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FEATURED Q&A

Is Inflation Becoming a Growing Problem in Latin America?

Q Workers at Brazil's central bank, the very entity that is responsible for controlling inflation, went on strike earlier this month to demand a 23-percent pay increase to compensate for inflation since 2008. Elsewhere in the region, most economists estimate Argentina's inflation at between 20 and 25 percent, and Venezuela's notoriously high inflation decreased to just below 20 percent in July, the lowest annualized rate in years. Is inflation in Latin America becoming a problem governments won't be able to control? What factors are driving prices higher, and what tools do the countries have to address the problem? Which countries and business sectors are most at risk from increasing prices? With falling growth rates in some economies, is stagflation something to be concerned about?

A Renzo Merino, associate analyst, and Sarah Glendon, assistant vice president, in the Sovereign Risk Group at Moody's Investors Service: "Over the past two decades, countries like Chile, Brazil, Colombia, Mexico and Peru have developed institutions that address concerns about the legacy of the hyperinflation of the 1980s. Today, we see independent central banks with an arsenal of tools to implement monetary policy like inflation targets, policy rates, reserve requirements and floating exchange rates. Particularly over the course of the last decade as authorities took a proactive stance, these institutions were strengthened during the boom-and-bust cycle, raising their policy credibility and predictability. Nevertheless, there have been exceptions to these developments. Some countries, like Argentina and Venezuela, have displayed low levels of transparency and pursued expansionist monetary policies that, while supporting growth in the short-term, have created significant macroeconomic imbalances. Important challenges persist. In countries

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Security Chief Under Colombia's Uribe Pleads Guilty to AUC Ties

Gen. Mauricio Santoyo, who served as security chief for Colombia's then President Álvaro Uribe, pleaded guilty Monday in the United States of aiding a drug-trafficking paramilitary group in exchange for bribes. See story on page 2.

File Photo: Colombian Government.

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NEWS BRIEFS

Entering Embassy Would Be 'Suicide' for Britain: Correa

If British authorities enter the Ecuadorean embassy in London to arrest WikiLeaks founder Julian Assange, it would amount to diplomatic "suicide" for Britain, Ecuadorean President Rafael Correa said Monday in a televised appearance, BBC News reported. "Then people could enter their diplomatic premises all around the world and they wouldn't be able to say a thing," said Correa. Ecuador granted Assange asylum on Thursday, but Britain is refusing to give him safe passage out of the country. Since June, Assange has been holed up at the embassy as he seeks to avoid extradition to Sweden where he faces sexual assault allegations.

Venezuela Probes Prison Riot That Left 25 Dead

A prison riot broke out in Venezuela's Miranda state on Sunday, killing 25 people and injuring 43, BBC News reported. The head of the prisons ministry, which President Hugo Chávez started last year after a major uprising, said that a full inquiry will be made and steps are being taken to avoid another such incident. According to the NGO Venezuelan Prisons Observatory, there are over 50,000 inmates in a system built to hold 14,000.

Argentina Files Complaint Against E.U. Over Biodiesel Exports

The Argentine government has filed a complaint with the World Trade Organization against the European Union, arguing that Spain is discriminating against its biodiesel exports, Reuters reported Monday. Spain enacted the trade restriction in April after Argentina seized control of **YPF** from **Repsol**.

Political News

Retired Colombian General Pleads Guilty to Paramilitary Links

Retired Colombian Gen. Mauricio Santoyo, who was security chief for then-President Álvaro Uribe, pleaded guilty Monday to helping the drug-trafficking United Self Defense Forces of Colombia, or AUC, paramilitary group evade authorities in exchange for bribes. Santoyo, who entered the guilty plea in U.S. federal court in Alexandria, Va., acknowledged helping the AUC evade U.S. and Colombian anti-drug efforts between 2001 and 2008, the Associated Press reported. He retired from Colombia's National Police in 2009. Santoyo admitted to informing AUC members of planned law enforcement operations, disclosing information to them about wiretaps and helping the group conduct wiretaps of their rivals. Prosecutors did not provide the dollar amount of the bribes paid to Santoyo, but said they were "substantial." Santoyo was Uribe's head of security from 2002 to 2005 and also was a top anti-terrorism commander in Colombia. He entered a guilty plea on one count of conspiracy to provide material support to a foreign terrorist organization and faced 10 to 15 years in prison when he is sentenced Nov. 30. In a posting on his Twitter account Monday, Uribe said the Santoyo case "offends our government," referring to his presidency, adding it is an insult to "the first and only government that dismantled the paramilitaries, effectively weakened the rebels and extradited them." Neil MacBride, the U.S. attorney for the Eastern District of Virginia, said the case "holds accountable a rogue individual who abandoned his duty to protect the Colombian people to serve his own interests and those of drug traffickers and terrorists." Last year, the former president's cousin, Mario Uribe, was found guilty of having ties to the AUC. Álvaro Uribe, however, has vigorously denied having any links to the paramilitary group, the BBC reported.

> *Prosecutors did not disclose the dollar amounts of the bribes, but said they were "substantial."*

Featured Q&A

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where dollarization levels are high and financial penetration is low, the effectiveness of monetary policy to restrain inflationary pressures can be diminished. However, in the fully dollarized economies (Ecuador, El Salvador and Panama), inflation remains manageable. As economies continue to grow, domestic demand will push prices higher, while volatile international energy and food prices have a strong pass-through effect on economies that import these goods. Slower global growth and softer commodities prices in 2012 have lessened concerns over inflation in most of Latin America. Nonetheless, the progress made in developing strong institutions positions certain countries to respond to these developments with counter-cyclical policies. The price stability achieved by those countries contributes to a benign investment climate and supports a successful growth model."

Tapen Sinha, professor of risk management at the Instituto Tecnológico Autónomo de México and professor at the University of Nottingham Business School: "Most central banks in Latin America are privately projecting a drop in the employee numbers in the coming decades. So, it is not surprising that Brazil's central bank employees feel threatened. It is wrong to conclude that Venezuelan inflation has been tamed. Recall that just before the 2006 presidential election, the inflation was 'tamed' too

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Economic News

Default Possible as Belize Misses $23 Million Bond Payment

Belize's government missed a $23 million bond interest payment due Monday and risks default if it fails to make the payment within a 30-day grace period, BBC News reported. The government said that even with the grace period, it is unlikely to be able to make the payment. After winning a second term in March, Prime Minister Dean Barrow said he would renegotiate the terms of the $550 million bond, which represents half of Belize's debt. Among the government's proposals are an extension of the bond's maturity date and also lowering the amount it must repay by as much as 45 percent. "[It's] not a haircut, it's a scalping," Arturo Porzecanski, an international finance professor at American University in Washington, told Bloomberg News.

> "[It's] not a haircut, it's a scalping."
>
> *— Arturo Porzecanski*

Company News

PDVSA Signs Accords Aimed at Speeding Orinoco Development

Venezuelan state oil company **PDVSA** signed accords Monday with two other government-run companies in an effort to accelerate development of the Orinoco heavy oil belt and boost output, President Hugo Chávez announced, MarketWatch reported. Chávez said PDVSA will transfer a 10 percent stake it holds in **Petropiar**, an upgrader of heavy oil, to government-run miner **Corporación Venezolana de Guayana**, known as CVG. A new oil company, called **Petro San Felix**, will also be formed, Chávez added in the televised address. Through the transfer, PDVSA's stake in Petropiar will be lowered to 60 percent. U.S.-based oil major **Chevron** has a 30 percent stake. Chávez did not explain how the changes would increase oil production. Chávez previously announced that he wants to increase the country's oil output from 3 million barrels per day at the beginning of this year to 3.5 million barrels per day at year's end. Chávez's critics have pointed out that PDVSA has often failed to meet its production targets during Chávez's 13 years in office because PDVSA's revenues have been diverted to social projects instead of reinvested in production.

Chávez

File Photo: ABN.

The Dialogue Continues

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 Sergio Bravo Orellana, professor at the Graduate School of Business (ESAN) in Lima: "Peru's growth in the past decade would not have been such if not for development of large infrastructure projects that were completed by past governments. The Inter-American Development Bank estimates that closing Peru's infrastructure gap, which is estimated at $40 billion, requires an annual investment of $9 billion. The amount announced is important in addressing this gap. Investments have a multiplier effect on GDP growth through the increase in demand as a result of encouraging consumption, and, in the long run, because they are the basis of competitiveness. In a study we conducted, it was estimated that for every 1 percent of investment, GDP growth rises by 0.36 percent immediately and then generates indirect effects in the long run. Financing of the projects can be through private-sector participation with support from the public sector, which is to say, co-financed. This method has been successful in the projects of the Initiative for the Integration of the Regional Infrastructure of South America (IIRSA). However, it is essential that there be a proper risk analysis in a public-private partnership and the subsequent distribution of risk through a suitable contract. An excessive transference of risk will affect the financing of the project—or render it not realizable—and an insufficient allocation to the private sector will leave no incentive to improve aspects of the investment. Providing an appropriate investment framework and at a faster speed is important to accelerate the different administrative processes necessary to implement a project. The international economic environment highlights the attractiveness of these investments for investors that currently don't get a proper return on capital. The positive effects of infrastructure investment are maximized when accompanied by adequate regulatory, organizational and institutional plans for their operation."

Editor's note: The above is a continuation of a Q&A published in the Aug. 14 issue of the Advisor.

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Featured Q&A

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—it went below 15 percent. This was achieved through price controls that temporarily pushed the inflation rate down. The Venezuelan government under President Chávez is trying the same thing for the forthcoming election in October.

Not a single independent analyst is predicting any inflation rate below 30 percent for Venezuela in 2013. Most of the recent price rises in the region are not being driven by underlying fundamental changes in policy with the exception of Argentina. Argentina is set to follow Venezuela with a projected inflation rate of 30 percent in 2013. Brazil will probably stay within the 5 percent inflation rate into 2013. Mexico's inflation will definitely stay under 4 percent in 2013. The same will also be true for Chile and Peru. In the case of Chile, it will probably stay below 3 percent in 2013. In Colombia too, inflation will stay under 3 percent. In summary, for the region as a whole, there is nothing in the horizon that points to stagflation with the exception of Argentina and Venezuela."

A Vladimir Werning, executive director at J.P. Morgan Chase in New York: "High inflation has been a major problem in Argentina and Venezuela for some time and policies in place do not inspire better expectations ahead. But both economies present exceptions. In other economies, inflation targeting frameworks provide a credible boundary for inflation expectations even when volatile prices and, in cases like Brazil or Mexico, a weaker currency, may raise inflation uncertainty in the near term. July's CPI inflation performance divides the region in two camps: in Brazil and Mexico, inflation picked up for different reasons while in Chile, Peru and Colombia, disinflation has continued. Food price pressures are prominent in Mexico but, in contrast, in Brazil core price pressure stood out in July—thus, contributing to the end of a downward inflation trend that characterized the first half of the year. In the smaller economies, lower domestic energy prices are supporting a disinflation trend, notwithstanding food price inflation in Chile and Peru. The debate on the inflation outlook for the year's second half is dominated by upside risk from food prices, but the data from the Andean region highlights that other volatile items, like energy, will be key. And in the second half, energy prices will exert upward pressure on inflation, in particular in Mexico where electricity subsidies will be reversed and in Brazil where regulated fuel prices are likely to be hiked. Thus, inflation in these economies will stay at the high end of central bank targets while in the smaller economies it should remain at the lower end. All told, there are no central banks in the region suspected of being inclined to hike interest rates in the future to lower inflation. In fact, the Colombian and Brazilian central bank are still moderately cutting interest rates to support activity at the moment."

> "All told, there are no central banks in the region suspected of being inclined to hike interest rates in the future to lower inflation."
>
> — *Vladimir Werning*

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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