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Capital Flows to Latin America

Third Quarter 2004

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CAPITAL FLOWS TO LATIN AMERICA
Third Quarter of 2004*

In the third quarter of 2004, the positive interaction of external and domestic factors in the Latin American region created a favorable environment for capital inflows. Among the external factors, an unprecedented amount of global liquidity, combined with an environment of low risk-free rates and a search for yield, was one of the main driving forces in the third quarter. Liquidity and low rates benefited not only emerging market debt, but all risky assets, which have become highly correlated among themselves. However, in the case of emerging markets, and Latin American markets in particular, the driving forces go beyond abundant global liquidity: there were improvements not only in emerging market economies, but in the health and structure of the emerging market asset class as well. The improvements in cash flow positions and country balance sheet in many of the large sovereigns, which contributed to a wave of credit rating upgrades in the third quarter, associated with the fact that emerging market crisis have become more predictable and fewer (given the greater amount of macro information), and that very few countries continue to have fixed or pegged exchange rates, contributed to a remarkable progress in emerging markets credit quality.

For the first time in seven years all Latin American countries are expected to have positive economic growth, with the region as a whole expected to grow at 5% in 2004, and to keep growing in 2005. This growth is based on the recovery of domestic demand, the impetus given by the external

BOX 1:

During the third quarter of 2004, Moody's and/or Standard & Poor's announced upgrades or improved outlook changes in foreign currency debt were for eight countries, representing 38% of Merrill Lynch's emerging markets index. Venezuela was upgraded an average of 1.5 notches, while Brazil, Turkey, Bulgaria, Uruguay and the Ukraine were each upgraded one notch. As a result of these upgrades, emerging markets not only got better, but are now approaching the highest quality level they have ever been at. The speed in recent rating improvement is greater than at almost any time in the past, excluding compositional changes.*

Credit rating agencies increased their sovereign debt ratings in the third quarter for 15 Latin American countries (both local as well as foreign currency, and both long-term as well as short-term debt). ** With respect to foreign currency debt, in July, Uruguay and Paraguay were upgraded by Moody's. Uruguay was upgraded from B- to B (July 21), and Paraguay from SD (selective default) to B- with a stable outlook (July 26).

In August, the outlook for Bolivia was changed from negative to stable (August 4). Venezuela's long-term foreign currency debt was upgraded by Standard & Poor's from B- to B on August 25, while Moody's upgraded the Venezuelan debt from Caa1 to B2 on September 7.

Brazil's long-anticipated upgrade took place in September. Moody's upgraded Brazil's long-term foreign currency sovereign debt from B2 to B1 on September 9, while Standard & Poor's upgraded the Brazilian debt from B+ to BB- on September 17.

The only negative action in the quarter was the downgrade of Barbados to BBB+ from A- by Standard & Poor's on August 4 (see Appendix A, Table 1). In terms of the outlook for the near future, downgrade risks persist for Dominican Republic, but Moody's upgrade of Mexico remains likely.

* Merrill Lynch, Emerging Markets Monthly, 29 September 2004.
** BBVA Latin watch, September 2004.

* This document has been prepared on the basis of market views and developments. All data and information are from market sources, unless otherwise noted.

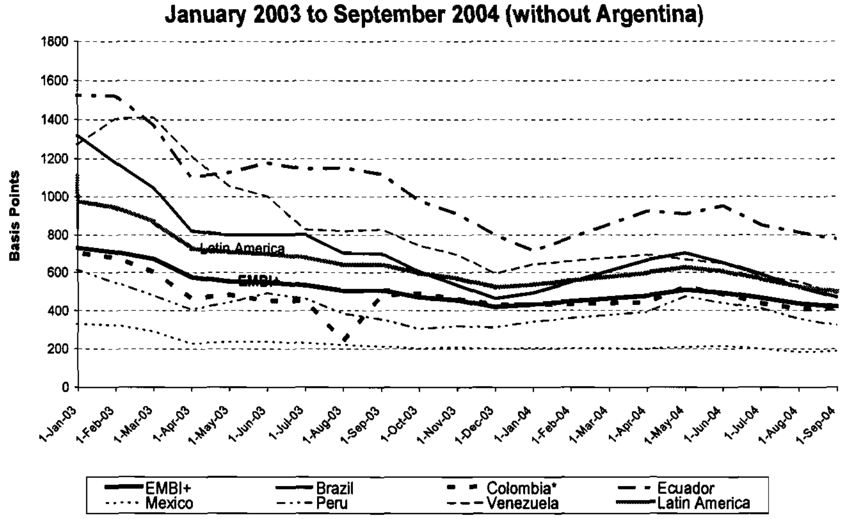
sector, especially due to higher commodity prices fueled by global economic recovery and strong demand from China, and a favorable international context. As a reflex of this performance, credit rating agencies increased their sovereign debt ratings for several Latin American countries in the third quarter of 2004. The most important upgrades were those carried out for the long-term foreign currency sovereign debt of Brazil and Venezuela (see Box 1 and appendix A, Table 1).

The wave of upgrades in the region led to a revival in new debt issuance in the third quarter. Issuance was also buoyed by a compression in spreads, as funds flowed into riskier assets as a result of the low interest rates and abundant liquidity. Spreads reversed course in mid-May and by the end of the third quarter had retraced most of the earlier increase of the second quarter. Latin American spreads decreased by 109 basis points during the quarter, from 607 bps at the end of June, to 498 bps at the end of September, after having reached a peak of 626 bps at the end of May. The supportive financing conditions have allowed for the near completion of 2004 external bond financing requirements as well as substantial pre-funding for 2005. Latin American issuers are estimated to have completed about one third of their external bond issuance plans for 2005 through end-October.

I. Bond Markets and Debt Management

Emerging market spreads, as measured by the J.P. Morgan EMBI+ index, declined from 493 bps at the end of June (after having reached a peak of 508 bps at the end of May), to 421 bps at the end of September. The Latin American component followed the movements of the EMBI+ index, starting at 607 bps at the end of June, to end at 498 bps by the end of September (see Chart 1).

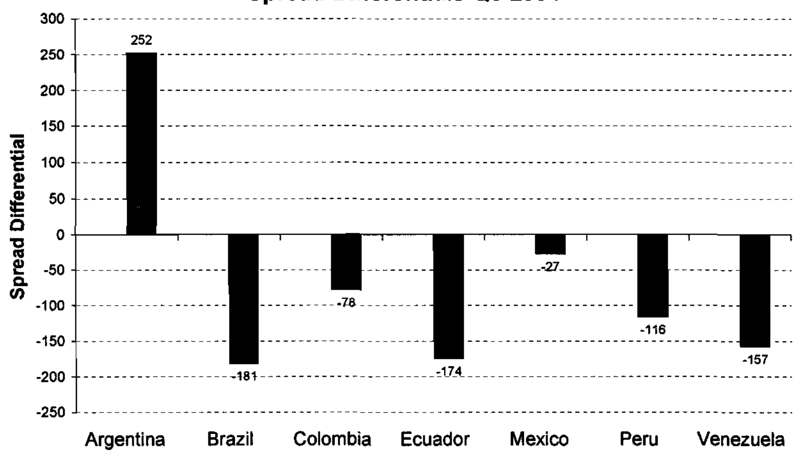
Chart 1:
Spreads on JP Morgan EMBI+ and Latin American Composites
January 2003 to September 2004 (without Argentina)



* The Colombia 7 5/8% due 07 and the Colombia 8 5/8% due 08 were added at the end of May 99.

Source: ECLAC, on the basis of data from "Emerging Markets Bond Index Monitor", JP Morgan.

Chart 2:
Spread Differentials Q3 2004

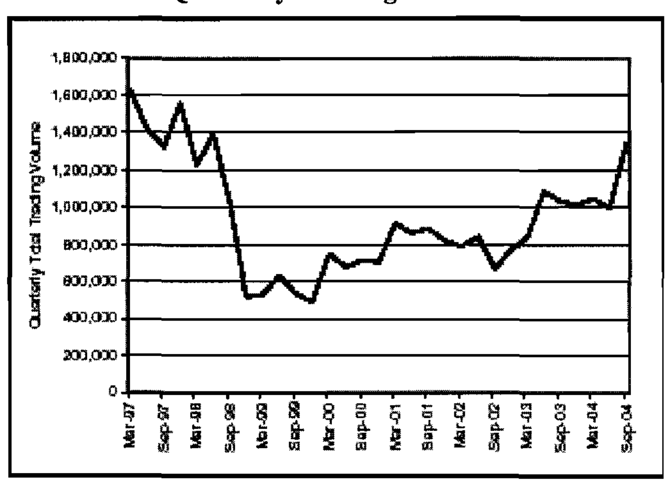


Source: ECLAC, on the basis of data from JP Morgan.

Spreads tightened for all major Latin American markets during the third quarter of 2004, with the exception of Argentina, whose spreads widened by 252 bps due to problems encountered after the initial debt restructuring terms were announced in June. Brazil, Ecuador and Venezuela showed the biggest spread tightening in the period: 181, 174 and 157 basis points, respectively, with Brazil and Venezuela's foreign currency debt receiving upgrades from all three main credit rating agencies in the quarter, while both Ecuador's and Venezuela's bonds were boosted by high oil prices (see Chart 2).

According to the Emerging Markets Traders Association (EMTA)[1], the emerging market trade volume stood at US$1.342 trillion in the third quarter of 2004, a 35% increase from the $997 trillion of the second quarter. This also represents a 23% increase compared with the $1.033 trillion reported during the third quarter of 2003. The survey results indicate that debt trading increased throughout most emerging market debt categories. Turnover was high in the third quarter because global conditions were favorable to the asset class. In addition, there were favorable local conditions as well, with a series of credit upgrades taking place during the quarter, involving some of the riskier credits such as Brazil and Venezuela. As a result of the current high liquidity, low yields, tight spreads, improved credit fundamentals and global flows into the emerging market asset class, emerging markets debt trading volume in dollar terms has risen sharply, and is approaching the peak trading volume levels reached before the Asia/Russia crises of 1997-1998 (see Chart 3).

Chart 3: Quarterly Trading Volume - Total

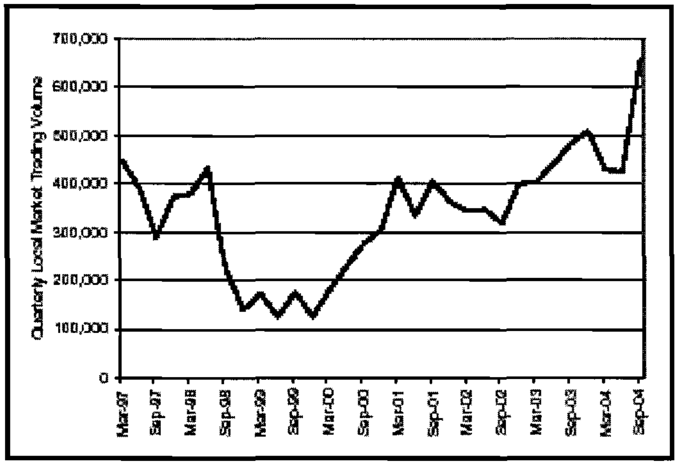


Source: EMTA

[1] Emerging Markets Traders Association, *EMTA Survey*, November 29, 2004.

Local instrument volumes accounted for 49% of reported volumes, standing at US$656 billion, a 54% increase from the 43% share and US$426 billion total of the second quarter. Participants reported large volumes for Mexican and Brazilian local instruments. Investors' focus on trading in local debt markets of various countries in the third quarter, especially long bonds of relatively low-rated sovereign debt (Brazil 2040s and Venezuela 2027s) reflects the willingness of investors to take on credit and currency risk and search for yield. The increasing importance of local markets trading can be seen in the evolution of the quarterly local market trading volume (see Chart 4).

Chart 4: Quarterly Trading Volume – Local Markets



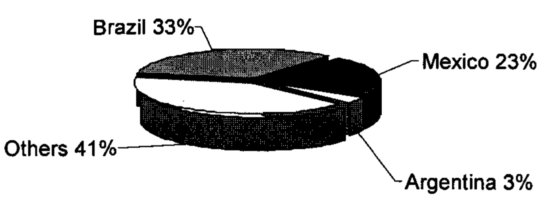
Source: EMTA

Brazilian debt instruments were the most frequently traded for the third consecutive quarter. With a reported total of US$448 billion, Brazilian instruments represented one third of total emerging markets trading volumes. This is a 38% increase from the second quarter and a 44% increase from the third quarter of 2003. Brazilian local instruments continued to lead the increase in Brazil's debt trading, rising from US$126 billion during the second quarter to US$207 billion during the third (a 64% increase).

Mexican debt instruments represented 23% of total emerging market trading. Mexico's debt trading increased by 48% in the third quarter, from US$204 billion in the second quarter to US$324 billion in the third. Much of the Mexican increase was due to a surge in Mexican local instrument trading (up 80% quarter-on-quarter to US$241 billion from US$134).

Chart 5:
Emerging Markets Debt Trading Volume: Country Shares

Trade Volume in Q3: US$ 1.342 trillion



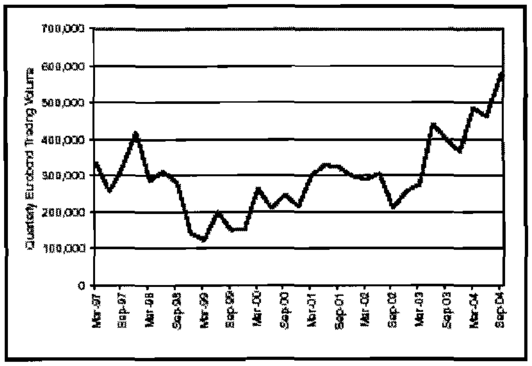
Source: EMTA

Argentina's debt instruments declined from fifth place to eighth, with trading amounting to US$38 billion (3% of reported volumes), down from US$46 billion during the second quarter (a 17% decline), but up from the US$12 billion reported in the third quarter of 2003 (a 68% increase).

At US$578 billion, Eurobond trading volume accounted for 43% of the volume. This compares to US$463 billion in the second quarter and a share of 46%. The Brazilian 2040 bond remained the most frequently traded individual Eurobond, at US$81 billion, while the Venezuelan 2027 bond kept the fourth spot with US$11 billion traded. Finally, Brady Bonds accounted for 6% of overall emerging market trading, slightly declining to US$79 billion (from US$80 billion during the second quarter). Eurobond trading volume has been replacing Brady bond and loan trading, which have been drifting gradually lower in the last 5 years (see Chart 6).

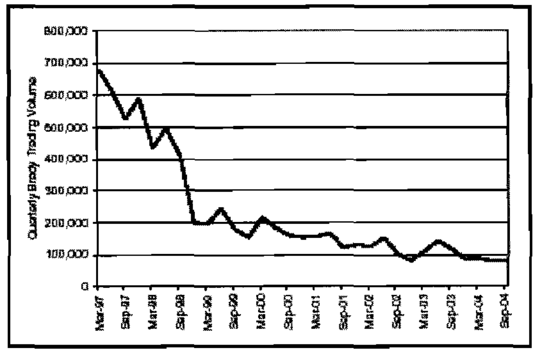
Chart 6: Quarterly Trading Volume: Eurobonds, Bradys and Loans

Eurobonds



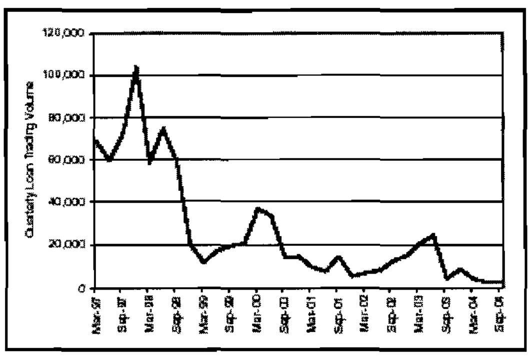
Source: EMTA

Bradys



Source: EMTA

Loans

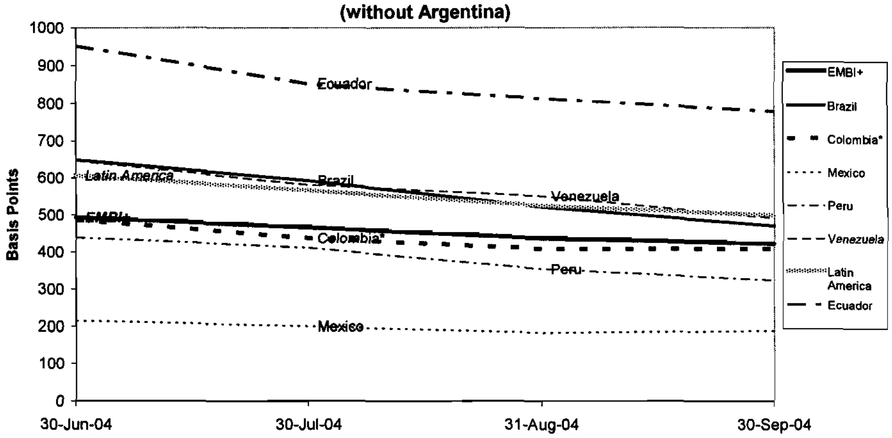


Source: EMTA

A. Spreads

Emerging market spreads started to reverse course in the second half of May and retraced most of the increase of the second quarter by the end of September. The EMBI+ tightened by 72 basis points in the third quarter, falling from 493 bps at the end of June to 421 bps at the end of September. Both the initial widening and the subsequent tightening of spreads were

Chart 7:
Spreads on JP Morgan EMBI+ and Latin American Composites
Q3 2004
(without Argentina)

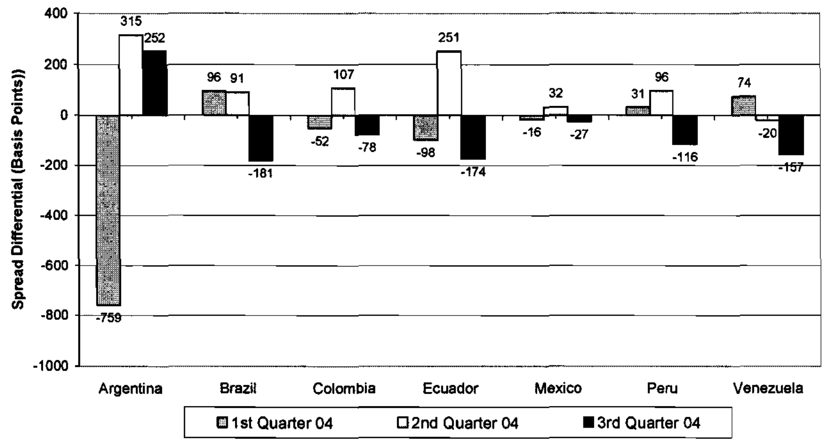


Source: ECLAC, on the basis of data from "Emerging Markets Bond Index Monitor", JP Morgan.

more pronounced for lower-rated credits (particularly oil exporters) than for investment-grade credits (Chart 7).

The Latin American component of the EMBI+ tightened by 109 bps in the third quarter, from 607 bps at the end of June to 498 bps at the end of September. It followed the same path of the EMBI+, and after a steady increase in April and May, it slowed down in June and continued to slow down during the third quarter. Spreads tightened for all Latin American countries in our sample, except Argentina (see Chart 8).

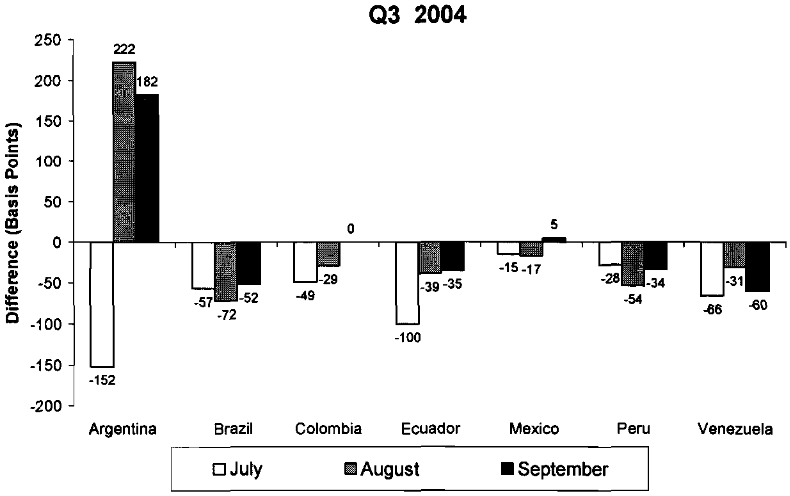
Chart 8:
Quarterly Spread Differential
Q1,Q2 and Q3 2004



Source: ECLAC, on the basis of data from JP Morgan.

Argentina was the only country in our sample to experience an increase in spreads in the third quarter. Spreads widened to 5440 bps at the end of September, from 5188 at the end of June, a 252 bps increase. Spreads tightened in July, only to widen again in August and September (Chart 9).

Chart 9:
Monthly Spread Differentials
Q3 2004



Source: ECLAC, on the basis of data from JP Morgan.

GDP data in August showed a deceleration of the economy. In addition, the government decided to postpone conversations with the IMF while staying current with the institution, after the Fund delayed the approval of the 3rd review in order to put pressure on the negotiations with private bondholders. The combination of negative news about the pace of the economy, together with the difficult debt restructuring negotiations, as well as the dealings with the IMF, adversely impacted bond spreads. The government is committed to present a debt restructuring proposal, even without the support of the IMF. It now seems that the proposal will not be presented before the end of the year, but it is likely to be presented in the beginning of 2005.

In the case of Brazil, creditworthiness warranted tighter spreads at the end of the third quarter. Spreads declined from 650 bps at the end of June to 469 bps at the end of September. The improvement in market conditions since May brought sovereign spreads back to the levels where they were in the beginning of the year. The factors that prompted the credit upgrade in September were the strong economic performance and improved fundamentals, combined with a bond-friendly backdrop in global markets. The favorable environment benefited Brazilian corporates, which became more active issuers during the third quarter.

In the case of Colombia, spreads were positively influenced by the acceleration of growth and the progress of the reelection bill. Spreads tightened by 78 bps, from 486 bps at the end of June to 408 at the end of September. However, uncertainty about the fate of fiscal reforms may dominate investors' expectations in the near future.

Spreads in Ecuador tightened by 174 bps in the third quarter, from 952 bps at the end of June to 778 bps at the end of September. Oil prices have been supportive, although financing conditions are tight, and political developments are currently less predictable. Ecuador, however, may be missing the opportunity brought about by high oil prices to improve longer-term creditworthiness, since it appears likely to spend this windfall to close its financing gap in the absence of an IMF program.

Mexican spreads remained relatively stable tightening by 27 bps during the third quarter. High oil prices are supportive and Mexico is a likely candidate for an upgrade by Moody's in the investment grade sector. In addition, the 2005 issuance needs are already covered. Mexico local markets have become very attractive to foreign-based investors, as it brings a wide array of instruments and low execution costs. With the front end of the external United Mexican States (UMS) bond curve trading at historically tight levels, the local market universe is now a very appealing option.

Spreads in Peru tightened by 116 bps in the third quarter, from 439 bps at the end of June to 323 bps at the end of September. The macroeconomic backdrop is good and there is an ongoing improvement in the country's growth outlook, despite the context of popular frustration with party politics and the president's performance.

Finally, Venezuelan spreads tightened by 157 bps, from 647 bps at the end of June to 490 bps at the end of September. A sharp recovery in economic activity was possible due to the substantive government liquidity resulting from the oil windfall, and Venezuela's credit rating was upgraded as a result. However, the political situation in the aftermath of the recall referendum is still complicated (although political confrontations are less likely to be a problem going forward) and economic policy, along with distortions and high costs, which could be exposed if oil prices drop, remain a source of concern to investors.

BOX 2
Bond Spreads versus Credit Ratings

Compared to credit ratings, market spreads reflect investor expectations and changing views of quality far more quickly than ratings. An array of different factors can cause market spreads to be different from the credit rating based value, such as, among others, oil prices, anticipation of a credit rating change, degrees of sensitivity to U.S. interest rates, political noise, dominance by local market investors. For example, Venezuela's tight spreads before it was upgraded by credit rating agencies in August and September showed that the market liked the country's fundamentals more than the agencies did. According to investors, Venezuela's credit rating was too low and could have been upgraded earlier.*

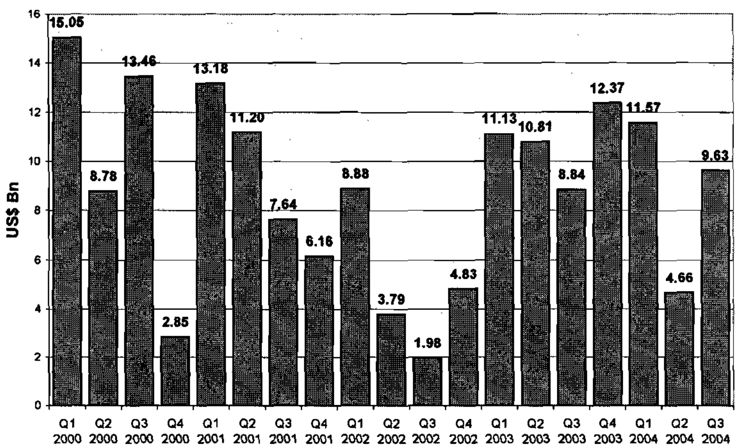
* *"Relative Value: The Value of a Credit Rating Change"*, Merrill Lynch, Emerging Markets Debt Monthly, 30 July 2004.

B. Issuance

According to Merrill Lynch, emerging market issuance in the third quarter of 2004 increased to US$31.3 billion from US$17.6 billion in the second quarter. The wave of new issuance responded to favorable borrowing conditions and falling yields, which reached record lows. Spread tightening and the improving credit quality of emerging market borrowers, reflected in the large number of credit upgrades, encouraged issuance and gave issuers the opportunity to borrow at better rates.

Latin American issuance, following the same pattern, also increased in the third quarter, with bond issuers placing a total of US$9.6 billion in international capital markets, a sharp increase from the US$4.7 billion issued in the second quarter (see chart 10).

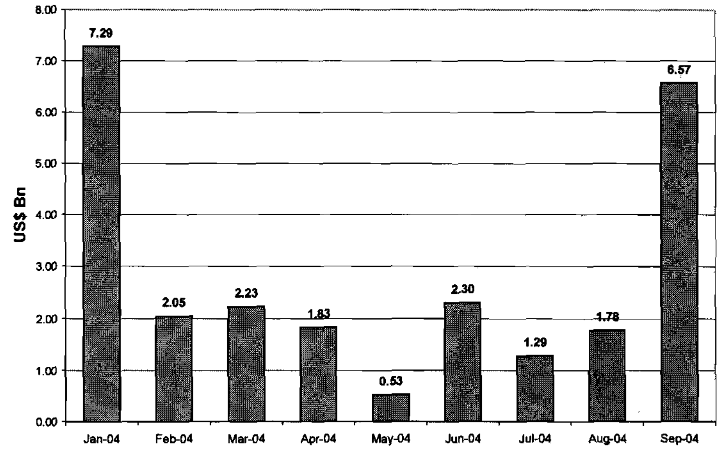
Chart 10:
Latin American Issuance by Quarter



Source: Merrill Lynch, Emerging Markets Debt Monthly, several issues.

Latin American issuance picked up sharply in September, standing at almost US$7 billion (see chart 11). This makes September the second highest monthly issuance in Latin America in more than four years, behind January only. Latin American sovereign issuers have now met this year's financing requirements and are looking at pre-finance for 2005, which is very advanced at this point. By the end of September Brazil had pre-funded US$0.2 billion of 2005's US$6 billion target, while Mexico had prefunded all of 2005's financing requirement. This is the earliest Brazil has ever started its pre-funding and the first time that Mexico has fully prefunded the following year's requirement.

Chart 11:
New Latin American Debt Issuance
2004 Year-To-Date

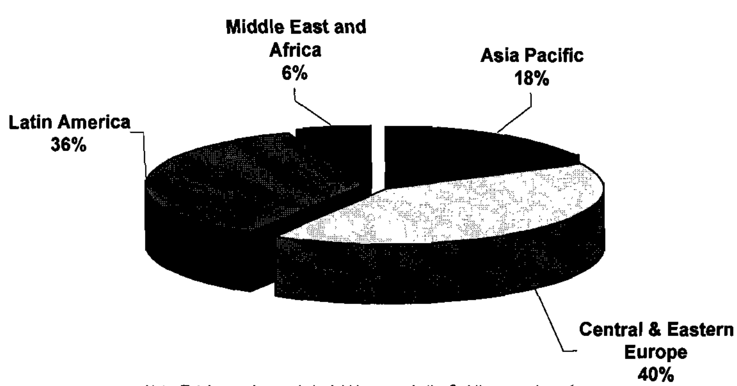


Source: Merrill Lynch, Emerging Markets Debt Monthly, several issues.

In Brazil, better economic performance boosted investor confidence. The Brazilian government was able to launch two big issues in the third quarter, one in July, worth US$750 million, and another in September, worth €750 million. In addition, Brazilian corporates encounter some success in seeking to refinance the high level of amortization payments due this year.

In the first week of October, capitalizing on low interest rates, Brazil and Peru offered a US$1 billion 15-year bond and a € 650 million 10-year bond respectively. Both countries increased the size of their offerings in order to get a big head-start on 2005 financing needs, a strategy being adopted by a growing number of emerging market countries as U.S. interest rate increases loom in the near future and threaten to increase borrowing costs. According to J.P. Morgan, by the end of October, Mexico, Brazil, Venezuela, and Peru had prefunded US$1.5 billion, US$1.2 billion, US$0.8 billion, and US$0.8 billion, respectively, for 2005. This pre-funding, as mentioned earlier, is well ahead of schedule and takes much of the pressure off issuers.

Chart 12:
Emerging Markets Debt Issuance: Regional Breakdown
Q1, Q2 and Q3 2004



Note: Total emerging markets debt issuance in the first three quarters of the year is US$73.1 billion.
Source: Merrill Lynch, Emerging Markets Debt Monthly, 29 September 2004

Regionally, Emerging Europe contributed to the largest share of total emerging market issuance up to the end of the third quarter. Latin America followed in second place, with 36% of total issuance (see Chart 12).

Issuance was nearly divided in half between corporates and sovereign. Corporate issuance in Latin America was US$4.37 billion dollars in the third quarter, which represented 45% of Latin American issuance, while sovereign issuance amounted to US$5.26 billion or 55% of Latin American issuance. Compared to the second quarter, corporate issuance was 1% higher, while sovereign issuance was 1% lower. Mexico and Brazil were the biggest sovereign issuers during the quarter, with as much as 80% of total Latin American issuance in the third quarter. Mexico alone issued nearly 50% of the third quarter Latin American total. Dollar-denominated debt represented 71.5% of the whole amount issued in Latin American in the third quarter, with euro-denominated debt following in second with a 25.9% share (see appendix C).

II. Portfolio Equity Flows into Latin America

During the third quarter of 2004, Latin American stocks gained 16.6% of its value according to the Morgan Stanley's MSCI (Morgan Stanley Capital International) Index.[2] The increase in the MSCI EM Latin American Index was mostly driven by increases in the Stock Price Index of Argentina (26.7%), Colombia (26.6%) and Brazil (25.7%). Among the seven biggest Latin American economies, all saw an increase of their Stock Price Index (see Table 1).

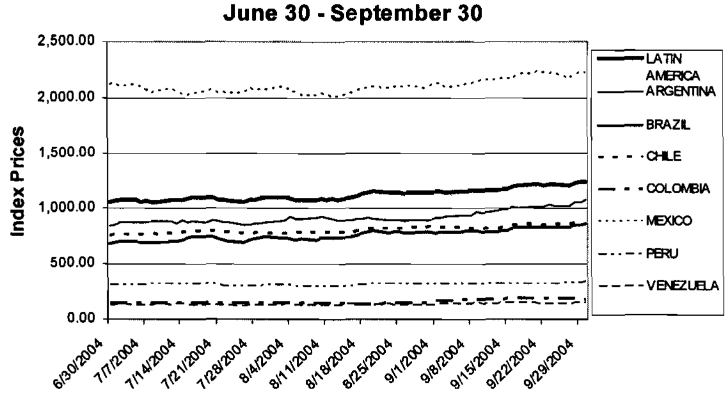
Table 1
Variation of Stock Price Indexes
Q3 2004

	30-Jun-04	*30-Sep-04*	*Variation*
Emerging markets	432.2	464.15	7.39%
Latin America	1062.432	1238.274	16.55%
Argentina	847.804	1073.742	26.65%
Brazil	686.372	862.926	25.72%
Chile	762.034	870.484	14.23%
Colombia	145.813	184.644	26.63%
Mexico	2114.104	2222.418	5.12%
Peru	308.745	340.487	10.28%
Venezuela	131.65	149.409	13.49%

Source:MSCI Equity Indices, http://www.msci.com/equity/index2.html

Latin American equity markets were particularly hit during April and May, with the Latin American Index falling by 12% as concerns mounted about the prospects of higher global interest rates. In the third quarter, however, expectations of a continued low interest rate environment supported equity valuations, leading to a recovery that allowed for moderate price gains (Chart 13). Favorable earning prospects, Latin American companies' own acquisitions and restructurings, rising commodity prices, improving domestic growth and strengthened credit quality boosted stock prices in Latin American markets.

Chart 13:
MSCI Equity Indexes Prices
June 30 - September 30



Source:MSCI Equity Indices, http://www.msci.com/equity/index2.html

On the other hand, new equity issuance by Latin American firms remained low. With only five of the region's corporates having been able to raise fund in the first half of the year, Latin America's share in total emerging market equity issues remained at a low 3%.[3]

[2] The MSCI EM (Emerging Markets) Latin America Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in Latin America. As of June 2004 the MSCI EM Latin America Index consisted of the following 7 emerging market country indices: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

[3] IMF, *Global Financial Stability Report*, September 2004.

III. Bank Lending

According to the latest available information on actual international bank lending by the Bank for International Settlements[4], in the second quarter of 2004 reporting banks' claims continued to shift away from Latin America, with claims on Latin America declining by 2.4%. A relatively large decline in claims on borrowers in Chile (4.8%), Argentina (3.3%), Mexico (3.1%) and Brazil (1.4%), drove total foreign claims in the region down to US$475 billion (see Table 2). As a result, the share of total foreign claims on Latin America fell to 28% of total foreign claims on emerging markets, from 30% in the previous quarter and 35% a year earlier. U.S. banks reduced international claims on the region the most, primarily vis-à-vis Mexico. Moreover, claims on Latin America have drifted away from the non-bank private sector. International claims on this sector fell to 59.5% of all international claims on Latin America, from 61.4% in the previous quarter and 64% a year earlier.

Table 2
BIS Consolidated banking statistics
Developing Latin America & Caribbean

Positions at end of period	Foreign claims on a contractual basis							
	Total	Local claims in local currencies	International claims					
			Total	*By maturity**		*By sector**		
				Short-term**	Long-term***	Banks	Public sector	Non-bank private sector
Borrowers in:	In billions of USD			As a % of international claims				
Developing Countries								
Q1 2004	1,646.9	650.6	996.3	47.3	41.8	29.9	19.5	49.5
Q2 2004	1,682.0	689.8	992.1	45.9	42.5	30.8	18.6	49.4
Latin America & Caribbean								
Q1 2004	486.7	261.2	225.5	45.4	47.2	17.9	19.4	61.4
Q2 2004	474.8	258.7	216.1	44.4	47.8	18.2	20.9	59.5
Argentina								
Q1 2004	33.3	11.7	21.6	45.8	45.7	16.4	25.2	58.4
Q2 2004	32.2	11.8	20.5	46.1	44.8	16.8	26.5	56.6
Brazil								
Q1 2004	111.7	54.4	57.2	47.6	41.7	23.4	16.1	58.0
Q2 2004	110.1	55.3	54.7	47.4	42.1	25.4	17.2	54.7
Chile								
Q1 2004	48.1	27.1	21.0	49.4	45.2	21.3	12.2	66.5
Q2 2004	45.8	25.7	20.2	48.4	44.9	20.4	13.0	66.6
Mexico								
Q1 2004	216.2	147.1	69.1	39.4	55.5	14.3	23.6	62.0
Q2 2004	209.4	144.6	64.8	35.2	59.2	12.7	26.3	60.9
Peru								
Q1 2004	12.6	2.9	9.7	57.0	34.3	19.9	10.2	69.9
Q2 2004	12.9	2.9	10.0	57.8	32.9	22.4	10.2	67.4
Venezuela								
Q1 2004	18.1	6.5	11.5	30.1	64.5	3.7	32.9	63.3
Q2 2004	18.1	7.0	11.0	31.6	63.3	4.6	35.9	59.3
Other								
Q1 2004	46.8	11.4	35.4	52.8	39.9	19.2	15.4	61.7
Q2 2004	46.3	11.3	35.0	53.6	38.5	19.9	16.3	60.0

Source: BIS, Consolidated banking statistics, second quarter 2004.

* Owing to the ommission of the unallocated item, the percentage shares do not total 100.

** Claims with a remaining maturity of up to and including one year. *** Claims with a remaining maturity of over one year.

[4] *BIS, Consolidated banking statistics for the second quarter of 2004*, October 2004.

However, although foreign bank lending seems to be shifting away from Latin America, there has been a strong recovery in local bank financing as a result of the improvement in economic conditions and the healthy situation of Latin America's main banking systems (bank's earnings, nonperforming loan ratios, and reported capital positions showed improvement).

Credit to the Latin American private sector in the first half of 2004 grew 10% in real terms, against a decline of 3% at the end of 2003. This growth applied to all Latin American countries (with the exception of Peru). Venezuela registered a big momentum in the second quarter of the year, during which credit growth in real terms reached 54%. The recovery in credit to the private sector was also significant in Argentina, which in June registered real positive growth of 6%, for the first time in the past five years.[5]

The healthy economic environment has also favored financial saving. Bank deposits in real terms, according to the BBVA Research Department, grew by 8% in the first half of the year, doubling the growth rate at the end of 2003. Given the favorable economic prospects for Latin America, financial saving should continue to grow over the coming months. In addition, the current positive global backdrop, combined with healthy and solvent banking systems in the majority of the economies of the region, should give a push to bank lending in coming months.

[5] BBVA *Latin watch*, Research Department, September 2004.

IV. Prospects

In the third quarter, the driving forces behind movements in emerging and Latin American markets were the beneficial global backdrop of abundant liquidity and active search for yield by investors, and improvements not only in emerging market economies' fundamentals, but in the health and structure of the emerging market asset class as well.

Improvements in the health of the asset class were possible because unlike in previous liquidity cycles, emerging market countries have been using the current cycle to "deleverage". Countries are taking greater advantage of global liquidity because this time around the external adjustment took place before the liquidity boom. The improvement in fundamentals, on the other hand, are the result of the growth in exports, which benefited from global demand and the wider use of flexible exchange rates in emerging markets, especially in Latin America.

The improvements in fundamentals and in the health of the asset class resulted in improved credit quality, which was reflected in a series of upgrades taking place during the quarter. Spread tightening and the improving credit quality of emerging market borrowers encouraged issuance and gave issuers the opportunity to borrow at better rates. Funding for 2004 has been completed, and pre-financing for 2005 already started to take place in the third quarter, and was greater than usual. Pre-financing for 2005 should accelerate in the fourth quarter.

The upgrade of Brazil to B2 by Moody's and to BB- by Standard & Poor's in September is viewed by many market analysts as a key event and a positive catalyst for the entire emerging market asset class, particularly for Latin America. The uptrend in credit ratings should continue and an upgrade of Mexico by Moody's in coming months is likely.

Uncertainties regarding the performance of the U.S. economy and the risk of higher U.S Treasury yields, as well as the implication on global growth of very high oil prices, are likely to remain as concerns to investors for some time, which could adversely affect investor sentiment and reverse the positive trend in capital flows. However, emerging market and Latin American debt should remain supported by good fundamentals, strong technical positions and favorable valuations. As long as fundamentals remain sound, the asset class should continue to be attractive to investors, and emerging market endogenous risk factors will continue to be scarce.

APPENDIX

A. **Credit Ratings in Latin America**
B. **Latin American Spreads**
C. **New Latin American Debt Issuance**

A. Credit Ratings

Table 1:

Credit Ratings in Latin America								
	Moody's		S&P		Recent Moody's Action		Recent S&P Action	
	Rating	View	Rating	View	Action	Date	Action	Date
Argentina	Caa1	-	SD	-	Upgrade, stable	20-Aug-03	Downgrade	6-Nov-01
Barbados	Baa2	-	**BBB+**	**-**	Upgrade, stable	8-Feb-00	**Downgrade, stable**	**5-Aug-04**
Bolivia	Caa1	-	**B-**	**-**	Downgrade, stable	16-Apr-03	**O/L changed to stable**	**4-Aug-04**
Brazil	**B1**	**-**	**BB-**	**-**	**Upgrade, stable**	**9-Sep-04**	**Upgrade, Stable**	**17-Sep-04**
Chile	Baa1	-	A	-	Affirmed, stable	1-Mar-00	Upgrade, stable	14-Jan-04
Colombia	Ba2	oo	**BB**	**-**	O/L changed to (-)	27-Mar-02	**Affirmed, stable**	**17-Sep-04**
Costa Rica	Ba1	oo	BB	oo	O/L changed to (-)	16-Apr-03	Affirmed, O/L (-)	24-Jun-04
Cuba	Caa1	-	nr	-				
Dominican Republic	B3	oo	**CC**	**oo**	Downgrade O/L (-)	30-Jan-04	**Affirmed, O/L (-)**	**11-Aug-04**
Ecuador	Caa1	-	CCC+	-	Upgrade, stable	24-Feb-04	Affirmed, stable	23-Dec-03
El Salvador	Baa3		**BB+**	**-**	O/L changed to (-)	18-Dec-03	**Affirmed, stable**	**10-Sep-04**
Guatemala	Ba2	-	BB-	-	Affirmed, stable	1-Mar-00	Affirmed, stable	30-Jul-03
Honduras	B2	-	nr	-	Affirmed, stable	3-Feb-00		
Jamaica	B1	-	B	oo	Downgrade, stable	27-May-03	Downgrade, O/L (-)	28-Jul-03
Mexico	Baa2	o	BBB-	-	O/L changed to (+)	12-Mar-03	Affirmed, stable	11-May-04
Nicaragua	B2	-	nr	-	Affirmed, stable	30-Mar-00		
Panama	Ba1	-	BB	oo	Affirmed, stable	7-May-03	O/L changed to (-)	10-Mar-03
Paraguay	Caa1	-	**B-**	**oo**	Downgrade, stable	28-Apr-03	**Upgrade,O/L to stable**	**26-Jul-04**
Peru	Ba3	-	BB	-	Affirmed, stable	28-Oct-02	Upgrade, stable	8-Jun-04
Trinidad & Tobago	Baa3	-	BBB+	o	Affirmed, stable	30-Aug-00	Upgrade, O/L (+)	16-Jun-04
Uruguay	B3	oo	**B**	**-**	Affirmed, O/L (-)	9-May-03	**Upgrade, stable**	**21-Jul-04**
Venezuela	**B2**	**-**	**B**	**-**	**Upgrade, stable**	**7-Sep-04**	**Upgrade, stable**	**25-Aug-04**

- stable outlook; o *positive outlook*; oo *negative outlook*. ***Changes for the third quarter of 2004 are highlighted.***
Note: Moody's ratings are qualified by outlooks and reviews while S&P ratings are qualified by outlooks and watches.
A review/watch is indicative of a likely short-term development.
An outlook suggests that a review/watch or long/intermediate-term movement is likely.

Source: JP Morgan, Emerging Markets Outlook, September 30, 2004. Changes for the third quarter are highlighted.

Rating Scale					
	MOODY's	S&P		MOODY's	S&P
Upper Investment Grade	Aaa	AAA	Lower Non-Investment Grade	B1	B+
	Aa1	AA+		B2	B
	Aa2	AA		B3	B-
	Aa3	AA-		Caa1	CCC+
	A1	A+		Caa2	CCC
	A2	A		Caa3	CCC-
	A3	A-		Co	CC
Lower Investment Grade	Baa1	BBB+		C	C
	Baa2	BBB+	Default		SD
	Baa3	BBB-			D
Non-Investment Grade	Ba1	BB+			
	Ba2	BB			
	Ba3	BB-			

B. Latin American Spreads

Table 2:

Sovereign Spreads on JP Morgan EMBI+ and Latin American Composites

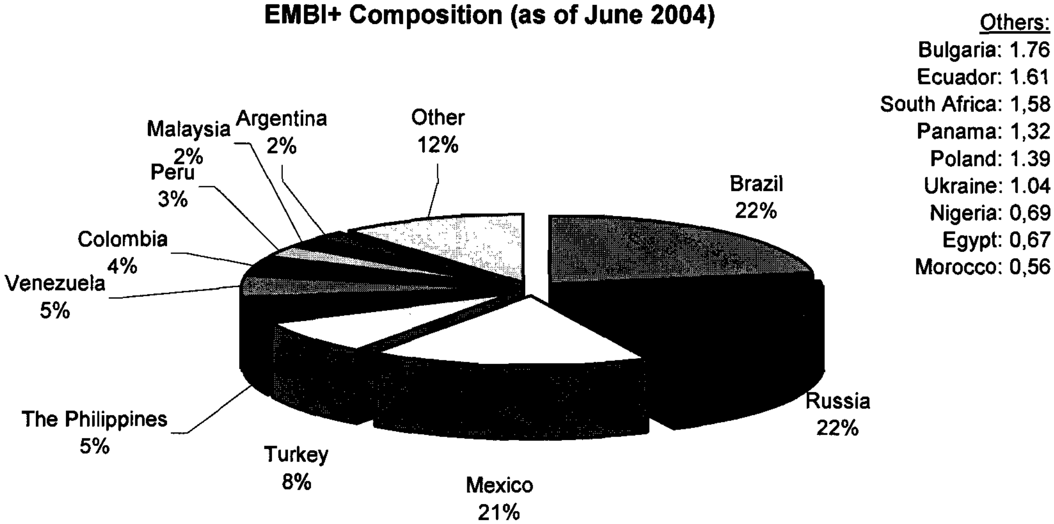
	EMBI+	Argentina	Brazil	Colombia*	Ecuador	Mexico	Peru	Venezuela	Latin America
31-Jul-98	633	454	608	n.a.	1371	461	515	829	554
31-Aug-98	1524	1278	1421	n.a.	2077	941	941	2575	1328
30-Sep-98	1330	904	1326	n.a.	1903	911	911	1558	1111
31-Oct-98	1190	779	1192	n.a.	1484	819	755	1372	980
30-Nov-98	1070	664	975	n.a.	1221	737	610	1612	858
31-Dec-98	1151	707	1231	n.a.	1631	741	612	1283	941
31-Jan-99	1288	858	1507	n.a.	2055	801	743	1463	1106
28-Feb-99	1330	794	1376	n.a.	2405	722	663	1393	1028
31-Mar-99	1171	683	1041	n.a.	1973	600	562	1121	839
30-Apr-99	1010	596	873	n.a.	1553	532	396	789	709
28-May-99	1157	786	1066	671	1862	647	603	1108	880
30-Jun-99	1070	758	957	667	2113	623	609	896	832
30-Jul-99	1147	853	1053	691	2473	677	610	1024	919
31-Aug-99	1166	776	1124	700	3402	644	700	1174	931
30-Sep-99	1098	663	984	613	4764	596	635	925	823
29-Oct-99	1010	635	851	505	3705	535	613	836	743
30-Nov-99	927	650	806	549	3093	449	526	940	715
31-Dec-99	824	533	636	423	3353	363	443	844	597
31-Jan-00	904	594	758	482	4033	438	482	894	682
20-Feb-00	816	551	688	524	3227	364	432	792	616
31-Mar-00	798	568	679	547	3111	354	518	879	623
28-Apr-00	708	572	742	740	3350	385	512	952	654
31-May-00	784	702	792	739	4499	438	611	985	737
30-Jun-00	712	676	722	722	3926	381	546	895	679
31-Jul-00	680	650	712	662	2846	353	522	837	654
31-Aug-00	643	681	672	686	1340	321	496	780	618
29-Sep-00	677	675	705	722	1261	318	664	798	634
31-Oct-00	745	815	758	768	1331	365	759	860	707
30-Nov-00	805	879	829	818	1441	385	772	902	759
29-Dec-00	756	773	749	755	1415	392	687	958	706
31-Jan-01	674	663	677	697	1230	363	674	838	631
28-Feb-01	748	803	753	646	1268	428	637	850	710
30-Mar-01	784	960	811	645	1366	414	650	874	763
30-Apr-01	773	1039	812	634	1482	366	824	833	766
31-May-01	751	993	858	600	1366	326	774	852	761
29-Jun-01	766	1050	847	541	1303	310	632	847	803
31-Jul-01	940	1599	972	585	1454	360	661	925	1016
31-Aug-01	885	1430	954	540	1411	354	601	916	959
28-Sep-01	1005	1615	1165	626	1516	431	669	995	1103
31-Oct-01	1073	2162	1163	628	1558	412	651	1034	1055
30-Nov-01	1069	3372	976	545	1393	357	572	1055	1119
31-Dec-01	731	4372	863	514	1233	308	521	1130	711
31-Jan-02	713	4379	866	586	1144	304	468	1254	837
28-Feb-02	644	4276	785	651	1147	272	474	1046	765
28-Mar-02	598	5062	718	536	1037	251	419	890	713
30-Apr-02	619	5004	849	578	1000	255	492	873	763
31-May-02	650	5979	981	567	1184	265	512	933	829
28-Jun-02	799	7074	1548	613	1262	323	628	1111	1063
31-Jul-02	991	7008	2341	930	1780	390	865	1226	1350
30-Aug-02	886	6430	1630	898	1704	360	774	1028	1131
30-Sep-02	1041	6553	2395	1084	1975	436	880	1162	1399
31-Oct-02	862	6192	1742	841	1854	372	742	1068	1153
29-Nov-02	778	6240	1606	694	1696	311	636	943	1054
31-Dec-02	765	6391	1446	645	1801	331	610	1127	1007
31-Jan-03	730	6022	1319	703	1524	329	613	1275	977
28-Feb-03	707	6736	1182	676	1522	324	547	1406	943
31-Mar-03	671	6165	1048	602	1372	291	478	1412	869
30-Apr-03	576	5225	822	465	1103	227	407	1215	727
31-May-03	553	5343	799	483	1128	236	443	1056	707
30-Jun-03	547	4554	801	451	1178	237	491	1002	697
31-Jul-03	532	5046	801	452	1147	230	462	828	678
31-Aug-03	504	4882	703	421	1153	220	383	820	639
30-Sep-03	506	5484	698	478	1121	212	355	828	641
31-Oct-03	470	5752	605	490	978	202	304	742	595
28-Nov-03	455	6260	533	460	910	208	319	693	570
31-Dec-03	418	5632	463	431	799	199	312	593	521
30-Jan-04	432	5764	493	430	714	204	343	641	536
27-Feb-04	449	5815	579	426	762	189	356	733	568
31-Mar-04	403	3449	508	360	668	182	349	510	490
30-Apr-04	478	4628	663	443	925	201	393	692	598
28-May-04	508	4964	701	523	909	208	473	666	626
30-Jun-04	493	5188	650	486	952	215	439	647	607
30-Jul-04	466	5036	593	437	852	200	411	581	566
31-Aug-04	436	5258	521	408	813	183	357	550	524
30-Sep-04	421	5440	469	408	778	188	323	490	498
	EMBI+	Argentina	Brazil	Colombia*	Ecuador	Mexico	Peru	Venezuela	Latin America

Source: "Emerging Markets Bond Index Monitors"; JP Morgan

* The Colombia 7 5/8% due 07 and the Colombia 8 5/8% due 08 were added at the end of May 99.

EMBI+ composition by market sector (end-September 2004): Brady, 24.27%; Benchmark Eurobonds, 75.22%; Loans, 0.51%.
by country: Brazil and Mexico account for 43.08% of the total weighting.
by region: Latin: 60.06%; Non-Latin: 39.94%.

EMBI+ Composition (as of June 2004)



C. New Latin American Debt Issuance

C1. July 2004

New Latin American Debt Issuance

Third Quarter of 2004

Jul-04

Country	Issuer	Amount US$ (mm)	Maturity
Brazil	Federative Republic of Brazil	750	14-Jul-14
Brazil	Banco Votorantim	125	19-Jul-06
Mexico	Vitro Envases Norteamerica	170	16-Jul-04
Jamaica	Republic of Jamaica	241	27-Jul-12
Total		**1,286**	

Source: ECLAC, on the basis of data from Merrill Lynch, "Emerging Markets Daily".

***July average maturity*: 8.28 years.**

Currency Breakdown

(% of Latin America's Total)

Currency	Jul-04
Dollar	81.00%
Euro	19.00%
Yen	0.00%
GBP	0.00%

Source: Merrill Lynch

Issuer Type Breakdown

(% of Latin America's Total)

Issuer Type	Jul-04
Sovereign	71.77%
Corporate*	28.23%

*Also includes bank issuance.

Source: Merrill Lynch

C2. August 2004

New Latin American Debt Issuance Third Quarter of 2004 Aug-04			
Country	**Issuer**	**Amount US$ (mm)**	**Maturity**
Mexico	Pemex	1,025	5-Aug-16
Uruguay	Republic of Uruguay	250	4-Feb-06
Mexico	United Mexican States	500	13-Jan-09
Total		**1,775**	

Source: ECLAC, on the basis of data from Merrill Lynch, "Emerging Markets Daily".

***August average maturity*: 8.55 years.**

Currency Breakdown
(% of Latin America's Total)

Currency	Aug-04
Dollar	28.17%
Euro	57.75%
Yen	0.00%
GBP	0.00%
Other	14.08%

Source: Merrill Lynch

Issuer Type Breakdown
(% of Latin America's Total)

Issuer Type	Aug-04
Sovereign	53.75%
Corporate*	42.25%

*Also includes bank issuance.

Source: Merrill Lynch

C3. September 2004

New Latin American Debt Issuance Third Quarter of 2004 Sep-04			
Country	**Issuer**	**Amount US$ (mm)**	**Maturity**
Brazil	Banco Bradesco SA	100	2-Sep-06
Brazil	Banco Votorantim	100	10-Sep-07
Brazil	Petrobras	600	15-Sep-14
Brazil	Banco do Brasil	300	20-Sep-14
Colombia	Republic of Colombia	500	22-Dec-14
El Salvador	Republic of El Salvador	286	21-Sep-34
Brazil	Federative Republic of Brazil	920	24-Sep-12
Brazil	CSN Islands Corporation	200	15-Jan-15
Mexico	United Mexican States	1500	27-Sep-34
Mexico	Pemex	1750	28-Sep-09
Brazil	Federative Republic of Brazil	311	24-Sep-12
Total		**6,567**	

Source: ECLAC, on the basis of data from Merrill Lynch, "Emerging Markets Daily".

***September average maturity*: 13.56 years.**

Currency Breakdown
(% of Latin America's Total)

Currency	Sep-04
Dollar	81.25%
Euro	18.75%
Yen	0.00%
GBP	0.00%
Other	0.00%

Source: Merrill Lynch

Issuer Type Breakdown
(% of Latin America's Total)

Issuer Type	Sep-04
Sovereign	53.56%
Corporate*	46.44%

*Also includes bank issuance.

Source: Merrill Lynch