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FEATURED Q&A

Are Hot Money Flows Into Mexico Overheating the Peso?

Q The Mexican peso has appreciated more than 9 percent since the beginning of 2010, and the exchange rate has dipped below 12 pesos to the dollar, *The New York Times* reported Feb. 8. The Mexican government has ruled out intervening in foreign currency markets despite complaints from exporters clamoring for a weaker peso. Is the peso likely to continue appreciating and, if so, should the government intervene? Which industries are hit hardest by a strong Mexican currency? Is there a danger that speculative 'hot money' will be quickly jerked out of Mexico if investors get skittish?

A Rogelio Ramírez de la O, president of Ecanal in Mexico City: "In 2008, the government reacted to counter the peso depreciation and went out of its way to help large Mexican firms which had been very long on dollars with derivatives. And amid a large fall in output, the government kept a tight fiscal policy, while the Bank of Mexico kept a relatively high interest rate next to the Fed's zero rate. In early 2009, Mexico was the first to obtain an IMF flexible credit loan. And later that year, it laid out plans for a tax increase, even as the peso had recovered most of its 2008 losses. Thus, large falls in output, a huge interest rate spread, tight fiscal policy and an unused IMF loan give a consistent message to the market that the authorities want a stronger peso. Now, with an international market

flooded with central bank money and investors exhausting opportunities for yield, the government reinforced this message with an expanded flexible credit line. Policy language has been consistent. In 2010, the government sounded proud for the Mexican government bond to become part of Citi's global bond index, when it should have been wary of it. More recently, on the submission of the request for the IMF credit line, President Calderón said Mexico had enough foreign exchange to confront any shock. On top of all, the gov-

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Napolitano Expresses 'Outrage' at Agent's Killing in Mexico

U.S. Homeland Security Secretary Janet Napolitano said Thursday that the United States is "outraged" at the killing of a U.S. agent earlier this week in Mexico and vowed to work with Mexico to punish the perpetrators. See story on page 2.

File Photo: Department of Homeland Security.

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NEWS BRIEFS

Police in Puerto Rico Arrest 469 in Sweep

Police in Puerto Rico have arrested 469 people in a major sweep in connection with crimes ranging from traffic violations to homicides, the Associated Press reported Thursday. Last year, the U.S. territory recorded its second-worst year for murders, said Police Chief José Figueroa Sancha, who added that the sweep happened over 36 hours and involved 450 police officers.

Chilean Central Bank Hikes Interest Rate to 3.5 Percent

The Central Bank of Chile increased its benchmark interest to 3.5 percent on Thursday after its monthly policy meeting, saying it would continue to withdraw stimulus measures in the near future, Dow Jones reported. Analysts estimate that the inflation rate will be around 5.5 percent by the end of the year. "The bank implies that there's a risk of imported inflationary pressures and that it will have to continue with its rate-normalization process as other countries are doing," said the chief economist at **BBVA Chile**, Alejandro Puente.

Banco do Brasil Reports \$2.39 Bn Fourth Quarter Net Profit

Banco do Brasil, Latin America's biggest bank in terms of assets, reported profits of 4 billion reais (\$2.39 billion) for the fourth quarter, a drop from 4.2 billion during the same period last year, Dow Jones reported. The state-controlled bank attributed the decline to a one-time gain the previous year. Banco do Brasil's profits for 2010 totaled 11.7 billion reais, a jump from 10.1 billion in 2009. In the year's fourth quarter, the bank's total credit portfolio was 388.2 billion reais, a 20.8 percent year-on-year increase.

Political News

U.S. Expresses 'Outrage' at Agent's Killing in Mexico

U.S. Homeland Security Secretary Janet Napolitano said Thursday that the United States is "outraged" at the attack in Mexico on two Immigration and Customs Enforcement special agents that left one of them dead, Reuters reported. The Zetas drug cartel is suspected in the attack, which happened Tuesday as the agents were driving in San Luis Potosí state. Jaime Zapata was killed and Victor Avila Jr. was wounded in the leg. Avila was released Wednesday after being treated at a U.S. hospital, the *El Paso Times* reported. Napolitano told a Senate committee that Mexican authorities were heading the investigation into the attack, adding that the Homeland Security and Justice departments had formed a joint task force to help Mexico in the investigation. "I can speak for the entire administration when I say we are not only saddened by the loss of an agent but we are outraged by this act of violence against

an officer of the United States," said Napolitano. "And make no mistake—justice will be brought to those involved." Separately, U.S. Attorney General Eric Holder said U.S. officials would review the policy that prohibits U.S. law enforcement officers from carrying weapons in Mexico. Also on Thursday, police arrested nine people and confiscated 300 weapons in raids in Arizona, Texas and Mexico in an effort to target alleged arms traffickers accused of selling weapons to Mexican drug gangs. In addition,



Zapata

File Photo: ICE.

Mexican authorities arrested an alleged cartel member Thursday in connection with shootings that left 20 people dead outside Mexico City. Juan Carlos Vasconcelos, 24, is accused of involvement with the La Familia cartel, said Mexico state Attorney General, Alfredo Castillo, the Associated Press reported. More than 34,000 people have been killed in Mexico's drug-related violence since December 2006.

Featured Q&A

Continued from page 1

ernment said it would not use any control, tax or deterrent against capital inflows. If it would be possible to put an announcement that short capital inflows

“The outlook is therefore that the government will aim at keeping a strong peso and this has to be through the presidential election in 2012.”

— Rogelio Ramírez de la O

are welcome and their returns would be sheltered by the government against any exchange rate fluctuation, it would not have been as effective as these actions. The outlook is therefore that the govern-

ment will aim at keeping a strong peso and this has to be through the presidential election in 2012. The consequence is that Mexico has lost competitiveness, export profitability will suffer and the economy will grow less than if it had not given such strong signals."

A Alfredo Coutiño, director for Latin America at Moody's Economy.com: "Mexico is not worried about the revaluation of the peso. First, the peso revaluation is one of the lowest in Latin America. Second, Mexico has enough experience in capital controls and knows the costs and inefficiencies of such measures. Third, the country has a dual mechanism of automatic adjustment of external shocks: exchange rate and interest rate. Undoubtedly, capital flows will continue to arrive in Mexico, but to a lesser degree

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Economic News

Initial Response System for Gulf of Mexico Oil Spills Completed

The American Petroleum Institute (API) announced Thursday that the Marine Well Containment Co., a non-profit group founded by **Exxon Mobil**, **Royal Dutch Shell** and **ConocoPhillips**, has completed a system that could respond to a spill in the Gulf of Mexico similar to BP's massive leak last year. The containment system has been at the heart of the debate over deep-water exploration permits. On Jan. 25, regulators at the United States Interior Department said that the permits would not be issued because companies hadn't demonstrated an adequate ability to respond to another significant spill, Bloomberg News reported. "The readiness of the Marine Well Containment Company and the systems necessary to respond to a deepwater drilling incident, show this industry has met every requirement for resuming operations in the Gulf and is ready to get back to work providing the energy this country needs," said the president and CEO of API, Jack Gerard. According to API, the system meets the government's requirements that it be capable of operating in 8,000 feet of water and capturing 60,000 barrels a day.



Gerard

File Photo: API.

Company News

Brazil's Banco PanAmericano Had Losses of \$2.6 Billion

Banco PanAmericano, which nearly collapsed in November due to high default rates on vehicle loans as well as alleged accounting fraud said Wednesday that it suffered losses that were nearly twice the previous estimate, the *Financial Times* reported. The bank's losses from "accounting inconsistencies" amounted to 4.3 billion reais (\$2.6 billion), said the

bank's new chief director, Celso Antunes da Costa. The Brazilian central bank has been closely watching credit growth in the country and the crisis at PanAmericano was an isolated incident, said da Costa. The central bank and police are currently investigating the alleged fraud. The central bank discovered that PanAmericano had maintained some loans on its books after selling them and also may have sold some portfolios multiple times. Brazilian investment bank

BTG Pactual, led by billionaire Andre Esteves, bought a controlling stake in PanAmericano for 450 million reais on Jan. 31.

To Our Subscribers

The Latin America Advisor will not be published Monday, Feb. 21 in observance of the Washington's Birthday holiday in the United States. We will resume publication on Tuesday, Feb. 22.

The Dialogue Continues

Will the U.S. Finish Trade Deals With Colombia and Panama?

Q In his State of the Union address Jan. 25, U.S. President Barack Obama said he would only approve trade deals that "keep faith with American workers and promote American jobs," adding that the administration would continue to "pursue agreements with Panama and Colombia." Earlier the same day, U.S. Rep. Dave Camp (R-Mich.) said he wanted to consider the trade deals within six months. Will the administration and Congress finish the trade deals this year or will opponents continue to have the upper hand? Have Colombia and Panama adequately addressed the critics' concerns about human rights and tax laws, respectively? What will result if the accords remain stalled?

A Susan Kaufman Purcell, director of the Center for Hemispheric Policy at the University of Miami: "All free-trade agreements 'promote American jobs,' since they expand trade between the countries involved. The real issue for the administration is whether the Colombian and Panamanian agreements will 'keep faith with American workers,' whatever that means. The U.S. labor movement has strongly opposed the signing of an FTA with Colombia, ostensibly because of the high murder rate of its trade unionists and the country's poor human rights record. This was a valid concern at the height of the

FARC insurgency, but it is not now. The FARC is a shell of its former self; the murder of Colombian workers has decreased significantly, as the murder rate in general has declined. Colombia's economy is booming, particularly its oil sector, and HSBC recently predicted that the country could become one of the world's 30 largest economies by 2050. President Juan Manuel Santos has made peace with Venezuela, which had been supporting the guerrillas, and has begun impressive efforts to reform Colombia's economy. Unfortunately, U.S. organized labor is adamantly opposed to a U.S.-Colombia FTA, which has become a political litmus test for the liberal wing of the Democratic Party. Colombia has tried to comply with U.S. demands, but Washington keeps moving the goal posts. In the meantime, Colombia continues to sign FTAs with other countries. As a result, U.S. wheat exports are losing ground to Canada and Argentina, and further U.S. export losses are sure to follow in other sectors. Progress on tax issues with Panama has improved prospects for that FTA, but until it is signed, Panama's multibillion dollar canal expansion project will benefit U.S. competitors from other countries that already have FTAs with Panama."

Editor's note: The above is a continuation of a Q&A published in Monday's Advisor.

Featured Q&A*Continued from page 2*

than in other countries. This is mainly because of the country's lower attractiveness to hot money, which has to do not only with the environment of insecurity and ties to the United States' slow economic performance, but also with the low level of speculative returns that domestic bonds offer. In real terms, for example, the highest return is offered by Brazil, followed by Peru and Chile, and Mexico is last. The country has tried almost all kinds of capital controls in the past, with very poor results and extremely high costs. In the end, the country had to abandon those measures and paid the cost of severe adjustments to clean the system from distortions. Policymakers know that the short-term benefits of capital controls are not worth enough to compensate for the future sacrifice. In case of increasing capital inflows, Mexican authorities can implement more market-friendly mechanisms, such as reducing the speculative attractiveness by lowering the benchmark interest rate. Also, the central bank can accelerate the accumulation of international reserves to withdraw the excess supply of dollars and consequently reduce the speed of the peso's revaluation. This way, capital controls seem to be an option with very low probability for Mexico."

A **Clyde Wardle, senior emerging markets FX strategist at HSBC Securities:** "We remain constructive on the outlook for the Mexican peso thanks to a.) an improving

U.S. economic outlook, that, given the strong links between the U.S. and Mexican economies, is likely to prove beneficial to Mexico's trade balance and currency; b.) the imposition of capital controls by other countries in the emerging world, which has made Mexico's hands-off policy to its currency relatively more attractive; and c.) a relatively undervalued currency (on a real effective exchange rate basis, the peso is still well below its peak of the last few years, while most other currencies in the Latin America region are close to their highs). We do not expect authorities to impose any controls on the movement of capital into Mexico. If anything, we could see the Exchange Commission increase the amount of the monthly U.S. dollar put options auctions (currently at \$600 million), but only under the circumstances that we see a rapid and substantial appreciation of the peso. These options can have a dampening effect on the peso's strength as the holders of the options trade their 'delta' by buying dollars into the peso's strength. Our target for the dollar-peso exchange rate is 11.80 by the end of the third quarter, but should we see a continued improvement in the U.S. economy, we recognize that we could reach this target sooner."

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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