demand and record-low interest rates. In 2008, Bradesco expects its loan portfolio to expand 21-25 percent. The year-on-year increase in lending in the first quarter was accompanied by a rise in provisions for bad loans. The bank provisioned 8.104 billion reais in the quarter, up 19.6 percent from the same period in 2007 and up 3.6 percent from the fourth quarter. Bradesco ended March with 355.52 billion reais in total assets, up 26.1 percent from a year ago and 4.2 percent from the end of 2007.

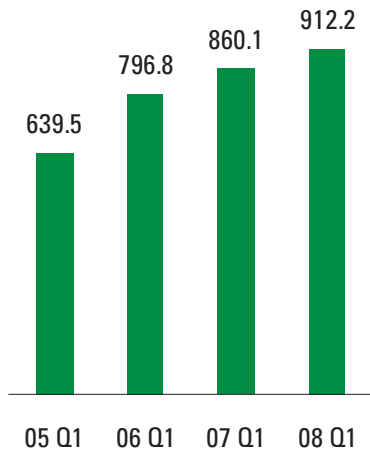
Banorte Reports 16 Percent Profit Increase on Loan Growth, Fee Income

Banorte, Mexico's fifth-largest bank, on April 24 reported a 1.93 billion-peso first-quarter profit, up 16 percent from the same period a year earlier, on loan growth and higher revenues from fees, according to media reports. The bank said lending rose 29 percent year-on-year in the first quarter to 199 billion pesos, led by increases of 34 percent and 39 percent in consumer borrowing and credit cards loans, respectively. Non-performing loans jumped 39 percent to 3.19 billion pesos, equal to 1.6 percent of Banorte's total outstanding loans, as the bank extended credit to poorer Mexicans, Reuters reported. Mexico has experienced a credit boom in recent years, sparked by relatively low inflation and a drop in interest rates that have allowed more Mexicans to access loans. "Mexico today is in a process of incorporating more people into the banking system, and that allows us to maintain our position in the market," Banorte interim CEO Alejandro Valenzuela was quoted as saying by Bloomberg News. Banorte said revenues from fees rose 11 percent in the first quarter. Credit cards commissions grew 22 percent and fees from electronic banking rose 11 percent. The bank also reported a 13 percent increase in deposits to 197 billion pesos, boosted in part by the opening of 64 bank branches in the last 12 months. Banorte plans to end the year with 1,300 branches, up from 1,062 currently.

Colombian Banks' Profits Grew 35 Percent on Bigger Loan Portfolios

Financial institutions in Colombia increased their profits by 35 percent year-on-year in the first quarter as loan portfolios grew, the country's banking regulator reported on April 29, according to Dow Jones. The banks posted profit of 1.32 trillion Colombian pesos (\$US 750 million) as their combined loan portfolios rose 21 percent to 115.37 pesos. Excluding government institutions and foreign banks, the sector reported profits of 929.4 billion pesos, up 37 percent from 679.6 billion pesos in the year-ago period. The largest bank, locally owned **Bancolombia**, saw profits rise 49 percent while second-largest bank **Banco de Bogota** reported a 35 percent increase. Foreign-owned banks did not fare so well. The Colombian unit of Spain's **BBVA** saw profits rise just 3 percent in the quarter to 72.7 billion pesos, while **HSBC** posted a net loss of 6.9 billion pesos in the quarter, compared to a net loss of 5.1 billion pesos a year earlier. However, US-based financial services giant **Citigroup** grew profit from 15 billion pesos in the first quarter of 2007 to 27.7 billion pesos in the first quarter this year.

Remittances to El Salvador (in \$US millions)



Data: Associated Press

Mexico, where transfers fell 7 percent year-on-year in January year amid an economic downturn in the US. Most remittances to El Salvador are sent from the estimated 2.5 million Salvadorans living in the US. Of those, some 240,000 enjoy temporary protected status granted by US President George W. Bush in the aftermath of earthquakes in El Salvador in January and February of 2001. The designation expires in March 2009.

Chilean Brokerages Required to Publish Data After Firm's Suspension

Effective April 25, all brokerages in Chile were required to publish their liquidity and solvency data on a weekly basis, following the Chilean market regulator's suspension of small-sized local brokerage **Alfa** due to solvency and liquidity problems, Reuters reported. However, officials said April 24 that Alfa's troubles were an isolated incident and did not signify the beginning of a broader collapse of the brokerage market in the South American nation. "I want to categorically rule out that this is the start of anything ... The market can be calm," Securities Superintendent Guillermo Larrain was quoted as saying. He said the brokerage system as a whole is "over-guaranteed," meaning there are excess financial guarantees to back the system. The securities superintendency, or SVS, suspended Alfa on April 23, saying it had been informed

Special Advisor Report

Region Vulnerable to Global Economic Distress on Many Fronts

By Elisabeth Burgess

WASHINGTON, DC—Latin America is in a good position to weather global economic turmoil sparked by the downturn in the United States, but the region—and especially its poor inhabitants—remain vulnerable, experts said on April 22.

"[Latin America's] direct exposure to global market turmoil appears to be quite limited," Brian O'Neill, the US Treasury's deputy assistant secretary for the Western Hemisphere, told an audience at the Inter-American Dialogue.

But this doesn't mean the region is "immune" to the global downturn, which has primarily affected growth prospects in the G7 group of wealthy nations, he explained. In Latin America, the subregions of Central America and the Caribbean are the most vulnerable because they are small net energy and food importers, and depend on US tourism and remittances, according to O'Neill. Mexico is also vulnerable because its exports to the US account for about 25 percent of its GDP, he explained.

Latin America's poor will be hit the hardest, especially as migrant remittances from the US are not growing as fast as they once were, according to Nora Lustig, a professor at George Washington University and former head of the Inter-American Development Bank's poverty and inequality unit. Even though the region's macroeconomic outlook is not bleak, the US slowdown will cause "moderate poverty" rates to increase by 1 percent overall and by 17 percent among remittance recipients, Lustig said.

Enrique Garcia, president of the Andean Development Corporation, believes that "Latin America today is much better prepared to face any crisis than it was ten years ago." Still, the region's economies have suffered on several fronts. He listed lower growth prospects, less access to global financial markets, high prices, and a deceleration in remittances.

Additionally, the region could be at risk as the US downturn affects China's growth, thereby reducing

the Asian giant's demand for Latin America's exports, Garcia said. Latin America has enjoyed a commodities bonanza in recent years, but if China's economy grows just 7 percent this year compared to 10 percent last year, Latin America will feel an impact.

"High concentration on few exports has become a rule, and that makes the region very vulnerable if terms of trade change," Garcia explained.

Meanwhile, rising prices for food staples are "a major crisis" for Latin America's poor, according to Lustig. Around the world, an estimated 105 million people will have become poor because of food price spikes since 2005, she said.

The US downturn and high food prices are two serious adverse shocks for the region's citizens, and dealing with them both will not be easy for policymakers, Lustig and

Continued on page 6



(L-R) Brian O'Neill, Enrique Garcia, and Nora Lustig at the Inter-American Dialogue.

Photo: Financial Services Advisor

through the **Santiago Stock Exchange** of solvency and liquidity compliance problems at the brokerage. The SVS is auditing Alfa and says the brokerage has sufficient resources to meet its obligations based on stock market closing prices for April 23.

Economic News

Argentine Economy Minister Resigns Over Inflation Policy

Argentine Economy Minister Martin Lousteau resigned April 24 after President Cristina Fernandez rejected his proposals to tame inflation in the South American country. According to local daily *La Nacion*, Lousteau had warned Fernandez in meetings that Argentina's economy is headed for a crisis if his proposals to combat inflation were not implemented. Argentine markets fell on the news of Lousteau's resignation and his replacement by Carlos Fernandez, the former head of Argentina's AFIP tax authority who is considered a loyalist of President Fernandez. Analysts say the appointment of Carlos Fernandez means the president intends to continue holding a tight grip on economic policy and is not inclined to alter the government's strategy for combating inflation. **Standard & Poor's** said April 25 it revised the outlook on its sovereign credit ratings for Argentina to "negative" from "stable," citing Lousteau's resignation and "the government's rejection of policies to correct the country's overheating economy." Inflation has posed one



Argentine President Cristina Fernandez swore in new Economy Minister Carlos Fernandez on April 25

Photo: Casa Rosada.

of the biggest challenges to the four month-old Fernandez government. Government statistics agency Indec, which critics say is politically manipulated, is reporting annual inflation of around 8-9 percent, while most economists agree the real number is closer to 20-25 percent. One measure aimed at controlling food prices—higher taxes on soy exports—met with a backlash last month by farmers, who staged a three-week strike that caused shortages of beef, poultry, dairy, and other basic food items in urban centers. The farmers agreed to suspend the strike for 30 days until May 2, but progress in negotiations is reportedly slow and Argentine markets have fallen on fears the strike will resume. [Editor's note: see related Q&A in the April 29, 2008 issue of the daily *Latin America Advisor*.]

Political News

Lugo Elected President of Paraguay, Ending 61 Years of One-Party Rule

Paraguayans on April 20 elected former Roman Catholic bishop Fernando Lugo president, ending 61 years of continuous rule by the Colorado Party. The Colorado Party's Blanca Ovelar, who would have been the first woman president in Paraguay, conceded the election after results showed she won just 31 percent of the vote, versus 41 percent for Lugo and 22 percent for former army chief Lino Oviedo, the Associated Press reported. "You have decided what has to be done in Paraguay. You have decided to be a free Paraguay," Lugo told thousands of supporters celebrating his victory. Lugo, who resigned as bishop three years ago in order to get around a constitutional ban on clergy seeking office, won office on promises to fight endemic corruption and tackle poverty in a country where more than 40 percent of the population is poor. He describes himself as a centrist and rejects being lumped with radical leftist leaders in the region like Venezuelan President Hugo Chavez. No one party was expected to win a majority in Paraguay's legislature, meaning Lugo will have to make deals with lawmakers to get his proposals passed, according to Reuters.

POLITICAL & ECONOMIC BRIEFS

Morales Rejects Autonomy Drive as Project by Wealthy Minority

Bolivian President Evo Morales said April 22 a push for regional autonomy in the country is an attempt by a rich minority to keep their long-held privileges, Reuters reported. "Now that they have lost power, they want autonomy ... The central issue is the fight for money," Morales was quoted as saying. The country's wealthiest province, Santa Cruz, is planning a referendum on autonomy on May 4. Morales said the referendum is illegal and will change nothing. The Bolivian leader has ruled out using the armed forces to keep the country united.

Leftist Lawmakers End Seizure of Mexico's Congress

Leftist Mexican lawmakers opposed to conservative President Felipe Calderon's oil sector reform proposal on April 25 ended their two week-old occupation of Mexico's congressional chambers after conservative and centrist deputies and senators offered a broad debate on the issue, Reuters reported. Calderon wanted to push through an oil reform by early May, but debate will now run until late July.

Colombian Opposition Senator Says Probe Should Include Uribe

Colombian Senator Luis Avellaneda of the opposition Democratic Pole party on April 29 asked Congress to investigate President Alvaro Uribe for bribery, Reuters reported. Avellaneda filed papers asking Uribe be included in a probe of ex-lawmaker Yidis Medina, who says she switched her vote to support Uribe's re-election after administration officials offered her political favors in return.

Featured Q&A*Continued from page 1*

suitors, especially among the firms that are looking to strengthen their global investment banking franchise, JP Morgan and, once again, Goldman Sachs come to mind."

A **Guest Comment: Luis Miguel Santacreu:** "There is only a rumor regarding this possible de-investment in Brazil. There is nothing that is evident, but it is clear that former Pactual shareholders and the Brazilian team were upset with the losses at the parent company in Switzerland. They were expecting a huge bonus after having performed very, very well during 2007 in the domestic IPO league, as well as on the asset management side—something they certainly will not reproduce this year, and maybe in the short term. Should [UBS] decide to sell down its business here, which I consider a wrong decision, I imagine several buyers would be interested in taking it over. Despite the fact that this industry has been suffering from the international crisis (e.g. in Brazil the number of new IPOs have reduced tremendously), the outlook for this segment is positive. Other companies in various sectors might be listed, and M&A opportunities are in the pipeline. Investors are also seeking good asset managers at a time when interest rates have achieved lower levels and managers have to justify the fees they charge investors. In acquiring UBS Pactual, the buyer would quickly gain market share in this segment, as it is well

known here that Pactual's culture—based on meritocracy and a pushy style of working—are undeniable assets. At the beginning of the year, I heard that the former [Pactual] team would even be interested in rebirthing the old Pactual with only the Brazilian team and buying the business from the Swiss. Taking into consideration the modest presence here of US investment banks (Goldman Sachs, Merrill Lynch, and Morgan Stanley) in a sophisticated financial market within an economy with huge growth potential, I would say that UBS Pactual would certainly be an interesting bid. The Brazilian commercial banks would also try to bid for it, but they already have full teams and have different cultures than a pure investment bank. The only think I don't know is whether there's momentum for US investment banks, due to the sub-prime crisis and the losses recently recorded. But, Brazil is about to get an investment grade, which cannot be [ignored].

Jose Barrionuevo is a New York-based financial strategist and advisor, and a former Director at Barclays Capital and Lehman Bros.

Luis Miguel Santacreu is a Banking Analyst at Austin Rating in Sao Paulo.

Editor's note: Brazil achieved an investment grade rating from Standard & Poor's on April 30, after Luis Miguel Santacreu submitted his comment.

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Special Advisor Report*Continued from page 4*

Garcia agreed. To protect the poor, governments could boost social safety net programs, but such countercyclical policy is unlikely to happen because most fiscal resources are already committed, Lustig said.

On the macroeconomic front, "the dilemmas that Latin America faces are similar to those the US is facing," Garcia said.

"On the one side, you have to lower interest rates to solve the financial crisis, but at the same time that can be contrary to anti-inflationary policies and the strength of the dollar," he said.