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FEATURED Q&A

Does Argentina Face Slowing Growth and Rising Inflation?

Q Speaking at the Inter-American Dialogue on Sept. 16, the former president of the Central Bank of Argentina, Martín Redrado, warned that the administration's expansionary policies are causing the economy to grow too quickly and predicted a slowdown in growth and increased inflation. The same day, President Cristina Fernández de Kirchner submitted a budget proposal which earmarks \$7.5 billion in central bank reserves to pay debt, perhaps signaling plans to delay the sale of international bonds. Will Fernández be able to get the budget proposal through Congress? What is the outlook for the Argentine economy in the short- to medium term? What are the repercussions of Argentina's isolation from the voluntary credit market?

A Horacio Verbitsky, president of the Center for Legal and Social Studies in Buenos Aires: "Martín Redrado was the head of the central bank for five years and is now the economic advisor to the opposition. The title of his recent book, No Reserve, describes his ability to make predictions: when President Christina Fernández de Kirchner removed him from his post for refusing to hand over \$6.5 billion to pay external debt, the central bank's reserves stood at \$48 billion. After using \$4 billion, the bank now has nearly \$51 billion in reserves. In its October meeting in Istanbul, even the IMF questioned countries that have accumulat-

ed excessive reserves as a financial cushion. Moreover, the Bank for International Settlements in Basel pays less than 1 percent a year for reserves. Borrowing to pay the external debt would have cost between 12 and 14 percent, thus demonstrating the rationality of the decision. The same applies to the \$7.5 billion in the proposed 2011 budget. It is the economy, rather than monetary policy, which is expanded. Redrado designed the 2010 monetary plan for economic growth of 2.5 percent, when it will actually reach 9.5 percent. Without

Continued on page 2



Opposition Colombian Senator Cordoba Removed From Office

Colombia's inspector general on Monday ousted prominent Colombian opposition Sen. Piedad Cordoba from office over alleged improper ties to Colombian rebels. See story on page 2.

File Photo: Office of Piedad Cordoba.

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NEWS BRIEFS

Venezuela Looking into Starting Nuclear Program: Chávez

Venezuela is studying the prospect of starting a nuclear energy program, President Hugo Chávez said Monday, the Associated Press reported. "We're taking on the prospect of nuclear energy for peaceful purposes and they aren't going to stop us," Chávez told reporters. "We need it and we're carrying out the first studies." Chávez is allied with Iran and has defended the Middle Eastern country's nuclear program, saying it is not building nuclear weapons despite the suspicions of the United States and European countries.

Mayor, Aide in Western Mexican Town Stoned to Death

The mayor of Tancitaro, a small town in western Mexico, and a city advisor were found stoned to death Monday, the Associated Press reported, citing Michoacan state Attorney General Jesús Montejano. Tancitaro has been plagued with drug related violence, including the murder last year of the city council chief and several police officers. Mayor Gustavo Sánchez's death marks the 11th city chief killed this year, Bloomberg News reported.

Public Health Sector Workers Strike in Jamaica

Hundreds of medical workers at Jamaica's public hospitals went on strike Monday to demand raises and allowances they say the government owes them, the Associated Press reported. The 24 hour walkout left hospitals short-staffed around the country as workers called attention to their demands for a 7 percent salary increase and food and travel allowances they say the government has failed to pay since 2007.

Political News**Prominent Colombian Opposition Senator Removed From Office**

Piedad Cordoba, a prominent Colombian opposition senator, was removed from office Monday by Colombia's inspector general under accusation of improper links to the Revolutionary Armed Forces of Colombia, or FARC. The move by Inspector General Alejandro Ordoñez also bars Cordoba from serving in public office for 18 years. Ordoñez has broad power to dismiss public officials, except for top officials including the president and high-ranking judges, the Associated Press reported. Cordoba, 55, has not been charged with a crime and has denied any improper ties to the rebel group. She has been a member of the Senate since 1994 and last year was considered to be in the running for the Nobel Peace Prize for negotiating the release of 14 hostages held by the FARC. The inspector general's office accused her of "promoting and col-

laborating" with the rebels. Cordoba, an ally of Venezuelan President Hugo Chávez, thanked her supporters in a message on her Twitter page. "We continue forward," she said. Leftist lawmaker Iván Cepeda, a friend of Cordoba, said

Cordoba last year was considered to be in the running for the Nobel Peace Prize.

Ordoñez has "demonstrated public hostility to Cordoba's work." Cordoba's lawyer, Ciro Quiroz, said he would seek to overturn Cordoba's ouster, possibly through suing him in Colombia's Constitutional Court. In a statement, Ordoñez's office said Cordoba was removed from office after the discovery of electronic documents found on the laptop computer of Raúl Reyes, a top FARC leader who was killed in a March 2008 raid by Colombia's military in Ecuador. The documents

Featured Q&A

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active financing, we would have a contractionary monetary policy and a decrease in employment, something that post-crisis Argentina cannot allow. This is the same criticism that Obama received from critics of expansionary policy, which he used to confront the financial crisis. The alternative is to offer good financial prospects or protecting production and employment."

A Miguel Kiguel, executive director of EconViews in Buenos Aires: "The government sent the 2011 budget to Congress which assumes that the economy will grow at 4.3 percent (which is plausible), an average exchange rate \$4.10 (which is on the low side, but possible) and an 8.9 percent rate of inflation (which is a joke). The large underestimation of inflation, and hence of tax revenues, is useful to the government as it

will be able to allocate the 'excess revenues' using the so called 'super powers' almost at will. This is a trick that the government has now been playing for some years, and that is likely to be particularly important in 2011, which is an election year. We also anticipate that the currency will continue to appreciate in real terms, as inflation is likely to be in the upper twenties, while the exchange rate will depreciate at a much lower rate. The priorities for the central bank appear to be financial stability and low interest rates, which imply a relatively stable exchange rate. Given the current terms of trade and the low international interest rates, this strategy could be maintained for another year. The budget also considers the use of international reserves to pay the debt. While this could be justifiable under certain conditions, there is confusion as it seems that the central bank gets the reserves for free. So far this year, the bank's debt has increased by around \$6 billion. In other words, there has been a

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showed that Cordoba "overstepped her government-authorized role" in seeking the hostages' freedom, the inspector general's office alleged. Ordoñez's office also accused Cordoba of making statements "that favored the interests of the subversive group." Cordoba has voiced support for the FARC's stated goals of more evenly distributing wealth in Colombia.

Economic News

Tropical Storm Matthew Kills Six, Floods Sugar Crops

Tropical Storm Matthew, which drenched parts of Mexico and Central America on Saturday, killed at least six people and damaged sugar crops, Reuters reported Monday. Amid severe flooding, four people were killed in Chiapas state and two others died in Nuevo León state in Mexico, EFE reported. At least three others were missing. Matthew flooded sugar crops in Honduras, where officials on Monday reduced their production forecast to 417,500 metric tons of sugar from 440,000 metric tons.

Company News

Scotiabank Acquiring Chilean Wholesale Operations of RBS

Bank of Nova Scotia, or Scotiabank, is acquiring the Chilean wholesale banking operations of **Royal Bank of Scotland**, the Toronto-based said Monday, Reuters reported. The bank will acquire approximately \$900 million in assets and did not disclose the terms of the deal, saying they were not material. The deal "represents the continued potential to grow our operation in this country," said



Callahan

File Photo: Canadian Government.

Scotiabank's general manager for Chile, Jim Callahan, said in a statement. The Canadian bank first entered Chile in 1990 and currently is the

Comings & Goings

Former Colombian foreign minister Jaime Bermúdez has joined **MBA Lazard** as president of the investment bank's Colombia operations, the company said in a press release Sept. 21. "Jaime's years of government work, along with his extensive business experience and knowledge of international business affairs brings a unique perspective to our clients and complements the strong team that we have built in Colombia," said Alejandro Reynal, the company's chairman and CEO. After opening an office in Bogotá earlier this year, MBA Lazard says it has had corporate advisory roles in transactions worth more than \$5 billion, including advising **Empresa de Energía de Bogotá** in its bid for a power transmission expansion project in Guatemala, and **Scotiabank's** acquisition of **RBS Colombia**. Bermúdez, 44, was minister of foreign affairs from 2008 through 2010 under President Álvaro Uribe's administration.

New York-based investment management firm **BlackRock** on Sept. 22 named Luiz Felipe Andrade as managing director and country head for Brazil. Andrade will lead a local team of 16 people in the company's São Paulo office and will report to Daniel Gamba, head of Latin America & Iberia for BlackRock. Prior to joining BlackRock, Andrade spent more than 13 years at **Itaú-Unibanco**, most recently as director of markets and liquidity risk. He holds a doctorate in finance from the University of Colorado and a master's degree in industrial engineering from Pontificia Universidade Católica in Rio de Janeiro. BlackRock reported in June that it has approximately \$3.15 trillion in assets under management worldwide.

Houston-based **Colombia Clean Power & Fuels**, a small coal mining company, announced Sept. 21 that it has named Graham Chapman as its chief operating officer. He will oversee the company's coal drilling and exploration program in Colombia, which commenced this month. Chapman's experience includes 16 years in South Africa with **Rand Mines** and **Ingwe Coal Corp.** Most recently, Chapman served as a consultant to **Clean Coal Ltd.**, a private firm developing underground coal gasification projects.

South American country's seventh-largest lender. It has \$10.4 billion in assets in Chile. Last Thursday, Scotiabank announced it was purchasing the Brazilian wholesale banking division of **Commerzbank**. The deal with RBS is the second this year with the Edinburgh-based bank. In March, it acquired the bank's wholesale operations in Colombia. RBS acquired the operations in Chile through its purchase of **ABN Amro** in 2007.

Telefónica Pays First Installment for Takeover of Brazil's Vivo

Spanish telecommunications provider **Telefónica** has paid the first installment in a 7.5 billion euro (\$10 billion) deal to **Portugal Telecom** for its takeover of Brazilian mobile provider **Vivo**, Reuters reported Monday. The deal would give

Telefónica full control of Vivo. The Madrid-based company has paid 4.5 billion to the Portuguese company and will pay 1 billion euros in December and 2 billion euros in October, 2011. Portugal

The acquisition of Vivo makes Telefónica the largest telecommunications company operating in Brazil.

Telecom can request the final payment to be made as early as next July, but that would decrease the price by 25 million euros. The acquisition of Vivo makes Telefónica the largest telecommunications company operating in Brazil, with 69.2 million customers.

Featured Q&A*Continued from page 2*

substitution of central bank for treasury debt. The balance of the reserves is bought using the inflation tax, that this year is equivalent to 1.5 percent of GDP. A second issue is that the issuance of new debt in the international financial markets should help to dispel doubts about financial access and jumpstart a reduction in Argentina's credit spreads."

A **Claudio Loser, visiting senior fellow at the Inter-American Dialogue:** "Martín Redrado is right in his assessment about the stance of Argentine fiscal policy. While revenues have been doing well, public expenditure at the federal and provincial level is growing very fast. Furthermore, the earmarking of international reserves for debt payments is in fact a subterfuge to expand the deficit without showing it transparently in the books. This measure either helps to expand domestic credit if used to pay domestic debt or reduce reserves without fiscal discipline if payments are made abroad as planned. Inflation in the country seems to be running at a rate of at least 25 percent, well above the official figures. While the economy is growing at a nice pace, this cannot be maintained beyond this year with the current level of investment. This will certainly cause problems for the re-election of either of the Kirchners in 2011. Regarding Argentina's approach to foreign credit, prospects remain cloudy. Argentina has amassed about \$51 billion in reserves, as of the latest reporting. These reserves are shielded from any action by distressed creditors, as they are deposited in the Bank of International Settlements and thus carry immunity. Argentina has unilaterally and unfairly settled a large proportion of its foreign debt, but even so external arrears and unfulfilled arbitration judgments may amount to an estimated \$30 billion (no credible actual numbers are available). Under these conditions Argentina cannot become a credible partner in financial markets, with dire consequences for its growth prospects in the medium term."

A **Erich Arispe, director in the sovereign group of Fitch Ratings:** "Argentina's 2011 budget process could become yet another political battlefield between the Fernández administration and the opposition given that the government can no longer rely on a rubber stamp Congress. Budget proposals under the Kirchner and Fernández administrations have consistently failed to reflect the fiscal policy stance by underestimating both revenues and expenditures, which has provided the government with the power to redirect discretionary spending according to its political priorities. In the end, Fitch expects fiscal policy to maintain the accelerated pace of spending, averaging 37 percent between 2007 and 2011, to stimulate the economy in the run-up to the October 2011 presidential elections. The Argentine economic performance has defied expectations, boosted by favorable terms of trade, an excellent harvest, accelerated public spending and positive spillover effects from Brazil. While growth prospects in the near-term are positive, the medium-term sustainability of this 'boom' is less clear. The economy continues to rely heavily on a strong fiscal impulse and inflationary pressures are estimated to be considerably higher than officially reported. Argentina's macroeconomic volatility remains high, thus rendering the economy vulnerable to shocks. Finally, the private sector faces an unfavorable business environment characterized by supply bottlenecks and interventionist policies. On the financing front, the government is likely to continue relying on intra-public sector financing. While this strategy is favored by the significant holdings of government debt by public sector institutions and growth in international reserves, a less favorable external environment, deterioration of fiscal accounts and capital flight could once again highlight Argentina's limited financing flexibility."

The Advisor welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.

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