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Economic Research Department

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Latin America: moderately slower growth in 2006
Calm after the oil market storm?
New emerging countries
FDI in Latin America: present and future
Brazil: structural interest rates and economic situation

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Editorial

The economic performance of the region in 2005 continued to be favourable, with GDP up by 4.4%. As in 2004, economic activity continued to increase at the same time throughout the region supported by a positive external environment, which was characterised by high levels of international liquidity, growth in world demand, and significant rises in commodity prices (the BBVA-MAP index was up by 28%). The favourable international environment was also reflected in strong upward exchange-rate pressure, which, with the exception of Chile, was reined in through the accumulation of foreign reserves to a greater or lesser extent. This situation was accompanied by relatively loose monetary policies domestically, with the exception of Brazil and Mexico. On the fiscal side, despite the relative improvement in public accounts, the increase in revenues was accompanied by a parallel rise in spending, which undermined the structural position of the countries in the region, with the exception of Chile, which follows a specific policy rule in this area. Slight corrections in the level of international liquidity and commodity prices (see articles on these subjects in this issue of Latinwatch) are expected to have only a marginal impact on growth in the region in 2006. Foreign demand will continue to be the lowest common denominator in regional growth, which will remain high for the third year in a row (4.1%). This slight slowdown could pick up pace if the electoral scenario has a greater than expected impact on domestic demand. The economic policy mix will change slightly, with fiscal stimulus on the cards in a busy electoral year, but with monetary policy at the same time becoming less expansionary, with the exception of Mexico and Brazil, which already have a more restrictive stance than the rest of the countries in the region (see article on the case of Brazil further on).

From a medium-term standpoint, we can see that after the crises at the end of the 1990s, the region has undergone a series of improvements. Amongst others, these include a period of more stable economic growth, reduced inflation, improvements in the fiscal balance of current spending and revenues, lower levels of net foreign debt, a greater degree of openness to foreign trade, and the reduced vulnerability of the financial system. This has resulted in greater inflows of foreign direct investment (see article dedicated to FDI) While this is undoubtedly positive, little effort has been made in taking further the structural reforms still pending from the past decade. As can be seen in the box on potential growth in Latin America, current rates of growth are above potential levels, and are not compatible with the productivity in the region, nor the scant capacity to generate domestic saving. In the face of a slowdown in the global economy, and if expansionary policies remain in place in countries looking to maintain high rates of growth, we could expect to see higher inflation rates in the medium term (the estimate for 2005 and the forecast for 2006 stand at 6%).

During this year, almost all of the countries in the region will either have new governments in place or elect new ones. Evo Morales takes office in Bolivia at the end of January, while in Chile Michelle Bachelet was recently elected president. While trends at present point to the current presidents of Venezuela and Colombia remaining in power, the situation is not so clear in the rest of the countries. The electoral process, which is key in any democratic system, lends stability to countries, but can also create volatility in the financial markets, and to a greater or lesser extent causes economic agents to put off investment and consumption decisions. The incoming governments need to maintain a balance between economic policies which maintain solid economic fundamentals and social policies aimed at alleviating poverty. With a less favourable external environment expected in the medium term, the key variable in squaring the circle is efficient public spending. The new governments need to reform the domestic process for assigning public resources in such a way as to offer better services with the same level of funding. The priorities given to spending on public investment need to be improved, while less leakage in social spending programmes is also required. This silent reform will not entail political costs. But it requires strong political will and legislative support both at the level of the central government as well as at lower levels of government for the reform of the public administration to become a reality. The next Latinwatch will pay special attention to the elections in process.

I. International environment

A different world

One of the most important characteristics of 2005 was the strong performance of the global economy despite the rise in the price of oil. The fact that both developments have been possible at the same time could be the result of an increase in world demand. This would be translating into a significant increase in trade flows and higher commodity prices, in particular for energy products and metals. The shock that is taking place is therefore not due to rising crude oil prices but to more countries (which represent half of the world's population) becoming active participants in world trade and economic activity (see article further on in this report).

On the supply side, the relative expansion in the labour force is resulting in a slower rate of increase of wages, which would partially compensate for the rise in energy costs and act as a global factor containing any inflationary pressures. This has allowed central banks to keep liquidity at high levels during a period of strong economic growth, without any upturn in inflation expectations in the medium term. Only those countries that are at a more advanced stage of the cycle have seen a rekindling of inflation expectations because of the fear of second-round effects deriving from higher energy prices. Long-term interest rates nevertheless remain low, reflecting the anti-inflation credibility of monetary authorities.

Growth remains solid

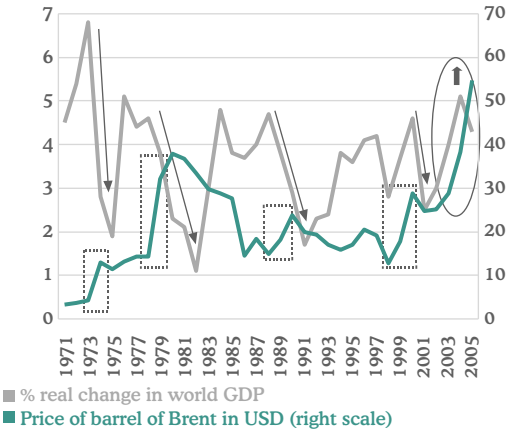
In 2006, world economic growth should be similar to that of the year before, but with a somewhat different composition. The United States is expected to experience a slowdown in growth, from 3.6% to 2.8%, largely because of two factors. One is the behaviour of the property market. While some indicators suggest that activity in the sector is still strong, an increasing number, following successive hikes in interest rates, point to a fall-off in demand for housing and are signalling that the expected slowdown is not far off. The second is a loss of momentum in private consumption. This would appear to be associated with a slower growth rate in real disposable income as a consequence of the convergence of productivity growth with its long-term trend rate (2-2.5%), a slower rate of job creation due to companies adopting a more cautious stance, the cooling-off in the property sector (a wealth effect) and a negative saving rate. With this domestic demand scenario, if investment in production fails to compensate for a weaker property sector, the rate of expansion of goods imports will decline, which in turn will reduce the U.S. current account deficit in 2006 and 2007. Conversely, we forecast a higher fiscal deficit in 2006 because of the reconstruction costs in areas hit by hurricanes.

In the Economic and Monetary Union (EMU), the prospects for growth look brighter thanks to a favourable international context and the euro, which lost value against the dollar in 2005. Confidence has begun to strengthen noticeably, particularly in Germany, which hints at a recovery in activity to around 2.0% in 2006, after an advance of 1.3% the previous year. The uncertainty surrounding growth in Europe has not cleared completely, however.

South-east Asia and, in particular, China, which has just revised up the value of its aggregate GDP, are expected to continue to register rates of growth near to the high average rate observed over the past few years. The world's fourth-largest economy will maintain a high level of investment in line with a growth model oriented towards the development of export platforms. Household spending, on the other hand, is expected to continue to show moderate growth. For its part, in 2006 Japan could be boosted by growth in the rest of the region, with a pick-up in GDP growth to close to potential.

Other regions will continue to benefit from the terms of trade shock resulting from the increase in the prices of the commodities they export.

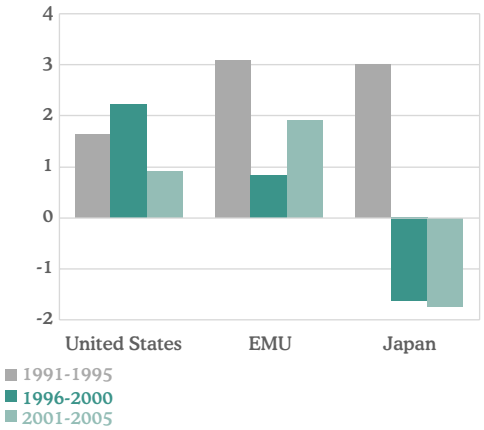
World growth and oil prices



Source: BBVA using IMF and Bloomberg data; *Forecast

Unit labour costs

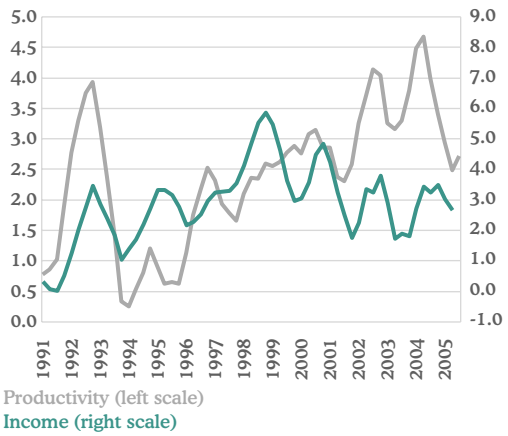
(% average growth)



Source: BBVA using national statistics

U.S. non-farm productivity and real disposable income

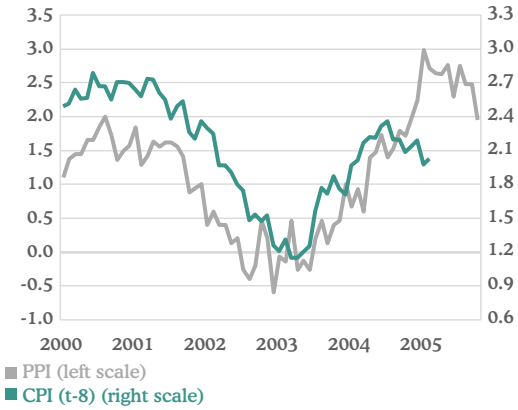
(% average annual rate)



Source: BLS, BEA

Producer and consumer prices

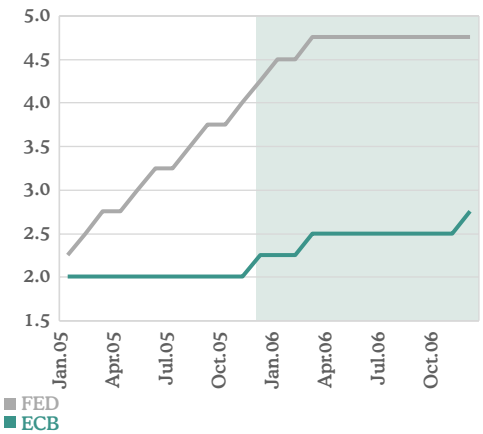
(underlying; % annual change)



Source: BLS

United States and EMU: official interest rates and forecasts

(in %)



Source: BBVA

Though below those of 2005, the prices of these products are expected to remain high. This is the case of the Middle East, which should sustain a rate of GDP growth of around 5%. Given the modest rate of growth in fixed capital investment, this area could register the highest current account surplus of any of the emerging markets.

Gradual monetary policy adjustment

In the context above, with further buoyant growth in the world economy in 2006, central banks can be expected to adopt a less expansionary monetary policy. However, given that the priority of the monetary authorities is to keep price expectations in check, and that in general these remain subdued, the adjustment of interest rates is likely to take place at a gradual pace. A scenario of sharp economic adjustment is therefore ruled out.

In the United States, our models indicate that underlying inflation will continue to trend upwards at a moderate rate during 2006 (2.5%) as higher production costs pass through into final prices with a lag. The position of the economy in the current cyclical expansion, with a strengthening labour market, the rapid advance in productivity and the low level of idle capacity attach upward risks to the price outlook. However, flexible markets, strong competition, low external prices, and, with high margins, the absorption of higher costs, supported notably by subdued expectations of inflation, will work to restrain price increases. Under these parameters, and with a forecast headline inflation rate of 2.8% in 2006, we expect the Federal Reserve to raise official interest rates to 4.75% in the first quarter of 2006, a level of more neutral monetary policy at which the Fed could bring to a halt the process of tightening initiated in June of 2004.

In the EMU, although the European Central Bank initiated the tightening cycle in December 2005 in response to high money growth rates and fears of a deterioration in inflation expectations, it is unlikely to hike interest rates aggressively. Bearing in mind the doubts and uncertainty about future growth in the region, we forecast official rates to stand at 2.75% at the end of 2006. In Japan, the possibility of aggressive tightening is even less likely, and the first adjustment may even be later than the hike in the middle of 2006 that the market is anticipating. The scope for upward movement is limited, however, since increasing rates prematurely could have a negative impact on the country's recovery from deflation.

Globalization and financial diversification support low long-term interest rates

The flattening in yield curves observed in a general context of less expansionary monetary policies is the result of the combination of two factors. The first is a deepening of capital flows, with increasing bond trading a key element driving such flows in recent years. Among the causes of this evolution are uncertainty in the world economy, high life-cycle saving in Europe and Japan, regulatory questions mainly affecting pension fund and insurance company operations, and the expansion of the European corporate bond market and the emerging local-currency bond market. The second factor is the diversification of capital flows, with an increasing number of agents and countries actively participating in the financial markets. Therefore, rather than decreasing over recent years, the dispersion of current account surpluses has actually increased. In this respect, it is noteworthy that, as the current account deficit of the United States continues to increase, the economies that traditionally have run current account surpluses such as those of South-east Asia and Japan have now been joined by the oil-exporting countries.

This deepening and diversification of capital flows could, according to some estimates, be reducing the yield at the 10-year part of the curve by almost 1 percentage point. Given that both trends are expected to continue unabated and in the absence of elements to suggest that there will be an increase in nominal and real volatility, it is to be expected that

long-term yields will remain at low levels. In particular, the U.S. yield curve could remain practically flat, with 10-year rates at the end of 2006 at levels close to 4.9%, rising to 5.1% in 2007, less than one percentage point above their December 2005 levels. In the EMU, 10-year yields are expected to stand at 4.0% and 4.3% at the end of 2006 and 2007, respectively. This means that there will continue to be a positive spread between the United States and EMU, although a lower one than at present.

Small misalignments and interest rate differentials; key factors for currencies

Although to a lesser extent than in 2005, the interest rate differential will continue to play an important role in propping up the dollar, despite the U.S. economy's high current account deficit. Additional factors offering support will be harder to find. In this sense, it should be noted that the dollar's highs at the end of the 1990s were accompanied, from the viewpoint of capital flows, by a marked rise in foreign direct investment towards the United States. Today that is not the case. Despite the fact that the U.S. economy still has positive productivity differentials with other areas, at the present moment it is impossible to pinpoint a sector that could lead a process of investment similar to the one that took place at the end of the 1990s on the back of technological developments.

Therefore, with no decisive factors to drive the dollar higher in the next 2 years, but with support from interest rate differentials, and with the risk of the current account deficit once again weighing on its exchange rate, we expect the dollar to range between 1.20 and 1.25 against the euro in 2006 and move 2-3% higher in 2007. The behaviour of other currencies will be influenced by two factors. One is the fact that no major misalignments are apparent between current exchange rates and the estimated equilibrium level of the different currencies. The other is yield differentials. Countries with high interest rates will continue to be more attractive investment destinations than those with low interest rates, leading to upward pressure on currencies in the former. All of the above hinges on the absence of elements that might bring about an increase in risk aversion, such as, for example, an episode of political instability in one or other of the emerging market countries, a deterioration in macroeconomic prospects in these countries or a reversal of the liquidity conditions in international financial markets.

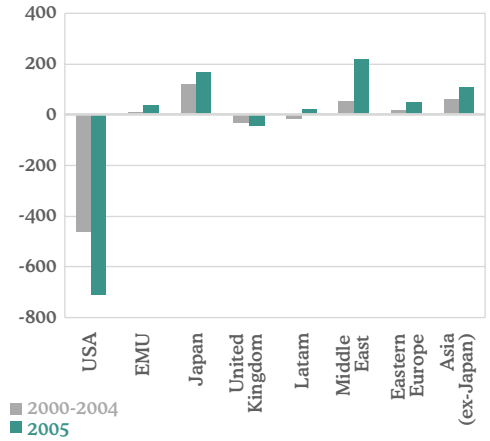
Risks to the central scenario

As far as the global risk factors for 2006 are concerned, one worth mentioning is the possibility of a deceleration in one of the world's most dynamic economies, in particular China or the United States. In the case of the former, the current strong momentum of economic growth and the absence of any signs of clear overheating lead us to assign a low probability to the risk of a hard landing. In the case of the United States, the signs of weakening in the property market draw attention to the risks associated with an adjustment in asset prices, which if it were to materialise could lead to a fall in interest rates along the entire yield curve. However, the probability of such an adjustment occurring is low, since a number of factors could offset the negative effect on household wealth, among them financial conditions, levels of productivity and the behaviour of the labour market.

Latin America faced with the benefits of a different world and an electoral year

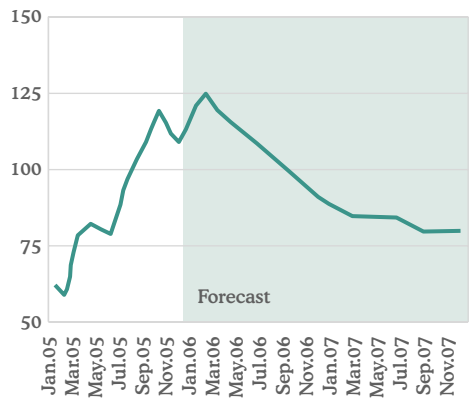
Against the international backdrop described above, Latin America enters 2006 with the prospect of sustaining a significant rate of growth for the third year running throughout the region. Forecasts are for growth to slow in the major countries from that observed in 2005 but complete convergence towards potential GDP will probably not yet be seen in most countries in the region. Only Brazil and Mexico will see greater levels of convergence (see Box further along in this report).

Current account balances by region
(billions of USD)



Source: BBVA

United States-EMU 10-year interest rate spread
(basis points)



Source: BBVA

Latin America: Main elections 2005-2007

COUNTRY	PRESIDENTIAL	LEGISLATIVE
Chile	Dec. 2005 √	Dec. 2005 √
Peru	Apr. 2006	Apr. 2006
Colombia	May. 2006	Mar. 2006
Mexico	Jul. 2006	Jul. 2006
Ecuador	Oct. 2006	Oct. 2006
Brazil	Oct. 2006	Oct. 2006
Venezuela	Dec. 2006	Dec. 2005 √
Argentina	Apr. 2007	Oct. 2005 √

Source: BBVA

The push to growth that will continue to be given by the United States and Asia, especially from China, will maintain the positive effects that have been seen across the region in the fiscal and external accounts. Continuing strong demand in the commodity markets reduces the risk of any sudden changes in the terms of trade of the Latin American economies. And international financing conditions, even with some monetary policy tightening, will support an orderly process of deceleration. This will allow these countries to continue to tap capital markets with a high degree of acceptance. In sum, as far as external economic and financing conditions are concerned, the central scenario may once again be considered favourable for Latin America, even if it is somewhat less so. In alternative contexts the risks are indisputable, but the probability of their occurring is very low, while the region's enhanced structural position in comparison with past crises gives good grounds for optimism.

The principal source of potential instability in Latin America on this occasion comes from within its own borders. The electoral processes taking place in virtually all of the countries in the region will introduce an additional element of uncertainty up until the end of 2006. This will again test international investor confidence and the maturity of political systems. So far, within the normal functioning of democratic mechanisms, the most noteworthy developments have been Kirchner's strengthened position after the Argentine legislative elections in October, Evo Morales' victory in the presidential elections in Bolivia in December and, at the beginning of this year, the change of socialist president in Chile (Bachelet took over from Lagos).

Given their undeniable importance and influence in the region, most attention will be focused on the result of the presidential elections in Mexico (July) and Brazil (October). In the case of the former, the main point of interest is whether the new government will have sufficient room for manoeuvre to be able to push through the structural reforms that the country had expected this legislature. In the case of Brazil, all eyes are on the possible impact of the corruption uncovered in 2005 on Lula's real possibilities of winning re-election, after he came through his baptism of fire three years ago and implemented much more orthodox policies than generally expected.

Potential growth in Latin America

When designing macroeconomic policy it is of vital importance to know the potential output of an economy and the main drivers of growth. In the case of Latin America, however, a lack of available data has meant that there has been almost no analysis of the determinants of potential GDP in the different countries of the region. In response to recent efforts by different organisations which have enhanced access to larger and more complete databases, this box aims to add to our knowledge of potential growth in the region.

Methodology

In order to estimate the growth rate of potential output in Latin America, we have used two different methodologies. The first is based on the use of the Hodrick-Prescott filter (HP)[1]. This technique is widely used in macroeconomic research and can be briefly summarised as follows: any time series (Y_t) is the sum of a cyclical component (Y^c_t) and a growth component (Y^g_t). The aim of the filter is to obtain (Y^g_t) such that the following loss function is minimised:

$$\sum_{t=1}^{T} (y_t^c)^2 + \lambda \sum_{t=1}^{T} [(y_{t+1}^g - y_t^g) - (y_t^g - y_{t-1}^g)]^2$$

where lambda (λ) is a constant that determines the smoothness of the trend estimates. In practice, the filter simply removes low frequency movements and emphasizes those observed throughout the entire economic cycle.

The choice of the value for λ is of particular importance. If λ is too high, the result of the filter tends towards a straight line. If on the other hand the value of λ is very low, the series obtained tends to include a greater number of variations. In general, we present estimates with two different values of λ in an attempt to restrict the values of potential growth: the one recommended by Hodrick and Prescott for annual data (100) and a much lower one recommended by Maravall and Del Rio (6.7)[2].

Although the HP filter is relatively useful for the calculation of potential growth, it says absolutely nothing about the sources of this growth. In order to understand what drives growth in the economies in the region, we use a second method based on the estimation of a Cobb-Douglas production function:

$$Y_t = A_t K_t^{\alpha} L_t^{1-\alpha} \qquad 0 < \alpha < 1$$

where Y is GDP, A is total factor productivity (TFP), K is physical capital, L is labour and α is the share of capital in output, which is assumed to be equal to 0.3 in all of the countries. From this starting point, the process followed is the following: first, we determine a TFP residual using the production function and the available GDP, capital and employment data. Next, we calculate potential GDP with the smoothed TFP data obtained previously and the estimated stock of employment and capital that potentially can be used.

For the labour factor, the standard practice is to calculate the rate of unemployment consistent with stable inflation (NAIRU) and multiply a smoothed version of this by the labour force. We use a proxy for the NAIRU and simply calculate the trend unemployment rate for the different countries in the region. Finally, we assume full utilisation of the existing capital stock at any moment in time.

Data

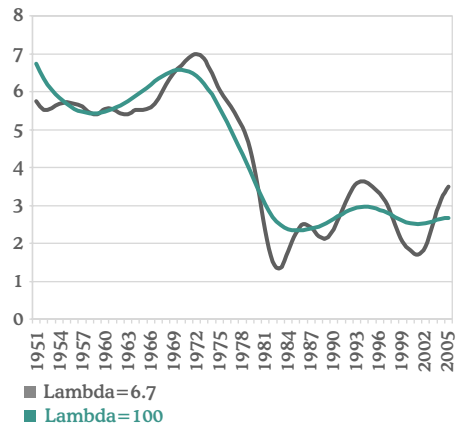
The data used in our estimation are mainly drawn from the Economic Commission for Latin America and the Caribbean (ECLAC) and include 7 of the region's leading economies: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

The GDP series spans the period 1950-2002 and has been extended to 2005 using the national accounts data of each country and our forecasts for that year. In calculating the total output of the Latin American region, and all of the other aggregate series, we weight according to the implicit weights in the GDP data in dollars, corrected for purchasing power parity, available from the Groningen Growth and Development Centre[3]. The physical capital data used in the production function estimation also come from ECLAC. In addition, although this series is available from 1950, the second estimation is only carried out using data from 1980 onwards due to the restriction imposed by a lack of employment data. Specifically, unemployment rate time series for all of the countries under consideration are only available from 1980.

Results

We begin with the estimation using the HP filter. The graph below presents the rate of growth of potential GDP between 1951 and 2005. At first sight, we can identify 3 periods: the first runs from the early 1950s to the beginning of the 1970s and is characterised by a high rate of growth around 6%. The second, between 1972 and 1982, seems to be a transition period before the third period and marks the start of a relatively low rate of potential output growth in the region of around 2.5-3%. This change in the level of potential growth was also accompanied

Rates of growth of potential GDP
(% annual increase)



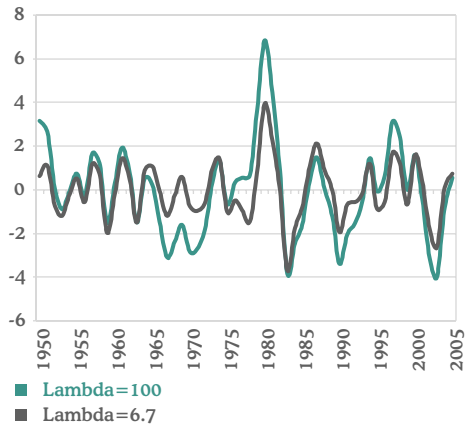
Source: BBVA

[1] See Hodrick and Prescott (1997).
[2] See Maravall and Del Rio (2001).
[3] Available at http://www.ggdc.net

by a rise in its volatility. In this regard, the percentage standard deviation of potential growth during the period 1980-2005 is almost double that observed during the rest of the sample period. As a result, Latin America has suffered in two ways: lower growth and greater uncertainty.

The current situation in the region shows that in 2005 Latin America grew at above potential rates for the second consecutive year. Given that the latest data for the series considered above estimate potential output growth at around 3% and that our forecasts for the region point to an aggregate advance of around 4% in 2006, we expect this situation to persist for another year and the output gap to continue to increase, albeit at a slower rate.

Cyclical component
(% departure from trend)



Source: BBVA

Given that we know that Latin America has experienced low rates of growth during the past 25 years, it is worth asking ourselves where the region has encountered the greatest problems. Our estimation of potential GDP using the Cobb-Douglas production function helps to clarify a number of issues.

First of all, as can be seen in the tables above, GDP growth in the region was low even when the contribution of labour to growth has been positive (more than 1.5 percentage points). To see if this is a relatively high figure, it suffices to note the situation in Europe since 1960[4]. Around that year, France and Germany had similar levels of GDP to those of Argentina and Mexico today. From 1960 to 1980, the working age population in Europe rose by 73%. In our sample period, this population in Latin America rose by 77%. However, the contribution of employment to growth was below 0.2 percentage points in Europe during the period 1960-1980. And, in recent years, even though the importance of this factor has been increasing in the EU, its contribution to growth is still 3 times lower than that observed in Latin America. Unfortunately, U.N. forecasts point to slower rates of growth and in some countries, such as Mexico, this population is expected to peak around 2030. From then onwards, labour will only be able to contribute through improvements in market functioning. There is now a degree of urgency therefore to take advantage of the considerable population stimulus as quickly as possible.

With regard to the contribution of capital to growth, it can be seen that over the past 25 years this has always been positive.

Contribution to potential output

Lambda=6.7	Potential growth	Productivity	Labour	Capital
1981-1985	1.2%	-2.3%	2.0%	1.5%
1986-1990	2.4%	-0.8%	2.2%	1.0%
1991-1995	2.9%	0.5%	1.6%	0.9%
1996-2000	2.6%	0.2%	1.4%	1.0%
2001-2005	2.4%	0.1%	1.6%	0.7%
Lambda=100	**Potential growth**	**Productivity**	**Labour**	**Capital**
1981-1985	1.9%	-1.8%	2.2%	1.5%
1986-1990	2.1%	-0.9%	2.0%	1.0%
1991-1995	3.0%	0.5%	1.7%	0.9%
1996-2000	2.6%	0.2%	1.5%	1.0%
2001-2005	2.4%	0.2%	1.5%	0.7%

With the exception of the first 5 years of the sample, the increases in the capital stock have accounted for around 1 percentage point of the growth in the region, a similar contribution to that observed in Europe during the period 1960-1980. Finally, the contribution of productivity has been disappointing, with sharp falls during the 1980s and contributions close to zero for the past 10 years. The limited role played by productivity in the region's growth over recent years may be due to a measurement error in our analysis. In particular, our employment measure could be overestimating the contribution of labour to growth in the region. However, it is difficult to imagine that the absence of improvements in productivity has not been the main cause of the stagnation in growth in Latin America.

Conclusions

The growth rate of potential output in the region has fallen considerably compared with the rate observed between 1950 and 1970. Given the positive contributions of both labour and capital to growth, the main reason behind this change is a fall in the rate of growth of productivity. The causes of this fall lie outside the scope of this box, but the relatively low levels of investment and weak institutional quality constitute the major challenges for the future of Latin America.

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[4] See Balmaseda, Izquierdo and Nieto (2005).

Impact of avian flu on the Latin American meat markets

Situation and precedents in Latin America

Avian influenza is a very contagious disease among birds, which is causing heavy losses in the poultry industry, and which in some exceptional cases can be transmitted to human beings. The highly pathogenic outbreaks of the disease belong to the type A virus of the subtypes H5 and H7, with mortality rates among infected free-range birds of between 50% and 100%. The socioeconomic impact of avian flu is mainly felt in the costs involved for the public and private sectors of countries affected as a result of outbreaks of the disease, as well as the measures required to prevent and control the disease. In addition to the loss of birds that have died, efforts to stop the disease spreading require the slaughter of animals, and the implementation of other control measures (vaccines, human resources, follow-up, diagnosis …). The costs and loss of income thus incurred weigh heavily on the affected sectors.

Although the disease has appeared throughout history at irregular intervals in all regions of the world, the latest wave of highly pathogenic bird flu cases has been in Asia. An outbreak was confirmed on December 19, 2003 in South Korea. This spread rapidly, and by January 2004, Vietnam, Japan, Taiwan, Thailand, Cambodia, Hong Kong and Laos had also reported cases of the disease. In February of the same year, it ended up spreading to Indonesia and China within Asia, and the United States and Canada outside of Asia.

Within Latin America, only Mexico and Chile were affected in previous outbreaks. The first of these was between the end of 1994 and the middle of 1995, when the latest highly pathogenic form of the virus was identified. The second was in 2002. Mexico reported the presence of the disease in the middle of the country, and immediately initiated a national campaign to eradicate it, which it managed to do in July 1995. In Chile, the outbreak was confined to the V Region, specifically the province of San Antonio. The authorities managed to wipe out the disease and the country was certified clear of it six months after it was first detected.

Commercial consequences of bird flu in Asia

The impact on business resulting from the spread of avian flu in Asia has shown itself capable of disrupting the economies affected. Revenues of the aviculture sector and small producers have fallen, and uncertainty has been created in the international meat markets. As a result of a ban in some countries on the import of poultry products and a drop in the consumption of poultry in 2004 due to the problems caused by the disease, international trade flows of these types of product dropped by 8% in that year, an unprecedented fall.

However, in 2005 trade picked up again. According to the United Nations, flows increased by 11% to a record 8.4 million tonnes. The favourable trade prospects are helping to underpin output, particularly in the United States and in Brazil, which although they only account for 35% of world production, supply 70% of international exports.

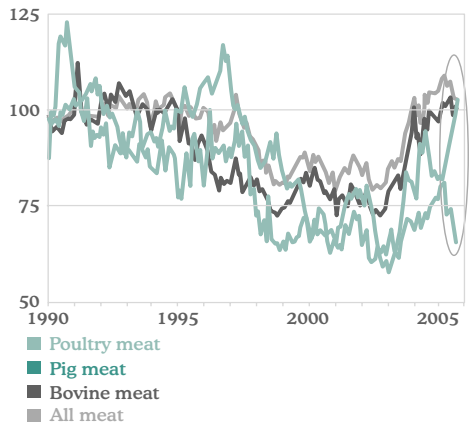
The direct commercial impact was a rise in international chicken prices, and an increase in demand for this type of meat from other important suppliers such as the European Union (EU), and from some other occasional exporting countries such as Chile and Argentina. Indirectly, it has also led to an increase in demand for other types of meat to substitute chicken, and a subsequent run-up in international meat prices.

The meat price index drawn up by the Food and Agriculture Organisation (FAO)[1] of the United Nations rose by 106 points in the first nine months of 2005, driven by the spike in chicken and beef prices. In the case of the latter, the current ban on beef imports imposed by Canada and the United States as a result of Bovine Spongiform Encephalopathy (BSE) has had a significant impact.

In addition, disruptions in the supply of chicken and beef have led to an increase in the consumption and export of pig meat. Specifically, it is estimated that for the period 2001-2006 the increase in demand will raise exports by Brazil, Canada and the EU by 115%, 51% and 28%, respectively. It is also estimated that the export market share of the United States could climb to 25%. However, the strong increase in pig meat prices seen in 2004 came to a halt in 2005 as consumers returned to eating poultry and beef despite the increase in the prices of these products.

From a longer term point of view, and in the absence of a spread of animal diseases, meat prices are expected to fall in 2006. One of the main factors that could lead to lower prices for all types of meat is the lifting of the ban imposed by Japan on imports of U.S. beef.

Monthly meat price index
(1990-92=100)



Source: FAO (2005)

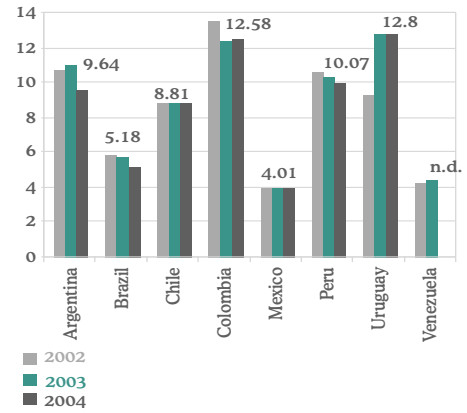
[1] This index is calculated using trade-weighted indicative international meat prices. More details of the composition of the index can be found at: www.fao.org.

Favourable impact on the Latin American meat trade

The recovery in consumer confidence in meat, combined with a gradual opening of markets, is leading to an increase in world trade in the product. According to estimates by the United Nations, the increase in 2005 was 10% to a record volume of 20.8 million tonnes. This development comes on the heels of the first annual fall in meat trade in 25 years in 2004 as a result of the reports on BSE and on cases of human beings affected by bird flu in Asia.

The increase in demand and world trade in meat will have positive consequences for the countries in Latin America. Logically, the positive effects will be greater in economies where the value added of production in the sector is larger in terms of its contribution to GDP.

Value added by agricultural production[1] as % of GDP



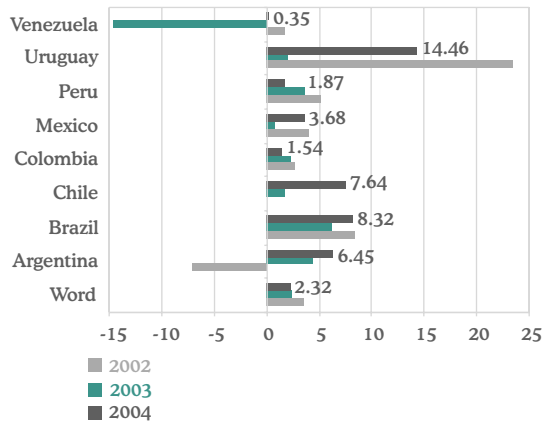
[1] Includes meat production
Source: BBVA, WDI

According to estimates by FAO[2], global meat production increased by 2.5% in 2005 to 267 million tonnes and will hit record levels in 2006 as a result of favourable yields in the sector. Almost 80% of the increase will come from strong growth in output for export in Latin America and a recovery in production in Asia. In 2004, total output of meat increased above the world average in all of the countries in Latin America, with the exception of Colombia, Peru and Venezuela where the increase was below 2%.

In addition, the change in market shares of countries affected by outbreaks of animal disease continued to accelerate in 2005. According to the same estimates, South American products managed to gain 33% of the world export market, compared with 10% a decade ago.

Specifically, according to estimates by the U.S. Department of Agriculture[3], exports of chicken will increase by 7% in 2006 to a record 7.5 million tonnes, due mainly to an increase in exports from Argentina, Brazil, China, Thailand and the United States.

Total meat production: % change oya



Source: BBVA, PSD

In 2004, Latin America accounted for 20% of the global output of chicken, with Brazil the main producer in the region with a market share of over 50%.

As a result, Brazil has been one of the countries which has most benefited from the ban imposed by countries such as Japan on imports from countries affected by avian flu. In the first eight months of 2005, Brazilian exports of chicken to Japan increased by 35%, with the Latin American giant replacing Thailand as the Asian country's main supplier. In 2006, it is expected to remain the leading exporter of chicken in volume terms for the third year in a row. Output of chicken in Brazil is expected to increase by 5% in 2006, in line with the upward trend seen in the past two years.

Lastly, international beef prices in 2005 were underpinned by the strong increase in trade, which is estimated to have risen by 11% to 6.7 million tonnes. This increase followed a fall of 1% in trade in 2004, when importers failed to completely replace shipments from North America, which accounted for 25% of world exports.

Supply shortages, and the evolution of prices in 2005 continued to be magnified by high domestic prices within the EU, which remained a net importer for the third year in a row. In 2004 and 2005 combined, the EU imported close to 131,000 tonnes, largely from Latin America. Average annual growth in exports from the region has come in between 20% and 40% since 2003, with its share of the global export market increasing from 17% in 2000 to an estimated 43% in 2005.

It is likely that Brazil, which became the largest exporter of beef in the world in 2004, increased shipments by 22% in 2005 despite unfavourable exchange-rate developments, and raised its share of global beef exports to over 25%. High prices and bilateral trade agreements also saw an increase in exports by India, and occasional exporters such as Chile.

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[2] See "September 2005 Meat Market Assessment".

[3] See "Livestock and Poultry: World markets and trade", November 2005.

Calm after the storm in the oil market?

Two distinct periods in 2005

The oil market registered a 60% surge in the price of a barrel of Brent in the first nine months of 2005. This was mainly the result of two factors. The first was the view that the world oil supply and demand equilibrium was weak, owing to fears that no supply cushion existed to offset an output disruption in one of the major producers, during a prolonged period of steadily rising demand. The second factor was the hurricane season, which took a heavy toll on the Gulf of Mexico, a region that is a major supply centre and import hub for crude oil and petroleum products for the United States.

Estimated oil prices

Source: Bloomberg

The above scenario later gave way to one of greater calm, in which the price of oil recorded a fall of 11%, to end the year with an average price of $54.48 a barrel. The key question now is whether this trend will be maintained or whether prices will begin to rise again.

Market views

The pessimists (high prices) believe that world economic growth, and therefore demand for oil, will remain buoyant. Given the low level of surplus supply and the reduction in production due to hurricanes, this development, together with the increased political risk in the Middle East, could bring about a sustained rise in oil prices.

The Energy Information Administration (EIA) of the Federal Government of the United States estimates an average price of above $63 a barrel, with prices expected to remain at these levels in real terms over the next few years.

The optimists (low prices) point to weaker world economic growth and demand for oil (demand will suffer as the high prices make themselves felt), accompanied by stronger inventory building, greater capacity for increasing supply and lower geopolitical risk. From this viewpoint, the oil price correction will be much faster than expected, with the average price forecast to come in at close to or below $50 a barrel.

In the short term, the pessimists are in the driving seat. 2006 began with fears of conflict between Russia and the Ukraine when the former carried out its threat to cut off natural gas supplies after the Ukraine rejected Russia's gas price hike. Gazprom, Russia's state-run natural gas company, began to lower the pressure in the pipeline that transports gas to the Ukraine, reducing supply by some 120 million cubic metres/day. This, in turn, affected the rest of Europe, which receives 85% of the gas supplies that cross the Ukraine.

This situation could push up prices, particularly in view of the possible impact on demand for gas of the low winter temperatures in Europe at the start of the year. Although this was a one-off, short-term development, the gas supply situation is a further element to factor in along with the other potential risk factors for future years.

The other element is the potential increase in geopolitical risk in the Middle East due to Iran's renewed nuclear activities and the precarious health of Ariel Sharon, the Israeli prime minister. Both factors could negatively affect stability in the region.

What can we expect in 2006?

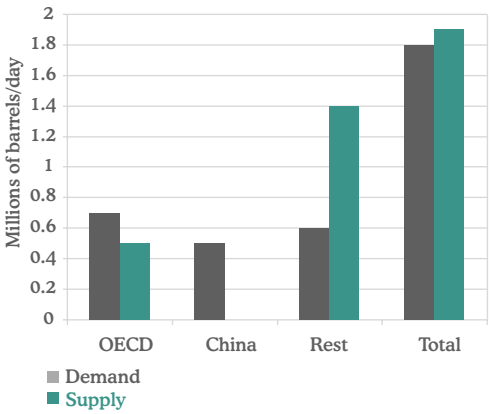
It seems likely that the behaviour of the market in 2006 will be midway between these two positions. 2006 is expected to be a year of solid growth in the world economy, with an average increase in demand for oil of 1.8%. Although this is higher than the rate of demand growth observed in 2005, growth on the supply side is expected to be similar or slightly higher.

A closer look at the supply side reveals that the oil-producing countries are not insensitive to the current elevated price levels. A stable price of $60 a barrel, in real terms, implies an increase in supply in the non-OPEC producing countries of 40% over the next 5 years, as at that price 85% of the reserves of these countries would become economically viable.

Conversely, a scenario with an average price of $40 would mean that 55% of these reserves would not be exploited, while at an average price of $20, this figure rises to 70%. In the current price cycle, non-OPEC members will therefore once again play a key role in increasing supply.

In fact, OPEC has announced that by the second quarter of the year, it will be necessary to cut output by at least 1 million barrels. The reasoning behind this is that inventories are set to rise this year and that on the supply side greater strength is beginning to becoming apparent.

Supply and demand growth in 2006

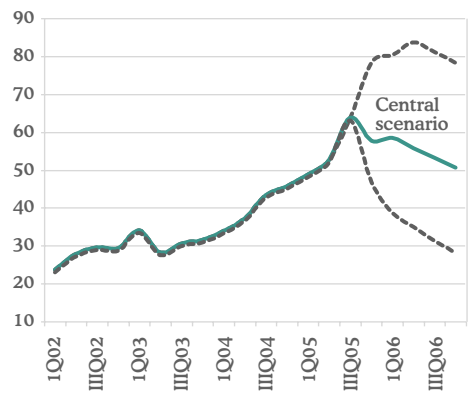


Source: BBVA

OPEC's behaviour and reactions will be crucial. However, the organization faces the dilemma that a sustained level of prices, in real terms, at $60 a barrel, could lead to a loss of market share in the medium term. This in similar fashion to the loss that occurred after the expansion that took place in the North Sea. It is therefore more likely to target an oil price benchmark in the medium term closer to $40-45 than current levels of prices.

Oil price scenarios

($/barrel)



Source: BBVA

A more detailed analysis of demand suggests that, despite having a low elasticity, improved efficiency is making it possible to absorb the increase in oil requirements associated with growth and higher living standards in the emerging countries with sustained rather than explosive oil demand growth.

Given, on the one hand, stronger market fundamentals than those envisaged by the pessimists and, on the other, a greater geopolitical risk than that anticipated by the optimists, the scenario for 2006 lies somewhere between these two positions. This will be reflected in an average oil price of $54.6 for Brent crude, a similar level to the one registered in 2005.

Iran: the main risk factor

The structural changes that lend support to a rather more optimistic view must, in the short term, be set against the geopolitical elements. And these have indeed turned more negative at the beginning of the year.

After the resolution of the Russian gas crisis, the oil market has begun to reflect the mounting tension between Iran and the West over its resumption of uranium enrichment. In view of this situation, the United States and the European three (France, the United Kingdom and Germany) took the issue to the U.N. Security Council, the body responsible for setting the conditions and an ultimatum for Iran to reverse its decision.

This has activated the only factor that we have identified since the middle of last year as being likely to produce our risk scenario. Already in the short term it has added a premium of $2-4 to the oil price, and its impact in the period ahead will depend upon the evolution of diplomatic efforts to resolve the international dispute.

The position of the U.S. Department of State is that Iran's uranium reserves are too small for a nuclear power programme. In fact, it would make more sense to deal with losses of associated gases in oil and gas fields, since this would guarantee more than three times more equivalent energy than would be generated with nuclear power. In contrast, the Department of State points out that Iran's uranium reserves are more than enough to support a weapons programme.

However, any U.N. decision to impose sanctions is more likely to be directed at international investment in Iran rather than take the form of an oil embargo. An oil embargo on Iran would take out 3.9 million barrels of oil a day from the market.

If these positions become radicalized, we could see the price of Brent crude oil jump to levels around $70. With prices at this level for the rest of the year, the estimated average price of oil would then be $88.7 a barrel, a rise of 62% with respect to the baseline scenario.

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Commodities

Fluctuations in copper

Between September and December of 2005, the average price of copper rose by almost 25%, as it continued to trend upward. In this regard, since January 2004, the price of the red metal has accumulated an increase of almost 100%. As has already been mentioned in previous issues of Latinwatch, the main reason behind this development is China. The impact of the Asian giant on the commodity markets has been felt particularly strongly in the price of copper. In particular, while demand for copper has fallen in most of the important markets, e.g. by 9% in the United States and by 7% in Japan, China has recorded a rise of 10.5%[1]. In addition, China's State Reserve Bureau (SRB)[2] was caught up in a series of rumours that they were short of copper. When the market realised that the amount needed to cover the SRB's operations exceeded the amount of inventories available in world exchanges, the price of copper recorded further rises.

We might therefore ask ourselves if the conditions that prevailed in the latter part of 2005 will be maintained during 2006. In this regard, as can be seen in our table of forecasts, we expect the average price of copper to be significantly lower than that registered at the end of last year (218 cents a pound). The main reason underpinning our forecasts is that we believe that this year copper production will exceed consumption by around 600,000 tonnes. This would allow inventories to be rebuilt to reasonable levels.

Behind this expected increase in supply is the fact that a number of production increases planned for 2005 were put back or compensated for by unexpected falls in demand. This additional production should come through in 2006, possibly in the first half of the year, which would provide the breathing space needed for the risk premia implicit in the current high price levels to come down.

What is more, the relative increase in prices observed over the past few weeks seems to be the result of short-term factors such as the strike by contract workers at the Chilean company CODELCO. Given that this seems to have had little impact on supply and assuming a rapid resolution of the conflict, we expect a reaction from the market that will drive the price of copper lower over the next few weeks.

The BBVA-MAP continues to rise

With regard to the BBVA-MAP index[3], copper is not the only raw material keeping the index at record high levels. After coming down in October and November, the price of oil turned upwards again during the month of December, to reach an average price of $57. Gold also rose in 2005, with an increase of almost 25% in the second half of the year. This means that the index averaged an increase last year of 27.5%, an almost identical rise to that of 2004.

As far as the index excluding oil is concerned, higher coffee prices, together with the increases observed in metals and other products, meant that lower prices for some agricultural goods, such as soya beans, had very little impact. Aluminium, for instance, took advantage of China's economic surge and the upturn of activity in construction and aeronautical companies to clock up a price rise of almost 30% during the second half of the year. Sugar prices also sustained the upward trend observed at the beginning of the second half of the year and ended the year at their highest nominal levels since 1995.

The impact on Latin America of this increase in the prices of raw materials is mainly apparent in those countries that are oil producers. Thus, although all of the countries in the region, with the exception of Brazil, recorded an improvement, Colombia, Mexico and Venezuela were the countries that benefited most.

Moderate corrections in 2006

With the exception of copper, we expect the prices of the most important raw materials for the region to stay in annual average terms at levels similar to those observed during 2005. Given that these are historically-high levels of prices, the region should continue to benefit from a positive scenario during 2006.

BBVA-MAP commodity index

(% average annual change)

	2004	2005	2006
BBVA-MAP	25.26%	27.53%	-0.03%
EX-OIL	19.13%	14.49%	-3.92%
COMPONENTS			
Metals	37.93%	20.40%	-8.61%
Agriculturals	9.96%	15.77%	-0.46%
Energy	29.92%	37.08%	-3.73%
COUNTRIES			
Argentina	12.42%	4.15%	0.01%
Brazil	2.53%	-0.35%	2.44%
Chile	28.76%	11.08%	-14.30%
Colombia	17.38%	29.09%	-1.05%
Mexico	16.84%	26.66%	-2.40%
Peru	16.03%	10.33%	-1.24%
Venezuela	28.68%	37.48%	-0.70%

Commodity prices

	Annual average			
	2003	2004	2005	2006f
Coffee (USc / lb)	65.0	85.1	115.7	112.8
Copper (USc / tonne)	81.0	126.0	166.0	129.0
Gold (US$ / ounce)	364.0	409.8	445.0	515.0
Oil (US$ / barrel)	29.6	38.6	54.7	53.7
Soya (US$ / tonne)	238.0	278.0	235.0	242.0

f/ forecast

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1 The changes are percentage increases in August compared with the same period of the previous year.

2 A body responsible for the administration of commodities in order to ensure the supply of raw materials to local industry.

3 The BBVA-MAP index is a weighted average of the prices of the main commodity and agriculture exports of Latin America.

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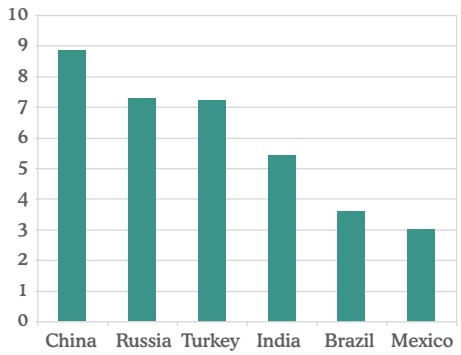
GDP per capita in 2004
(% real annual change)

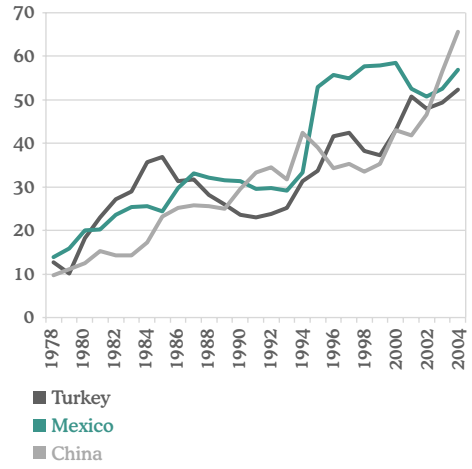


Source: IIF

	Public deficit (% of GDP)		Inflation (% annual change)	
	High deficit period*	2004	High inflation period*	2004
Brazil	12.1	1.5	1470.3	6.3
Russia	8.0	-4.1	461.1	11.0
Mexico	12.2	1.4	110.1	4.7
Turkey	7.3	4.4	86.8	10.6
China	1.6	2.5	18.6	3.9
India	5.4	4.3	9.7	6.5

*/ For Mexico the period of high inflation and deficits was 1986-88, whereas for the other countries it was 1993-95.
Source: BBVA using national accounts data

Openness to trade
(% of GDP)



Source: IIF

III. Under the Microscope

The new emerging countries

At different times in history, there have always been countries that have led world economic growth. If we focus on the period after the Second World War, it is possible to identify three distinct phases. During the 1950s and 1960s, Japan and the southern European countries led the way, with the baton taken up by the Southeast Asian countries until the start of the 1990s. In the mid-1990s, Eastern Europe, Russia, China and India came to the fore. The latter three countries along with Turkey, Brazil and Mexico form a new class of emerging economies.

The new emerging economies show within their expected and significant differences, a number of things in common. They have big populations, ranging from 70 million in the case of Turkey to more than 1.3 billion in China, and together account for 45%, or close to 3 billion, of the world population. In terms of surface area, four of them are among the seven biggest countries in the world, and together they make up almost a third of the surface area of the globe. From an economic point of view, however, their contribution to the world economy still remains modest. The combined GDP of the six was below 10% of the world GDP in 2004, compared with 60% for the United States and the EMU.

The foundations of growth

There have been a number of different prescriptions for growth and their application to different countries has thrown up a variety of serious incompatibilities. However, amongst these it is possible to identify areas in common such as macroeconomic stability, a greater openness to trade, improvements in competitiveness, deregulation, rationalization, and greater efficiency in public funding. In this section, we examine the most recent important development initiatives undertaken in the new emerging economies.

There is a general consensus that **macroeconomic stability** is needed to sustain high growth levels. The new emerging countries have achieved notable progress in the past few years in reducing their budget deficits and in reining in inflation. This evolution has been driven, according to the country in question, either by an improvement in the quality of democratic institutions (Brazil, India and Mexico), or by a greater degree of governability and leadership (China and Russia), or by a combination of both factors (Turkey).

The increase in levels of **openness to trade** is also playing a significant role in the economic growth of these countries. The strategies involved in this area are also different, with different procedures and speed of implementation between one country and another. On the one hand there is the “big bang” model of China, Mexico and Turkey, which consists of extensive and rapid liberalisation in order to take advantage of lower labour costs. On the other is the gradual approach taken by Brazil, India and Russia, with a slower rate of opening to trade in parallel with the development of domestic industry.

There are more things in common in the area of **competitiveness and the labour market**. The new emerging economies can call on the advantage of high productivity levels[1] and low labour costs. In addition, except in the case of Russia, these countries are backed up in their efforts to grow by having a young population, a phenomenon which will make itself felt increasingly in the next few years, particularly in India and Turkey.

[1] Always in relation to other countries, given that within the group under study there are obvious differences. For example, Mexico has suffered from China’s strengths in the past few years, given that its productive structure faces greater competition from China than that of other economies.

The process of **deregulation** in the six countries under consideration is not taking place at the same pace, and this area presents considerable problems in a number of countries. The inheritance from previous decades continues to make itself felt strongly, and in a way that goes in the opposite direction from what the authorities are trying to achieve. The outcome is the maintenance of excessively bureaucratic systems such as in the case of Brazil and India, and a highly discretional approach to legal matters with a tendency towards corruption (the case of Russia and China). The end result is a deterioration in the business climate.

In the area of **public finances**, besides the reduction in public deficits, significant progress has been made in other areas. A number of countries have pushed ahead vigorously with the process of privatisation. In China, for example, the public sector has reduced its share of employment and industrial value added by 30 points during the past decade. Pensions systems have undergone significant change in countries such as Brazil, Mexico and Turkey. In the case of Brazil, the new pension law for civil servants has significantly reduced the future spending commitments of the State. The tax system has also been subject to change in the past few years, with Russia successfully introducing a flat-rate income tax, which has allowed the state to double tax collections as a percentage of GDP since 2000.

In short, the new emerging economies have managed to achieve significant economic growth through a variety of different policies, which although not necessarily the same, share in common their rejection of sticking to the old way of doing things.

Risks

The achievements so far of the new emerging countries have been significant, but their vulnerability to different shocks, both domestic and foreign, has not disappeared. As a result, we believe it would be useful to go over the different areas of risks they might be subject to.

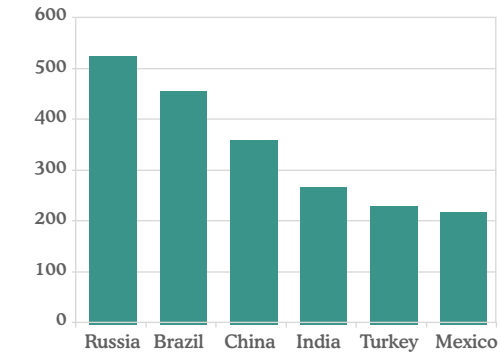
Among the **external risks**, we view a reduction in levels of international liquidity as a key source of instability in the financial field. Under current conditions, emerging countries are benefiting from greater access to funding under better conditions.

However, although the entry of funds could come to a halt, or even reverse itself as carry-trade runs its course, the economies under consideration enjoy foreign account situations of varying degrees of comfort, supported by current account surpluses and the ability to attract foreign direct investment. Even in the case of Turkey, which is the worst placed in this area, the country is backed by a successful privatisation programme, and by the start of negotiations for its entry into the European Union.

What would have a bigger negative impact than the mere halt in inflows of foreign capital would be a sustained increase in interest rates as a result of a reduction in international liquidity. This is particularly the case of Brazil, India and Turkey, where public debt levels are higher. In the case of Brazil, despite the notable reduction in the past few years, almost two thirds of the debt of the public administrations is linked to financial variables (the exchange rate or benchmark rates). Under these circumstances, the need to develop local markets for the issue of debt instruments denominated in the local currency, which are less sensitive to international markets, takes on added importance.

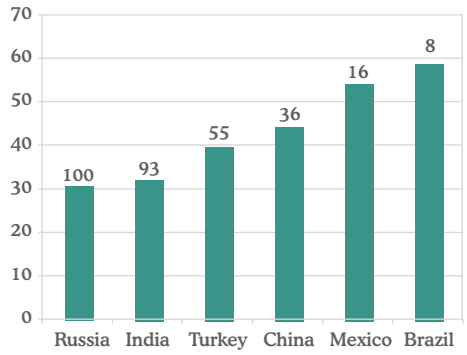
Sharp changes in the terms of trade also constitute a significant risk for the growth of the new emerging countries. The need for this becomes more pressing to the extent that the productive structure of the economy

Processing of licenses
(days)



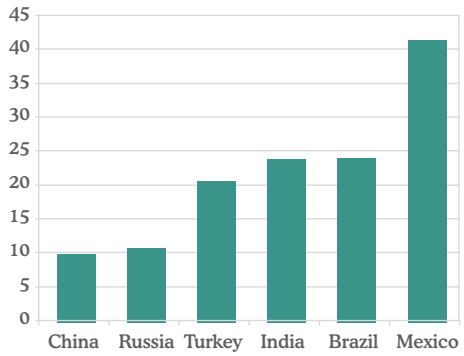
Source: World Bank

Gini index*



* The number above the column is the position in the world ranking. The lower it is, the greater the inequality
Source: World Bank

Financial stregth index* (2004)



* Poorest financial strength corresponds to 0, best to 100. Constructed according to a numerical scale that is assigned to the weighted average of ratings by country.
Source: Moody's

	Share of world GDP (2004)	Share of world population (2004)
United States	35.7%	4.6%
EMU	22.9%	4.8%
Other industrial countries	21.4%	6.3%
China	4.0%	20.4%
India	1.7%	17.0%
Mexico	1.7%	1.6%
Brazil	1.5%	2.8%
Russia	1.4%	2.3%
Turkey	0.7%	1.1%
Total emerging markets	11.0%	45.3%
Rest of world	9.0%	38.9%

Source: BBVA using United Nations data

is dependent on commodities, whose prices tend to be more volatile than those of other products. With commodity exports accounting for 40% and 60% of total exports, Brazil and Russia are respectively considerably more exposed to this risk. A reversal of the current favourable conditions in the commodity markets would reduce the dynamism of the economies in question as well as their ability to attract foreign capital.

Finally, among the external risks, there is a certain fear regarding an increase in protectionism with respect to China, given the rapid growth in its exports worldwide. A halt to the process of trade liberalisation could have a negative impact on the growth path of the new emerging countries, which as we have previously stated, have different degrees of openness to foreign trade.

In the area of **domestic risks**, what stands out most is political uncertainty. The high levels of inequality in the majority of countries under consideration, both on a personal and geographical level, could unleash social tensions which lead to a loss of support for the reforms that are needed. In this respect, Brazil and Mexico are the least well-positioned, although China would suffer most from a situation of domestic instability. The western and central regions of the Asian country, where close to 800 million people live, have a GDP per capita which is 36% of that of the coastal regions, which means that the attraction of the latter is enormous.

There is a general perception that the financial systems of the new emerging countries are in need of more radical reform. The main problems include the predominant role played by the public sector, and high levels of dollarisation, which frequently create respectively a loss of efficiency, and an increase in the vulnerability to external financial shocks. Russia is an example of the first of these problems, given that the two main public banks, in a highly fragmented market, control 35% of the assets in the financial system and close to 60% of the deposits.

By way of summary, and with the aim of presenting an **anatomy** of the economies under study in this article, we have grouped them on the basis of the external and domestic risks we have just indicated. The countries most exposed to a liquidity crisis are India, Turkey and Brazil, the latter being along with Russia the most vulnerable to a change in the terms of trade. China, and to a lesser extent India, would feel the effects of a trade war most. And China, along with Russia, is the country subject to the biggest financial-banking risk. Mexico is not subject to the highest risk level in any of the above areas examined, but faces medium risk on the political front.

Summary and Conclusions

New emerging countries today are driving world growth. Their significant geographic and demographic dimensions are not being economically exploited to the full, which leaves room for considerable potential expansion in the next few years. In order for this to become a reality, the countries in question need to further enhance macroeconomic stability (control of inflation and the public deficit), extend openness to trade, deregulate markets, further improve competitiveness and reform public finances.

The vulnerability shown by the emerging economies to different external shocks over the past few decades requires measures directed at achieving the goals mentioned above. However, it is likely that these measures will not be sufficient to resolve other problems on the domestic front. It is necessary to strengthen property rights and application of the law. Above all, there is an absolute need to fight endemic poverty and a lack of equitableness in the distribution of income.

FDI in Latin America: present and future

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From the end of the 1980s, emerging markets have undergone a continued process of liberalization, albeit with ups and downs. The process of opening up has brought with it significant net inflows of capital with the accompanying benefits of this. There is a general consensus among economists that the main reason behind the shift in behaviour that has been seen in foreign investors has been the reform process undertaken some time back. But it is equally important to highlight the net inflows of capital as well as the rebalancing of these flows.

In the 1970s, bank loans represented 80% of total flows, and the main recipient of these was the public sector. In the period 1990-1995, bank loans represented less than 36% of total flows, while Foreign Direct Investment (FDI) and Portfolio Investment (PI) accounted for 20% and 44%, respectively, with the main recipient now being the private sector. In the specific case of Latin America, during the 1990s the increase in FDI inflows was the result of the privatization of state-owned companies rather than mergers and acquisitions by private companies. The privatization process has now practically run its course, and the question that arises is what role Latin America will play in capturing FDI.

The consensus among economists that FDI is beneficial, with some calling it "good cholesterol", due to its positive economic effects on recipient economies, highlights the relevance of this question. Higher inflows of FDI bring about improvements in corporate management, and in general are accompanied by technological advances, which, combined with greater financial stability, generate economic benefits for the recipient country.

In this article we focus on FDI flows to emerging countries. We review the main determinants of FDI flows, and the differences which exist between different economies. Lastly, we analyse FDI flows to Latin America and the prospects for these over the next few years.

Determinant factors and strategy?

Historically, it can be seen that most FDI goes to the United States and Europe. However, currently flows to these two areas have dropped, and there is now growing interest in a number of emerging regions.

Asia and Latin America are the two emerging regions which receive most flows from foreign investors. China is the main recipient in Asia, while this is the case for Mexico and Brazil in Latin America. China alone receives net inflows that double those for Latin America. This region currently receives FDI flows equivalent to 1.5% of its GDP, almost half the level in 2001. Asia on the other hand receives flows representing 1.7% of GDP, compared with 1.2% in 2001.

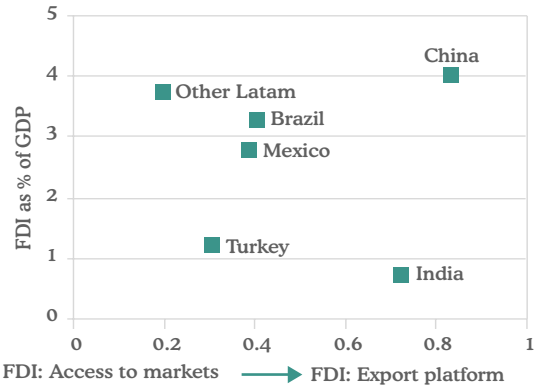
Why is it that while the international environment for markets over the past few years has been favourable and benign, the news coming out of Latin America on this front is not altogether positive? Has there been a fundamental shift in the determinants of FDI which has worked against the region to the benefit of Asia?

Among the main determinants of FDI cited in the literature are the size of the market, the degree of openness to trade, productivity levels, political risks, infrastructure development, and the quality of institutions.

At first sight, the size of the Latin American market as a whole is attractive, and it continues to grow at a moderate rate, albeit substantially below that of other geographic areas such as Asia. The extent of openness to trade has also increased year after year since

FDI in Asia and Latin America: volume and model

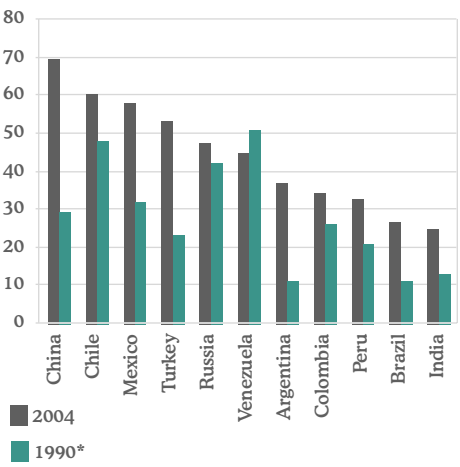
(2001-04)



Source: BBVA and national statistics offices

Degree of openness

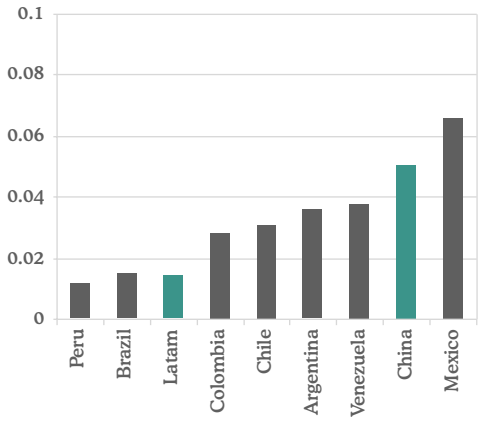
(in %)



Source: BBVA using IMF and WTO; *1994 for Russia

Kilometres of motorways and roads

as % of country area in km²



Source: CIA

Confidence index for FDI

2003	2004	Country	Attractiveness
1	1	China	2.03
2	2	USA	1.45
6	3	India	1.40
7	4	United Kingdom	1.25
5	5	Germany	1.17
11	6	France	1.03
8	7	Russia	0.97
4	8	Poland	0.96
10	9	Spain	0.96
13	10	Czech Republic	0.93
23	11	Malaysia	0.92
9	17	Brazil	0.91
3	22	Mexico	0.80

Source: At Kearney

1990 and is now at record levels, but also well below those seen in Asia. High productivity levels and low labour costs are further elements in Latin America's favour in attracting investment. Although political risks have decreased, there have been episodes of political noise in Bolivia and Venezuela, which may have harmed the commercial and investment environment. The political question will be particularly relevant in 2006, as many countries in the region are due to hold elections. As regards the level of infrastructure development in Latin America, while the situation is improving, the pace of improvement is far from optimal, and a great deal remains to be done. The region's weakest point remains the slow pace of reforms aimed at improving investor protection and legal and accounting transparency.

In addition to the above determinants, at least two other factors should be mentioned. The first is the degree of receptiveness of FDI and the model for the incorporation of companies which set up in a recipient country. There is a substantial difference in this area between Asia and Latin America. Companies setting up in Asia use the recipient country as an export platform, basically in the manufacturing sector, while companies that invest in Latin America seek access to specific sectors, mainly services and natural resources.

To sum up, the determinants of FDI flows toward Latin America do not appear to have changed. Perhaps some volatility has been perceptible on the odd occasion, but not sufficient to lead to a diversion of FDI to other areas. Therefore, if the determinants have not changed, why is it that Latin America has failed to capture a bigger share of FDI directed at emerging countries? The problem lies in the very fact there has been little change in the determinants mentioned above. Investors seem to have been differentiating between Asia and Latin America on the basis of the receptiveness to FDI and the relative advantages one region offers over the other when deciding on a definite investment strategy.

How do we see FDI in Latin America?

Explaining the determinants of FDI by country or region is in itself a difficult task, since we are dealing with flows, which as we have seen, depend not only on economic or financial variables, but also others which are more difficult to calculate, such as human capital, productivity or simply political risk. Below, we have carried out a simple exercise to show which factors might help explain FDI in Latin America.

The variable analysed is FDI as a percentage of GDP. The figures used are for the period 1974-2004, and were drawn from our own and publicly available sources. As explanatory variables we have selected a) the market growth rate measured by growth in the population and GDP growth, b) the extent to which the region is open to trade in the form of the ratio of imports and exports to GDP, and c) the risks to civil liberties and political rights, for which we have used the "Freedom House" index, which operates on a scale of 1 to 7 (the lower the value, the lower the political risks).

All of the variables are significant and have the expected sign. As we can see in the attached table, GDP growth as expected has a positive sign. The openness to trade variable is also positive, something which could be indicating that the region would attract more FDI if it continued with the process of trade integration with other regions and expanded its markets further. The variable used to calculate the political risk or climate of the region has a negative sign, that is to say, if the region can maintain a stable political and social situation, it will create a more stable platform for investors to fix their objectives in Latin America. Finally, population growth is found to be a significant variable, as might be expected since we use it to estimate market growth.

Based on our estimates and certain assumptions about social and economic developments, our results indicate that, in the years ahead, Latin America will experience a moderate rate of growth in FDI inflows. At any rate, it is important to note that this modest growth translates into a significant flow of investments. In 2005, FDI inflows amounted to around $60 billion. For 2006 and 2007, we expect to see inflows rising to $74 billion and $88 billion, respectively.

Challenges facing the region

Latin America is still playing an important role as a recipient of FDI despite the enormous appeal of other emerging regions. However, a certain loss of interest seems to be developing among international investors, which at the very least begs the following question: what are the keys to revitalizing capital inflows to the region?

All the evidence suggests that Latin America must strengthen certain pillars in order to increase FDI inflows. Perhaps the most important of these pillars in the current environment in Latin America is to achieve a strong and sustained rate of economic growth. Political uncertainty is another crucial question, both in individual countries and at a regional level. In this regard, it is very important that these countries assimilate once and for all the importance of pursuing State policies that clearly define the direction or model to be followed in questions of FDI. It is no less important to promote trade and investment agreements both within the region itself and outside of it. Doing so would not only help to ensure a continuous inflow of capital, but also diversify the sources from which it comes. In this regard, the FTAA could be a step forward, along with the free trade agreements with the United States (CAFTA, Peru and Colombia). As examples we could cite the case of Mexico and the signing of NAFTA, or Spain and Portugal after they joined the European Union.

One of the risks giving rise to most concern in Latin America is that associated with talk of nationalisation of natural resources and companies in strategic sectors. This situation is likely to contribute to divert FDI flows towards other regions.

Conclusion

Latin America has the capacity to generate substantial change in a number of factors in order to boost inflows of FDI into the region. Our findings show that the chief determinants of such flows are those associated with GDP growth and the extent to which the region is open to trade. These remain very different in Latin America as compared to other regions such as Asia. Efforts to bring about the changes needed should be accompanied by a greater transparency in legal frameworks, improvements in infrastructure and political stability.

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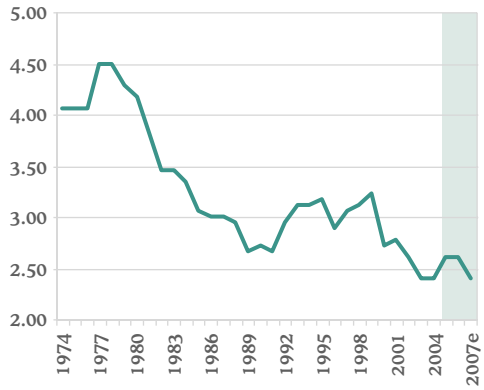
Political risk and corruption



Source: Freedom House

FDI flows towards Latin America

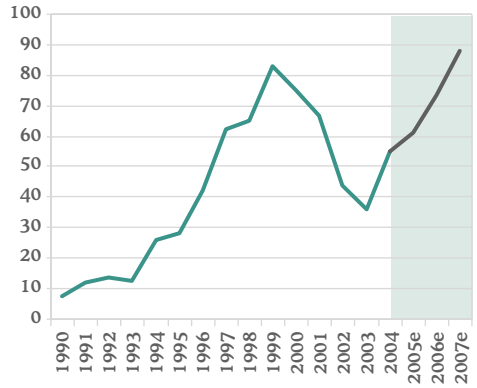
Variable	Coefficient	Error	t-est.	Prob.
GDP growth	0.001	0.0003	2.8902	0.0085
Openess	0.076	0.0418	1.8221	0.0821
Social and political risk	-0.006	0.0036	-1.8130	0.0835
Population growth	3.008	1.0121	2.9716	0.0070

R^2	0.351	AIC	-7.8600
EER	0.004	Durbin-Watson est.	2.4422
Log likelihood	106	SCR	0.0004

Source: BBVA

Latin America: FDI inflows

(billion of dollars)



Source: UNCTAD and BBVA forecasts

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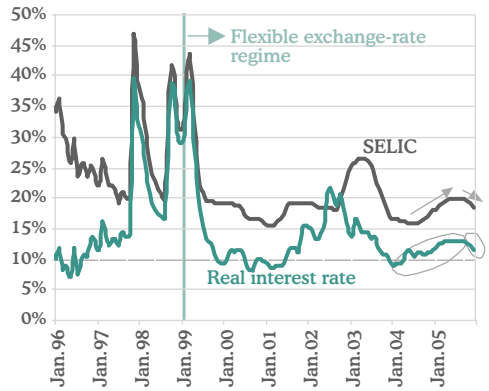
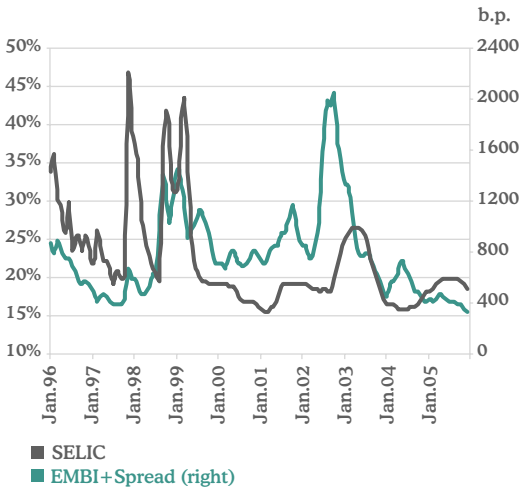
Real and nominal interest rates



Source: BBVA using BCB data

Interest rates and country-risk



Source: BBVA using BCB and JP Morgan data

Brazil: How far can the Central Bank lower interest rates? Structural interest rates and the current economic situation

In the past few months, the Central Bank of Brazil (BCB) has started an expansionary phase in monetary policy, reducing its intervention rate (SELIC) from 19.5% to 18% at a rate of 50 basis points per month. Reviewing the evolution of this interest rate in Brazil over the past few years (from the point at which the exchange-rate system was made more flexible), this is the fourth time the BCB has started an easing cycle.

Traditionally, an increase in Brazil's country-risk either due to a change in international financial conditions or because of domestic factors put downward pressure on the exchange rate, leading eventually to interest rate hikes to stem the constant loss of international reserves and further depreciation of the currency. During the crisis of 2002, the depreciation of the real, the increase in inflation expectations, the BCB's failure to meet its inflation target, and the growth in public debt obliged the BCB to start a cycle of aggressive hikes in the SELIC to 26.5%, and in turn bringing on a recession.

After the country's financial variables stabilized, the BCB began a new cycle of cuts in the SELIC, lowering real interest rates to below 10% at the start of 2004. However, this caused renewed inflation expectations, which as part of its commitment to meeting its inflation target, obliged the central bank to raise interest rates again, but this time around not as a result of the evolution of the country risk.

Currently, the low aversion to risk in the international financial markets is maintaining the country-risk of emerging countries at minimum levels. At the same time, both inflation in Brazil as well as expectations of inflation are under control, coming within the target set by the BCB. As a result, the central bank has decided to start a new cycle of interest rate cuts. How far can the BCB lower interest rates? Can the country sustain real interest rates of below 10%?

The levels of real interest rates (and also nominal rates) are determined by two factors, and it is necessary to distinguish between the two. On the one hand, there are structural factors, and on the other temporary and cyclical factors. Amongst the first is the potential growth of the economy defined as the capacity to grow using all available resources (capital and labour), and the perception of structural risk in the economy, measured using a whole series of basic macroeconomic variables.

On the other hand, there are temporary factors which affect the real rate of interest in the economy. These in turn can be divided into domestic, that is concerning a specific country, and external or exogenous. Amongst the first are the cyclical position of the economy (the differential with respect to potential growth), inflation expectations (how far these diverge from target) and political factors. External factors include interest rate levels in the rest of the world (particularly in those countries which compete with Brazil for capital inflows), international aversion to risk and the terms of trade.

Can Brazil sustain structurally lower real interest rates?

Interest rates in Brazil have historically been affected by a series of factors which have caused them to remain at structurally high levels (amongst the highest in the world). Among the reasons most cited for this are the high level of public debt as well as its composition, with indexation to financial variables[1], repeated international liquidity crises, insufficient domestic savings, and a lack of foreign confidence in the future conduct of economic policies. Also, although the use of fixed exchange-rate regimes helps to contain inflation expectations over the

[1] Favero, C. A. and F. Giavazzi, 2002, "Why Are Brazil's Interest Rates So High?", *Working Paper No. 224*, IGIER, Università Bocconi.

short term, it ends up not only helping to keep interest rates high but also more volatile. These factors, along with an economy closed to trade, and the constant public deficits sustained over time, have kept the country-risk at high levels, obliging Brazil to take on debt at high interest rates, and preventing at the same time a reduction in real interest rates[2].

One way of estimating the equilibrium real interest rate would be to estimate a structural aggregate demand curve. Calhman de Miranda and Kfouri Muinhos (2003) found this rate to be between 4.5% and 5%. Similar results are obtained if one studies the steady state of the economy from a general equilibrium approach[3].

In long-term growth models which use a Cobb-Douglas production function[4], the level of real interest rates of an economy depends mainly on its potential growth. In these models, the savings rate and total factor productivity (TFP) are the ultimate determinants of that growth. Using the TFP and the growth potential estimates of Neut and Rodríguez with figures up to 2003 and different values for the equilibrium savings rate over the long term (steady state), equilibrium real interest rates vary between 6% and 8%.

Only heavily time-weighted methods produce long-term real interest rates in a range of 10-15%, which is logical if you take into account that in the past 20 years alone the country has gone through five stabilization plans aimed at taming inflation caused by recurrent crises, with high and volatile nominal interest rates.

The Brazilian economy currently is not vulnerable to a return to the crises of the past nor is it close to its theoretical steady state. In any case, all of the above studies agree that a necessary but not sufficient condition for achieving low real interest rates is macroeconomic stability, with consistent policies over time which reduce uncertainty and the risk of rapid shifts in economic models. The lowering and control of inflation has always been pointed to as a goal in this area, as well as responsible fiscal policies which control the public sector balance, and along with this public sector debt.

The setting of inflation targets as a monetary policy tool has helped stabilize interest rate levels. Uncertainty and volatility surrounding the evolution of inflation have also been reduced by the setting of a clear inflation target beforehand, by the commitment to achieving this goal, and through the credibility generated by this system.

One of the changes needed to lower the perception of structural risk for the Brazilian economy consists in changing the composition of public debt, which is too exposed to the evolution of financial variables (exchange rate and the SELIC). In this sense, the current favourable international situation has allowed the country to resume fixed interest-rate debt issues and increase the indexation of debt to the evolution of prices. It has also reduced its financial exposure, with foreign public debt currently at limited levels. At the same time, it has taken advantage of the current situation to extend maturities.

On the other side, the foreign sector is going through structural change. Trade barriers have been eliminated, while tax incentives for exporters have been created. The contribution of real exports to the economy has increased from 10% of GDP to 17%, and the level of openness to trade to 29% of GDP, providing increased cover for potential international liquidity crises.

All the indications are that the interest rates the country is forced to pay on its long-term borrowing will come down, which will result in lower benchmark short-term interest rates. However, as well as taking further the changes already initiated, there is a need for more reforms such as

Conditional volatility of SELIC rates

Collor Plan	
1991 - 1994	1.9213
Real Plan	
1995 - 1998	0.2795
Flexible exchange-rate regime and inflation target	
1999 - 2005	0.0090

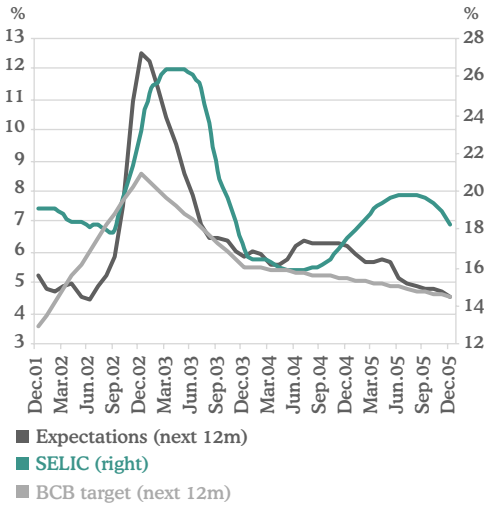
Source: BBVA

[2] Garcia, M., 2003, "Brazil in the 21st Century: How to Escape the High Real Interest Trap?", *Working Paper No. 162*, SCID, Stanford University.

[3] Bugarin, M., R. Ellery Jr., V. Gomes Silva and M. Kfoury Muinhos, 2005, "Steady-State Analysis of an Open Economy GEM for Brazil", *Working Paper No. 92*, Central Bank of Brazil.

[4] Neut A. and J. Rodríguez, 2005, "On sustained growth in Brazil", *Latinwatch first quarter 2005*, pp. 10-12, BBVA.

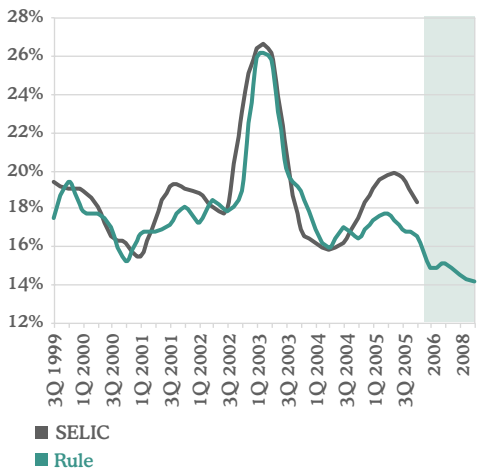
SELIC rates, inflation expectations and BCB target



Source: BBVA using BCB data

Estimated SELIC rate using monetary rule

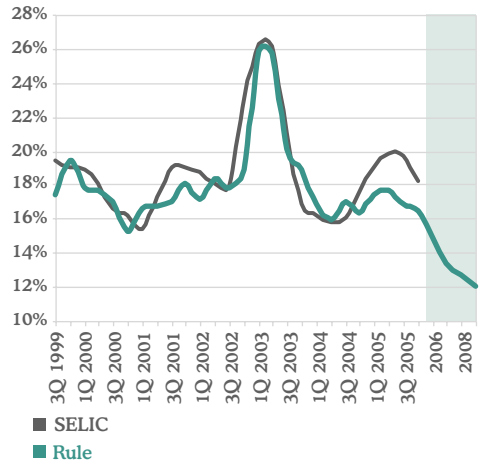
(equilibrium real interest rate=8%)



Source: BBVA

Estimated SELIC rate using monetary rule

(equilibrium real interest rate=6%)



Source: BBVA

the independence of the BCB and control of public spending. At present, the public accounts are permanently in deficit despite a large primary surplus, and the social security system is expected to record increasing deficits as the population structure makes itself felt. There is also a need for deeper capital markets: the small number of financial instruments hampers substitution among debt with different maturities, increases transaction costs and impedes the transmission of monetary policy changes (in short-term interest rates) along the term structure of interest rates towards longer terms. And, vice versa, a change in structural risk and therefore lower long-term yields is not transmitted to short-term yields.

Other monetary policy transmission mechanisms (low levels of lending) and inefficiencies in the financial sector (very high margins) are still sustaining structurally high interest rates.

How far can nominal interest rates come down in the current situation?

As we have explained at the beginning of this article, the BCB has begun an easing cycle of its SELIC rate against the backdrop of clearly favourable market conditions. There are therefore no inflationary pressures resulting from the exchange rate.

This situation has helped consolidate expectations of a decline in inflation. Inflation expectations are converging with the targeted rate of inflation and are the ultimate cause of lower interest rates. However, economic growth is also lower than had been anticipated and is therefore not contributing any inflationary pressures. While it is true that capacity utilization has increased, unemployment has fallen (hence a smaller output gap), and real wages have risen, no pressures are being exerted on the side of aggregate supply since idle resources still exist (unused capacity for production and an unemployment rate of 9%). With economic growth below the potential rate of GDP growth, there is no evidence of price pressures in the Brazilian economy.

Certain factors nonetheless caution against future rate cuts. Amongst these are government-administered prices, which are still rising rapidly at rates well above those of prices that are left free, and underlying inflation, which is also higher than IPCA inflation.

In order to determine the SELIC rate, we have assumed that the BCB acts on the basis of a simple Taylor rule. This rule is specified so that at each moment the BCB chooses a SELIC rate that is close to the long-term structural rate of interest we have discussed above, after correcting for short-term factors such as the gap between actual GDP and potential GDP and the difference between next period inflation expectations and the inflation target set by the BCB.

Under a benign scenario in which the current behaviour of the financial markets remains unchanged, for values of real structural interest rates of between 6% and 8%, the BCB could take SELIC rates down to below 16% over the course of 2006. It could also continue to reduce interest rates for a further 3 or 4 years after that, at best to levels close to 12%.

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International Context

	Real GDP (%)				Consumer prices (%. average)			
	2003	2004	2005	2006	2003	2004	2005	2006
USA	2.7	4.2	3.6	2.8	2.3	2.7	3.4	2.8
EMU	0.7	1.8	1.4	2.0	2.1	2.1	2.2	2.0
Japan	1.4	2.7	2.0	2.5	-0.3	0.0	-0.2	0.2
China	10.0	10.1	9.8	9.0	1.2	3.9	1.8	2.5

	Official interest rate (%. end of period)				Exchange rate (vs $. end of period)			
	06/01/06	Jun-06	Dec-06	Jun-07	06/01/06	Jun-06	Dec-06	Jun-07
USA	4.25	4.75	4.75	4.75				
EMU ($/€)	2.25	2.50	2.75	3.25	1.22	1.21	1.23	1.24
Japan (yens/$)	0.10	0.10	0.10	0.50	114	117	115	110
China (cny/$)	5.58	5.58	5.80	5.80	8.07	8.05	7.90	7.75

Latin America

	Real GDP (%)				Consumer prices (%. end of year)			
	2003	2004	2005	2006	2003	2004	2005	2006
Argentina	8.8	9.0	9.0	7.0	3.7	6.1	12.3	12.0
Brazil	0.5	4.9	2.7	3.4	9.3	7.6	5.7	5.5
Chile	3.7	6.1	5.9	5.6	1.1	2.4	3.7	3.6
Colombia	4.1	4.1	4.9	4.4	6.5	5.5	5.2	4.5
Mexico	1.4	4.4	3.0	3.0	4.0	5.2	3.3	3.6
Peru	4.0	4.8	6.2	4.7	2.5	3.5	1.5	2.5
Venezuela	-9.2	17.9	9.4	4.1	27.1	19.2	14.4	15.3
LATAM [1]	**1.7**	**5.9**	**4.4**	**4.1**	**7.1**	**6.8**	**6.0**	**6.0**
LATAM Ex-Mexico	1.8	6.5	5.0	4.4	8.3	7.3	6.9	6.9

	Fiscal balance (% GDP)				Current account balance (% GDP)			
	2003	2004	2005	2006	2003	2004	2005	2006
Argentina [2]	0.5	2.6	1.7	1.9	5.9	2.2	3.2	2.4
Brazil	-3.6	-2.5	-3.0	-3.0	0.8	1.9	2.0	1.3
Chile [2]	0.0	2.5	4.8	2.2	-1.5	1.5	-0.4	-1.6
Colombia	-2.7	-1.3	-1.2	-2.0	-1.3	-1.0	-0.1	-1.1
Mexico	-0.6	-0.3	-0.1	0.0	-1.3	-1.1	-1.1	-1.3
Peru	-1.7	-1.1	-0.4	-0.6	-1.5	0.0	1.0	0.4
Venezuela [2]	-5.1	-1.9	1.6	-2.3	10.3	14.1	17.7	10.7
LATAM [1]	**-1.9**	**-0.9**	**-0.8**	**-1.1**	**0.7**	**1.2**	**1.9**	**0.8**
LATAM Ex-Mexico	-2.7	-1.2	-1.1	-1.7	2.2	2.6	3.5	1.9

[1] Average of the countries. [2] Central Government.

	Exchange rate (vs $. end of year)				Interest rates (%. end of year)[3]			
	2003	2004	2005	2006	2003	2004	2005	2006
Argentina	2.96	2.99	3.01	3.15	3.7	3.1	5.0	8.0
Brazil	2.89	2.72	2.28	2.65	16.5	17.8	18.0	15.5
Chile	603	576	514	550	2.3	2.3	4.5	5.5
Colombia	2865	2404	2279	2365	8.0	7.8	6.3	6.9
Mexico	11.24	11.15	10.63	11.30	6.0	8.7	8.8	7.0
Peru	3.47	3.28	3.42	3.40	2.5	3.0	3.3	4.5
Venezuela	1600	1920	2150	2150	15.1	12.4	10.9	10.3

[3] For each country interest rate see the following page.

Argentina

	2004	2005f	2006f
GDP (%)	9.0	9.0	7.0
Consumer prices (% end of year)	6.1	12.3	12.0
Trade balance ($bn)	12.1	11.7	10.4
Current account (% GDP)	2.2	3.2	2.4
Reserves ($bn. end of year)	19.6	27.0	26.8
Exchange rate (end of year vs US$)	2.99	3.01	3.15
Fiscal balance (% GDP) [1]	2.6	1.7	1.9
Interest rate (end of year) [2]	3.1	5.0	8.0
Real effective exchange rate (end of year. dec-97=100)	50	52	56
BBVA-MAP (end of year, Jun-95=100)	117	131	129

1/ Argentina: Central Government Balance. Excluding privatisation receipts

2/ Argentina: 30-d deposits interest rate in pesos; Brazil: SELIC rate

Brazil

2004	2005f	2006f
4.9	2.7	3.4
7.6	5.7	5.5
33.7	44.8	32.0
1.9	2.0	1.3
52.7	53.8	49.5
2.72	2.28	2.65
-2.5	-3.0	-3.0
17.8	18.0	15.5
65	81	71
79	77	80

Chile

	2004	2005f	2006f
GDP (%)	6.1	5.9	5.6
Consumer prices (% end of year)	2.4	3.7	3.6
Trade balance ($bn)	9.0	9.0	4.8
Current account (% GDP)	1.5	-0.4	-1.6
Reserves ($bn. end of year)	16.0	16.0	16.0
Exchange rate (end of year vs US$)	576	514	550
Fiscal balance (% GDP) [1]	2.5	4.8	2.2
Interest rate (end of year) [2]	2.3	4.5	5.5
Real effective exchange rate (end of year. dec-97=100)	84	97	91
BBVA-MAP (end of year, Jun-95=100)	89	72	70

1/ Chile: Central Government

2/ Chile: Official interest rate (from August 2001 in nominal terms); Colombia: 90-d DTF interest rate

Colombia

2004	2005f	2006f
4.1	4.9	4.4
5.5	5.2	4.5
1.4	2.8	0.2
-1.0	-0.1	-1.1
13.5	14.7	15.5
2404	2279	2365
-1.3	-1.2	-2.0
7.8	6.3	6.9
83	92	89
128	151	143

Mexico

	2004	2005f	2006f
GDP (%)	4.4	3.0	3.0
Consumer prices (% end of year)	5.2	3.3	3.6
Trade balance ($bn)	-8.8	-9.3	-10.8
Current account (% GDP)	-1.1	-1.1	-1.3
Reserves ($bn. end of year)	61.5	64.0	63.0
Exchange rate (end of year vs US$)	11.15	10.63	11.64
Fiscal balance (% GDP)	-0.3	-0.1	0.0
Interest rate (end of year) [2]	8.7	8.8	8.0
Real effective exchange rate (end of year. dec-97=100)	107	114	108
BBVA-MAP (end of year, Jun-95=100)	158	193	176

2/ Mexico: 28-d Cetes interest rate; Peru: Interbank interest rate

Peru

2004	2005f	2006f
4.8	6.2	4.7
3.5	1.5	2.5
2.8	4.5	3.7
0.0	1.0	0.4
12.6	14.5	15.0
3.28	3.42	3.40
-1.1	-0.4	-0.6
3.0	3.3	4.5
90	87	87
99	113	95

Uruguay

	2003	2004	2005f
GDP (%)	2.2	12.3	6.2
Consumer prices (% end of year)	10.2	7.6	4.9
Trade balance ($bn)	0.2	0.0	0.0
Current account (% GDP)	-0.5	-0.8	0.6
Reserves ($bn. end of year) [3]	1.9	2.3	3.1
Exchange rate (end of year vs US$)	29.19	26.56	23.51
Fiscal balance (% GDP) [1]	-3.2	-1.8	-2.5
Interest rate (end of year) [2]	7.5	5.7	n.d.
Real effective exchange rate (end of year. dec-97=100)	75	81	88
BBVA-MAP (end of year, Jun-95=100)	86	89	81

1/ Venezuela: Central Government

2/ Uruguay: 30-d BCU Papers interest rate in pesos; Venezuela: 90-d Certificado Participaciones rate

3/ Venezuela: including FIEM

Venezuela

2004	2005f	2006f
17.9	9.4	4.1
19.2	14.4	15.3
21.4	30.4	23.8
14.1	17.7	10.7
24.1	29.6	24.8
1920	2150	2150
-1.9	1.6	-2.3
12.4	10.9	10.3
91	90	102
208	286	255

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Perspectivas Macroeconómicas 2005-2007	Banca Mayorista Global	Caracas, October 05
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