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FEATURED Q&A

Is $10 Billion a Significant Investment in Peru's Infrastructure?

Q Peru's government is planning to award infrastructure contracts worth $10 billion next year to improve the country's roads, provide more irrigation for arable land and build a second gas conduit running from the country's southern production fields to the coast, President Ollanta Humala announced July 28. Is $10 billion a significant amount in the face of Peru's infrastructure needs? How would the projects be funded, and will they meaningfully improve the country's economy? Which players stand to gain, or lose, the most from the planned projects?

A Anthony Laub, partner at Laub & Quijandría in Lima: "In his speech during Peru's National Day, President Humala made several announcements regarding the promotion of new investments in infrastructure projects to sustain Peru's economic growth. Humala said that the state will award and promote the execution of infrastructure projects that accrue to more than $10 billion, and include roads, airports, natural gas pipelines, irrigation and others not specified. The question is whether these projects are going to be enough to sustain growth. Assuming that Peru will keep growing at a similar pace as in the last few years, and considering that Humala announced mining projects ready to be executed of more than $30 billion, our guess is that the execution of said projects will fall short. We need much more than what has been offered. Most of the projects Humala mentioned are already known and have been on standby for some time, while others are new, such as the security loop of the transportation pipeline from Camisea to be offered in a bidding process in November. Peru will not only need more roads, airfields and ports, but it also needs more electric power and natural gas. There is an urgent need to develop new natural gas infrastructure as well as more hydropower plants and power lines. There is confusion on how the government is going to

Continued on page 3

Brazil Looks Toward 2016 as Olympic Flag Arrives in Rio

The mayor of Rio de Janeiro and other officials arrived in Brazil from London on Monday with the Olympic flag in hand. The flag's arrival marks the beginning of four years of preparations as Rio looks toward hosting the summer games in 2016. See story on page 2.

Photo: Agência Brasil.

Inside This Issue

FEATURED Q&A: Is $10 Billion a Significant Investment in Peru's Infrastructure?.....1

Rio Looks Toward Games With Arrival of Olympic Flag.....2

Mexico Sees Better-Than-Expected Rise in Industrial Output.....2

Honduras Cooperating With U.S. Probe of Chief: Foreign Minister 2

Ecuador Posts Surplus of $390 Million for First Half of 2012.....2

Colombia May Boost Dollar Purchases to Stem Peso's Rally.....3

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NEWS BRIEFS

Honduras Cooperating With U.S. Probe of Chief: Foreign Minister

Honduras' foreign minister said Monday that the government is cooperating with the United States in its probe into allegations of human rights abuses by the country's new police chief, Juan Carlos Bonilla, the Associated Press reported. Foreign Minister Arturo Corrales' statement followed a U.S. State Department report saying Washington will suspend aid to agents working under Bonilla until an investigation is completed. An internal Honduran police report a decade ago alleged Bonilla was involved in at least three killings or forced disappearances from 1998 to 2002. For this year, the United States has pledged to provide the Central American country $56 million in security and development aid.

Ecuador Posts Surplus of $390 Mn for First Half of 2012

Ecuador had a trade surplus of nearly $390 million for the first six months of 2012, the central bank said in a statement on Monday, Reuters reported. Total exports for the period rose 10.1 percent, including a 6.1 percent rise in oil exports, while imports increased by 8.7 percent. It is the highest surplus for the first half of the year that Ecuador has posted in at least four years.

Samsung Engineering to Build Chemical Plant in Bolivia

South Korea's **Samsung Engineering Co.** has won a contract to build an $843 million chemical plant in Bolivia, Reuters reported Monday. The facility, to be located in Cochabamba, will produce ammonia and urea and will be operated by the government. Construction is slated to be finished in 2015.

Political News

Rio Looks Toward Games With Arrival of Olympic Flag

The mayor of Rio de Janeiro and other officials touched down in the Brazilian city Monday with the Olympic flag in hand, as the country looks toward the Summer Olympics in 2016, the Associated Press reported. Mayor Eduardo Paes brought the flag from London, which capped its Olympics with closing ceremonies on Sunday. "I see the arrival of this Olympic flag as not the start, but the consolidation of an important process of transformation for the city of Rio de Janeiro," said Paes, the AP reported. After arriving at Rio's international airport, Paes said the Olympics mark an "important moment" for Brazil and for Rio. "Rio is a city that spent the lion's share of its history, much more time than it should have, looking toward the past. I'm sure that this process of transformation, this turning toward the future, has been consolidated here," he added. Some demonstrators protested outside the airport, voicing objections against the possible expulsion of about 4,000 people living in the Vila Autodrómo community, where officials are to build the Olympic Park. In all, as many as 170,000 people could be removed from their homes due to projects related to not only the Olympics, but also the World Cup, which Brazil is hosting in 2014. When asked about the residents of Vila Autodrómo, Paes said officials will not move people from their homes without consultation. "No one is going to throw anyone out of anywhere ... without there being an alternative," said Paes. "The people will only leave there with lots of consultations, with lots of discussion, with lots of respect." The 2016 games will be the first Olympics to be held in South America. Some concerns have been raised that Rio has not yet built the Olympic Park and other necessary infrastructure. In June, International Olympic Committee members visited Brazil and said timelines for preparing for the 2016 games were "already very tight," adding that "the amount of work to be completed is considerable," BBC News reported.

> "I see the arrival of this Olympic flag as not the start, but the consolidation of an important process of transformation for the city of Rio de Janeiro."
>
> *— Eduardo Paes*

Economic News

Mexico Sees Better-Than-Expected Rise in Industrial Output

Gains in the manufacturing sector drove Mexico's industrial output in June to its largest increase in nine months, Reuters reported Monday. The country's industrial production increased a seasonally adjusted 1.3 percent in June as compared to May, according to the national statistics agency. The rise was better than the 1 percent increase that analysts surveyed by Reuters had expected. In May, industrial output declined an adjusted 0.65 percent. The increase in June was the quickest since September as export orders helped to fuel the sector. Manufacturing, a component of industrial production, grew 1.6 percent in June as compared to May. Another component, mining production, was flat, but the country's construction activity rose 1.49 percent on solid demand domestically. "Industrial production performance draws a clear picture of the current sources of the Mexican economy's growth: both external and domestic factors," Marco Ovido, an analyst at **Barclays** wrote in a note, Reuters reported. Mexico is Latin America's second-largest economy, behind only Brazil, which has cut interest rates amid the global economic slowdown. As compared to the same month last year, Mexico's industrial output grew 3.7 percent in June, a larger increase than the expected 3.5 percent. In this year's second quarter, Mexico's gross domestic product growth

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was likely to have slowed to 0.8 percent, according to a Reuters poll of analysts. In the first quarter, the economy grew 1.3 percent. The government is expected to report GDP growth numbers for the second quarter on Thursday. Mexico's inflation rate increased in July to 4.42 percent higher than the central bank's 4 percent target. However, policymakers have said the increase is likely temporary, and investors are expecting the bank to hold the country's benchmark interest rate at 4.50 percent.

Colombia May Boost Dollar Purchases to Stem Peso's Rally

Colombia's central bank may double its daily purchases of dollars in an effort to stem the rally in the country's currency, Bloomberg News reported today, citing Cesar Vallejo, a co-director of the bank. "If we change, it would be from $20 million to $40 million, for an announced time frame," Vallejo told the news service. "The other alternative would be, instead of stopping in November, to keep buying until December 31, or until February." Colombia's peso has soared 8.1 percent this year against the dollar, as foreign investment flows into the country's mining and oil projects. President Juan Manuel Santos and Finance Minister Juan Carlos Echeverry have called on the central bank to boost its dollar purchases in order to help exporters. However, the bank has not done so. Santos has proposed boosting Colombia's foreign currency reserves by $13 billion, but the central bank is not considering that because it would "completely distort" the country's local credit markets, said Vallejo. As of July, Colombia had $34.7 billion of foreign currency reserves. In a study, the Finance Ministry said the country's optimal level of reserves is $54 billion, but the central bank's head, José Dario Uribe said last week that the study "is of no more than academic use."

Santos

File Photo: Colombian Government.

Featured Q&A

Continued from page 1

accomplish this task. It has announced that state-owned companies like Electroperu and Petroperu will actively participate in the development of energy projects that the state encourages, but nobody has yet explained how this participation is going to be executed and the private sector is very cautious about it."

> "We need much more than what has been offered."
>
> — *Anthony Laub*

A César Gutiérrez, director of utilitiesperu.com in Lima: "The need for investment in Peru is a recurring theme and the figures are in the billions, with the amount depending on which projects are included as essential. President Humala, in his message to the nation at the end of July, made reference to investments of $10 billion. It is important to understand the role that the state's framework plays in these types of works. The preference is to grant a concession, which occurs through a competitive process where the applicant promises to build using its resources and recuperates the investment in its respective utility by charging users. In the case that demand is insufficient, payment is awarded through public funds. The current difficulties facing these projects are of two types: low demand, which forces the state to guarantee a stream of considerable funds, and a lack of efficiency in organizing the contests by the state investment agency, Proinversión. This entails long waiting periods between the announcement and the selection of a winner. The prediction of $10 billion of investments is too ambitious for the way in which the state manages the process today. What is more probable is that they succeed in building some roads and close to 300km of a natural gas pipeline."

A José Luis Bonifaz, head of the economics department at the Universidad del Pacífico: "In a 2011 paper, I made an estimate of the infrastructure gap in Peru through a methodology that addresses demand pressures in the different types of infrastructure. This amounts to $21.76 billion for the 2011-2015 period and $62.91 billion between 2011 and 2025. Therefore, the investment of $10 billion proposed by Proinversión for the next five years would only cover a quarter of the investment necessary to bring sustained growth of 6 percent per year. Therefore, public investment should be promoted through public-private partnerships (PPPs). They should direct public spending on infrastructure to intermediate cities and rural areas, 'bundling' different investments in different sectors (water + electricity + telecom + access roads) in the form of PPPs. Multi-year programs should be evaluated by various public agencies. Proinversión should direct its efforts toward smaller projects in which the poorest sectors will feel the greatest social impact. Most projects on Proinversión's agenda will take several years to be structured and will be operational in three or four years. This is the case of irrigation works, the pipeline of the south and the 'Sierra Highway.' These projects will benefit all (users, construction companies and concessionaires) if the concession contracts are made with appropriate risk sharing. That is the difficult task that Proinversión faces."

A Enzo Defilippi, partner at Inteligencia Financiera (INTELFIN): "Peru's infrastructure gap is estimated at between $30 billion and $50 billion. Compared to this figure, President Humala's plan does not seem impressive.

Continued on page 4

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Featured Q&A

Continued from page 3

It can be considered optimistic, however, if one takes into account the government's track record in private investment promotion. Bureaucratic and cumbersome procedures; the lack of adequate human, financial and administrative resources; and a system that penalizes decision-making cause projects to be delayed for years. And the consequences may be dear. For example, the electric system's reserve margin is approaching zero, as supply has not grown at the same pace as demand. Given the importance of hydro power, if rains in mid-2013 are not as copious as in previous years, the country will surely face blackouts and very expensive power bills. The projects would be funded mostly through local pension funds and multilateral agencies. There are several reasons why the announced projects are important for the local economy. They are long-term and thus less subject to the variability of world markets. If the world economy keeps deteriorating, these investments have the potential to limit its impact on growth, at least in the short term. They also will foster further private investment in areas far from the country's capital city, Lima, where most of Peru's wealth is concentrated. These investments will mostly benefit rural areas. Everyone has to gain from incorporating the rural population to the modern economy, from the government, which will enact more taxes, to the private sector, which will face a larger demand."

> "If rains in mid-2013 are not as copious as in previous years, the country will surely face blackouts and very expensive power bills."
>
> *— Enzo Defilippi*

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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Latin America Advisor
is published every business day by the Inter-American Dialogue, Copyright © 2012

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Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at:
1211 Connecticut Avenue NW, Suite 510
Washington, DC 20036
Phone: 202-822-9002 Fax: 202-822-9553
www.thedialogue.org ISSN 2163-7962

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