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Latin America Advisor

The Interactive Forum for the Region's Leaders

Monday, June 2, 2003

Today's Top News

Advisor ANALYSIS

Q **Recent comments by US Treasury Secretary John Snow suggest the US may be backing away from its strong dollar policy. Should Latin American economies be worried about this possibility? What would be the impact in the region of a weaker dollar?**

A **Guest Commentary: Graham Stock:** "A gradual decline in the dollar is not something for Latin America to worry about and, in fact, it is probably good for the region. It improves prospects for US growth, which is good for Latin American exports and for capital flows. Most of the countries in Latin America now have flexible exchange rate regimes. Volatility has certainly picked up in recent weeks, but the main currencies started the second quarter significantly undervalued on a historical basis. What we have seen since then is currencies in the region appreciating against the US dollar, but holding fairly steady against the Euro, and therefore remaining pretty competitive on a trade-weighted basis. John Snow is in effect only countenancing the decline of the dollar; he's making it explicit that the US won't do anything to stop it. This may be a concern for policymakers in Europe and Japan because it boosts US competitiveness relative to their currencies, but it should not have a significant impact on Latin America."

Board Commentary: Geoffrey Milton: "To the extent that a weaker dollar should translate into lower oil prices in their local currency, then the Latin economies should be able to reduce inflation expectations. Yes, exporters may be negatively effected; however, if their competition is from Europe and Asia, then the impact is mitigated. On the other hand, if a more competitive dollar supports US industry, then the global economy benefits with the United States once again the driving force. An overvalued or artificially weak currency in an important market (*i.e.*,China) does no one any good in the long run. It was time for an orderly dollar correction to combat the growing deficit in the US current account. Latin America should welcome this prospect."

> "There are no gnomes in Washington turning 'strong' or 'weak' dollar dials."
>
> -- Steve Hanke

Guest Commentary: Steve Hanke: "The so-called strong dollar policy is an artifact of some well-timed remarks by former Treasury Secretary Rubin. It qualifies as a great canard. After all, for some years, the US has embraced a freely floating exchange rate

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regime. That's a policy. And with a floating exchange rate, market forces act to strengthen or weaken the dollar. There are no gnomes in Washington turning 'strong' or 'weak' dollar dials. At present, interest rates are relatively low in the US, and investors are hungry to enhance the yields on their investments. As a result, carry trades are all the rage. Investors borrow in a 'low'-yielding currency -- such as the dollar -- and invest in a 'high'-yielding currency -- like the Brazilian real. This acts to weaken the low-yielding currency against the high yielders. But carry trades are risky and eventually unwind. When that unhappy day arrives, the hot money that has surged into the Latin currencies will be withdrawn as fast as it was injected. Latin countries should be worried about this state of affairs because their half-baked currencies are subject to the ups and downs associated with carry trades. The only way to defang volatile hot money flows is for Latin countries to retire their domestic currencies and replace them with the greenback."

Guest Commentary: Cristian Gardeweg: "In terms of trade competitiveness, such a policy does not affect the currencies in Latin America. The currencies will be competing in a normal way in the US market. The problem is the fear of a slowdown in the US economy or deflation that drives this change in policy. That could affect the situation in Latin America and the rest of the world. In terms of flows, it would be positive for international investors, except for those investing in the US who could suffer from depreciation of the dollar. For Chile and, I expect, other countries in the region, when the dollar depreciates against the euro or other leading currencies, commodity prices increase, and that will help Latin American exports, but we haven't seen that so far."

Graham Stock is Head of Sovereign Strategy for Latin America at J.P. Morgan Chase & Co.

Geoffrey Milton is a member of the ADVISOR board and works as an independent consultant.

Steve Hanke is a Professor of Applied Economics at The Johns Hopkins University.

Cristian Gardeweg is an Economist at Santander Investment Chile.

Political News

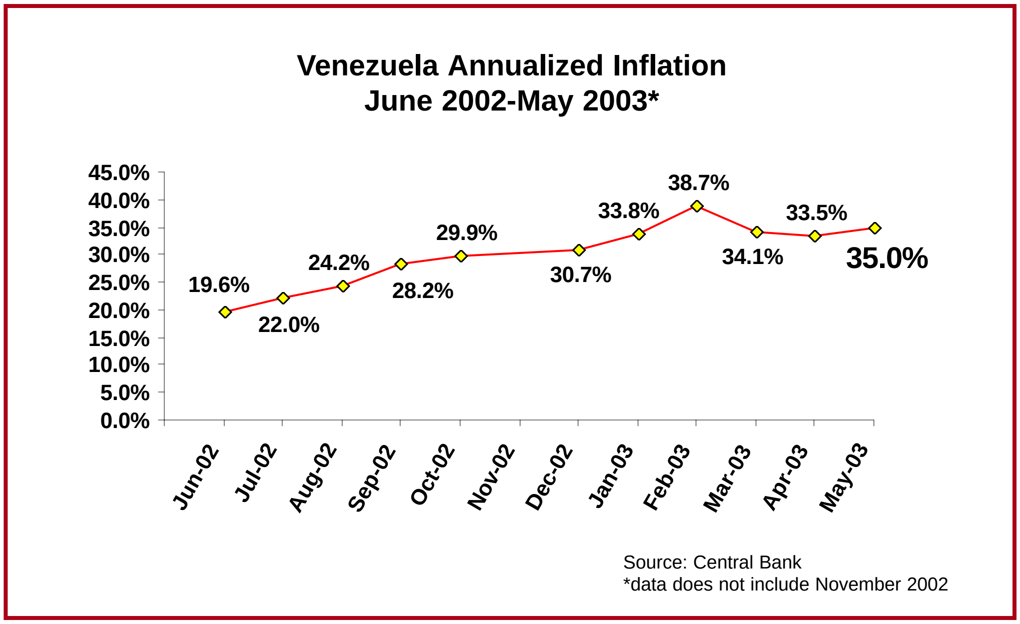
Peru Faces Fresh Protests by Students, Striking Workers

Despite the return of calm over the weekend to much of Peru, labor leaders and university students are threatening to launch a new round of protests and defy a nationwide state of emergency imposed last week by embattled President Alejandro Toledo, the Associated Press reported this morning. Peru's largest labor confederation is planning a march in downtown Lima on Tuesday, while students have vowed new demonstrations against the Toledo government. Last Thursday, soldiers and police opened fire on protesting university students in the southern city of Puno, killing one and wounding close to 50 others. It was the worst day of violence since Toledo declared the 30-day state of emergency last Tuesday to restore order in the face of mounting strikes and protests. The government said Saturday it had restored order in the country, clearing 64 sections of highway blockages created by striking workers and protesters. Strikes by teachers, farmers, and health workers, have handed Toledo his worst crisis since taking office in 2001, amid already dismal approval ratings for his perceived failure to deliver on campaign promises of greater prosperity. Nilver López, the leader of union SUTEP, which represents some 280,000 teachers in Peru, said the union would not back down from demands that the government double its offer for a monthly salary increase from $29 to $60. "We teachers are not going to permit this kind of intimidation an aggression," López said. The teachers currently earn $200 per month.

Economic News

Annualized Inflation 35 Percent in Recession Wracked-Venezuela

Annualized inflation rose to 35 percent in Venezuela in May, the Central Bank said Sunday. The figure was nearly double the rate recorded during the same month of 2002, as the country reels from a steep recession that saw the economy plummet 29 percent in the first quarter. Accumulated inflation for the first five months of the year was 13.8 percent, versus 10.5 percent for the same period a year ago. Monthly inflation in May stood at 2.3 percent, up from 1.1 percent in May 2002 and 1.7 percent in April. The Central Bank attributed the acceleration in consumer price hikes to shortages of some goods. Earlier this year, the government imposed strict foreign currency exchange controls to halt a plunge in the bolivar currency and established price controls for some basic goods. The country is still recovering from a devastating, two-month-long general strike launched in December. The strike brought oil exports, Venezuela's primary source of foreign exchange, to a halt and created turmoil throughout the South American country's economy.



Company News

Brazilian Judge Blocks Auction of Eletropaulo Shares by BNDES

A judge on Friday barred Brazil's state-owned National Social and Economic Development Bank (BNDES) from auctioning off stock in power company **Eletropaulo Metropolitana**, Reuters reported. The Rio de Janeiro state judge banned the auction of 548 million reais ($US 182 million) in shares of the local unit of the US' **AES Corp.**, following the company's default earlier this year on a $1.2 billion debt owed BNDES. While talks continue between BNDES officials and AES to restructure the debt, which stems from the 1998 privatization of Eletropaulo, the bank has taken steps to seize control of the power distributor, Latin America's largest in terms of revenues. Although litigation could take years, BNDES hopes to auction off the stock in Eletropaulo before the end of 2003. BNDES plans to appeal the court's decision. The government is currently investigating allegations that AES colluded with US energy firm **Enron** to buy Eletropaulo before the 1998 sale of the company. AES and Enron have denied any wrongdoing. [Editor's note: see related Q&A in May 30, 2003 issue of the *Latin America Advisor*].

Iusacell in Talks with Creditors to Restructure $814 Million Debt

Mexican mobile phone company **Iusacell** is in the process of restructuring its heavy $814 million debt load, the company's finance director said Friday, according to Reuters. Russell Olson said Iusacell was continuing to work with creditors on a debt restructuring agreement, which he said the company will formally announce within the next few weeks, although he provided no details. Iusacell, Mexico's third-largest mobile operator, has a $266 million syndicated bank loan, $350 million in bonds which are due 2006, and an additional $150 million in notes that will mature next year, piled on top of other, smaller debts. Iusacell's main shareholders are **Verizon Communications** and **Vodafone Group**.

Brazil's Aracruz Reaches Tentative Deal with Klabin on Pulp Plant

Brazilian wood pulp maker **Aracruz Celulose** said Friday it signed a preliminary agreement to buy a pulp plant from cellulose maker **Klabin** for $610.5 million, Reuters reported. The purchase of the Riocell plant in Rio Grande do Sul state would add 40,000 hectares (98,842 acres) of eucalyptus plantations to Aracruz's existing 188,000 hectares in the states of Espirito Santo, Bahia, and Minas Gerais. The Riocell plant has an installed annual capacity of 400,000 tons of bleached eucalyptus pulp, which is used to make paper products such as toilet paper and writing pads. Last month, it was announced that Aracruz, the world's largest producer of bleached eucalyptus pulp, and European forest products company **Stora Enso** would start building an $870 million mill in Bahia. The facility would be the largest single-line bleached eucalyptus pulp mill in the world with a capacity of 900,000 tons per year [Editor's note: see related story in the May 9, 2003 issue of the *Latin America Advisor*.]

THE DIALOGUE CONTINUES

Q In a recent report, the US General Accounting Office expressed concern that the US Trade Representative's office lacks the resources and expertise to plan November's FTAA ministerial meeting in Miami, and raised the specter of a repeat of the disastrous WTO meeting in Seattle in December 1999. Are the GAO's concerns exaggerated? Is the FTAA in jeopardy because of a simple lack of resources and expertise?

A Guest Commentary: Jon Huenemann: "The central issues are not resources or expertise. Having been directly involved in organizing international trade meetings -- including the mid-term review of the Uruguay round and numerous FTAA summits and ministerials, the issue is the handling of the political and substantive negotiating issues. The US can handle the practical logistics and infrastructure. USTR is mandated to coordinate the resources of agencies in the carrying out of US policy. The trade policy agencies in the US in total have sufficient resources to lead the FTAA ministerial this fall. The challenge for the USTR and the administration is how effectively those resources are being integrated into an effective approach to the ministerial. Furthermore, since the FTAA is interrelated with other negotiations, their pace will implicate the outcome of the FTAA. While the staff of USTR are under enormous pressure, that is to be expected as you approach these meetings. To the degree USTR is working cooperatively with other agencies -- which is no easy task -- that will greatly increase or decrease the pressure on the staff. But again, the critical issues are: does the US have a clear set of precise objectives agreed within the US government, a coherent negotiating and political strategy both domestically and internationally to achieve those objectives, and to what degree will the FTAA ministerial be determined by the situation with Doha and other developments? Finally, the question is how will the US and other countries participating in the FTAA define success? That calibrating has started and will continue. For Seattle, the US preparation process was simply 'too little, too late' and, frankly, incoherent. For the upcoming FTAA, there is a good prospect we will be better prepared."

Jon Huenemann is Senior Vice President and Group Leader at Fleishman Hillard / GPC and a former Assistant US Trade Representative with responsibilities in the Americas.

Editor's note: The above is a continuation of a Q&A that appeared in the May 27, 2003 issue of the Latin America Advisor.

TAM Reports 87.7 Million Q1 Net Loss on Higher Costs

Financially troubled Brazilian airline **TAM** on Friday reported a first-quarter net loss of 87.7 million reais ($US 29.5 million) on weak demand and increased costs, Reuters reported. Brazil's second-largest airline said fuel costs rose 116 million reais compared to the same quarter a year ago, as a result of a weaker real currency, while aircraft maintenance and leasing costs rose 110 million reais. The company said revenues declined 1.8 percent from a year ago. TAM is in talks with Brazil's flagship airline, **Varig**, over a possible merger between the two debt-laden companies.

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