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KEY POLITICAL RISKS TO WATCH IN LATIN AMERICA

The transition to a new government in Brazil, drug violence in Mexico and presidential elections in Peru and Argentina are among the political events in Latin America that could pose risks for investors in 2011



BY TERRY WADE LIMA, DEC 21

BRAZIL

WHAT TO WATCH FOR:

- Slower economic growth and changes in government spending and tax policies.
- Political pressure on the central bank.

President-elect Dilma Rousseff, a protege of President Luiz Inacio Lula da Silva, has gone a long way to allay investor concerns over slipping fiscal discipline and central bank autonomy since her Oct. 31 election victory, naming an experienced economic team that suggests policy continuity.

But the career technocrat, who has never held elected office before, has yet to prove she can deliver on pledges to run a more austere budget. She will likely face opposition from members of her Workers' Party, civil servants and pensioners.

Lula's recent comments that he could run for president again in 2014 or later could weaken Rousseff as she tries to assert control.

There are also concerns that Brazil's stellar economic growth could slow and that



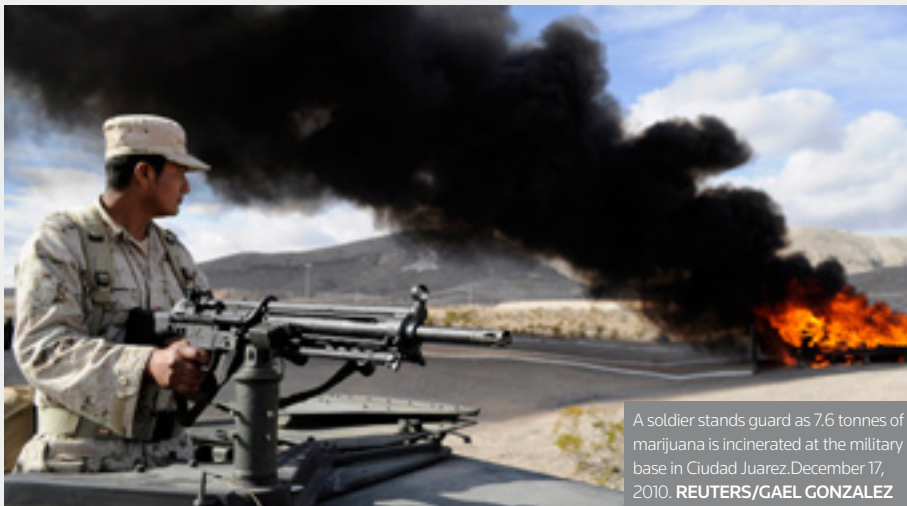
Brazil's new president Dilma Rousseff and former president Lula da Silva, both of the Workers' Party, wave during a campaign rally in Diadema, Brazil. October 23, 2010. REUTERS/NACHO DOCE

Rousseff will give the state a bigger role in key areas of the economy, especially the vast oil industry.

Possible interest rate rises by the central bank, less fiscal stimulus, and a currency that is leaving exports less competitive could

sharply trim economic growth from 2010's expected pace of 7.6 percent.

Some analysts have voiced concerns that asset bubbles have formed in Brazil as yield-hungry foreign investors pour billions into the country. ■



A soldier stands guard as 7.6 tonnes of marijuana is incinerated at the military base in Ciudad Juarez. December 17, 2010. REUTERS/GAEL GONZALEZ

MEXICO

WHAT TO WATCH FOR:

- Growth or contraction in exports.
- Escalating violence hurting Calderon's support.

Mexico will struggle next year to keep up the pace of recovery from its deep recession in 2009 and will face mounting challenges in the war against powerful drug cartels.

President Felipe Calderon's government has jailed hundreds of cartel henchmen, seized some 90,000 weapons, and captured major drug lords including Edgar "La Barbie" Valdez.

But investors and businesses are concerned that attacks -- beheaded corpses strung up from bridges, women and children gunned down at parties-- are smearing Mexico's reputation as an attractive market for foreign investment and a leading destination for U.S. and European tourists.

The drugs war has not yet become a major drag on Mexico's peso or bond yields, but violence is becoming a real business concern.

Although he has solid approval ratings, Calderon is unlikely to get labor and tax reforms approved by Congress as political parties jockey for position ahead of the next presidential election in 2012. Under Mexico's constitution, Calderon is unable to run again and his conservative National Action Party trails in opinion polls.

The lack of reforms could hurt long-term growth. Expansion was forecast at 4.5 percent in 2010 after a 6.1 percent contraction in 2009. It is expected to grow around 3.6 percent in 2011.

Whether the recovery continues will depend in large part on exports to the United States and monetary policy decisions by the central bank. ■



Native people hold spears during a protest in Bagua province, a remote Amazon region of northern Peru. Peru has lured mining companies to pour \$35 billion into new projects over the next decade, but more and more investors are facing unpredictable local opposition and the threat of violence or lawsuits. June 4, 2009. REUTERS/FELIX PARICAHUA

PERU

WHAT TO WATCH FOR:

- A surprise rally by Humala in campaign polls.
- Violent protests over mining and oil projects.
- Escalating drugs war.

The three front-runners in the race for Peru's April 10 presidential election all favor mainstream economic policies that have been in place for much of the past 20 years.

Left-wing nationalist Ollanta Humala, who scared investors when he nearly won the 2006 race, trails well behind in polls. He has cast himself as more of a moderate this time around but he continues to languish. Unless he can catch up, the contest will be fought by a clutch of parties in the center or on the right, averting pressure on local markets.

Peru's economy is forecast to grow about 6 percent in 2011, after an expansion of almost

9 percent this year. While growth has cut the poverty rate to about 35 percent, social tensions linger.

Peru's human rights office says more than 100 communities have organized to stop big mining or petroleum projects planned by foreign firms, potentially delaying billions in foreign investment.

Peru has overtaken Colombia as the No. 1 producer of coca leaf used to make cocaine. The government will likely look to step up its drugs war in 2011 but has struggled to stamp out remnant bands of Shining Path rebels in the drug trade. ■



Venezuela's President Hugo Chavez talks during a ceremony at Miraflores Palace in Caracas. February 10, 2010.

REUTERS/CARLOS GARCIA RAWLINS

VENEZUELA

WHAT TO WATCH FOR:

- More nationalizations.
- Deeper economic trouble.
- Clashes with parliament.

President Hugo Chavez will legislate by decree throughout 2011 after his allies in parliament recently gave him decree powers for 18 months. The move aims to halt the advance of opposition parties, which did well in September elections and will have a much bigger bloc in the new parliament. Opposition leaders have condemned the move as authoritarian and will likely redouble their efforts to find a single candidate to challenge Chavez at the next presidential election in 2012. [ID:nN13230687]

The socialist leader's drive to nationalize companies and the country's tepid economic performance also poses risks for investors. More

than 200 companies passed into state hands in 2010, a time of economic contraction and inflation, and parliament recently passed a law making it easier for Chavez to nationalize financial institutions.

The OPEC member's economy should grow next year, but it may still struggle unless there is a leap in oil prices.

Risk indicators like Morgan Stanley's EMBI+ and CDI spreads consistently rate Venezuelan debt as the highest default risk in the world. But few think Venezuela will default thanks to its large oil production and history of meeting its obligations.

A draft of a bill obtained by Reuters showed plans to tighten control over the oil services sector. If passed it could affect companies such as Schlumberger, Halliburton and Baker Hughes. ■

ARGENTINA

WHAT TO WATCH FOR:

- Fernandez's decision on whether to run for re-election or not.
- Other candidates emerging, especially if there are challengers to Fernandez inside ruling Peronist party.
- Government moves to ensure access to billions in foreign currency reserves to pay debt next year.
- Any sign the Senate could approve a bill to reform the questioned INDEC national statistics agency in March.
- Any labor unrest when wage talks start in March or April, and social protests linked to skyrocketing prices.

President Cristina Fernandez has not said whether she will run for a second term at the presidential election in October. Her husband and predecessor, Nestor Kirchner, had been expected to run but his death in late October turned Argentine politics on its head and there is considerable uncertainty over which candidates will emerge.



Argentine President Cristina Fernandez de Kirchner stands with her daughter Florencia and her son Maximo in front of the coffin of her late husband, former president Nestor Kirchner, at his wake in the Presidential Palace. October 28, 2010. REUTERS/HO NEW

Kirchner's death also robbed Fernandez of her closest ally and drove Argentine bond and stock prices higher as investors bet it would eventually put an end to the couple's interventionist economic policies.

Several recent announcements, such as a surprise overture to the International Monetary Fund (IMF) on the country's

discredited inflation data, suggest Fernandez is taking a more pragmatic approach.

But with a record soy and corn harvest swelling state coffers and the economy booming, Fernandez is expected to maintain brisk social spending as the election draws nearer, prioritizing growth despite inflation risks. ■



A car bomb placed by FARC exploded in front of the police station in Vegalarga in Huila province. December 1, 2010. REUTERS/GERARDO VILLEGAS

COLOMBIA

WHAT TO WATCH FOR:

- Urban attacks by FARC to show presence.
- Details on how royalty reform will share out cash.

President Juan Manuel Santos' ambitious reform agenda, the guerrilla and drugs war, measures to tame the soaring peso and still delicate relations with neighboring Venezuela and Ecuador are key issues to watch in Colombia in 2011.

Since coming to office in August, Santos has pushed an ambitious set of reforms ranging from the management of oil royalties to overhauling the health system and a tax system adjustment. The success of the reforms are seen as essential for

Colombia to tackle its fiscal deficit and regain the investment grade it lost in a 1990s fiscal crisis.

Key to watch will be the royalties reform, tax overhaul and a fiscal regulation proposal that seeks to lower debt and better savings.

Santos has a strong majority in Congress and has managed to make significant progress on the reforms. But several proposals already must have to wait to a second legislative session start in March. Under Santos, Colombia has improved strained ties with left-wing leaders in Ecuador and Venezuela. But underlying political differences linger.

While it has made big inroads against FARC rebels involved in the country's cocaine trade, Colombia still faces security risks from guerrillas and new militias. ■

Supporters of Ecuadorean President Rafael Correa face off against striking police in Quito. Police attacked Correa in an eruption of political unrest over austerity measures, leaving the leader trapped in a hospital. September 30, 2010. REUTERS/GUILLERMO GRANJA



ECUADOR

WHAT TO WATCH FOR:

- Renewed political instability.
- Efforts to lift oil production.

Political stability will be the key issue in Ecuador in 2011 after recent violence revived memories of the coups and street protests that have hounded the OPEC member nation.

Hundreds of police officers mutinied on Sept. 30, causing deadly riots and surrounding leftist President Rafael Correa for hours in a Quito hospital where he had taken refuge.

The mutiny was finally ended when the military rescued Correa, and the country

has since calmed down, but it raised fresh concerns about the government's dependence on support from army chiefs.

A struggling dollarized economy, a possible bid to re-enter the international capital markets with a new bond issue, which would be the country's first since defaulting on its global debt in 2008, and a possible move by Correa to dissolve Congress and call elections are all points to watch in 2011. ■

CUBA

The success or failure of Cuba's economic reforms will be the key issue to watch in the next year as the government moves to strengthen the economy and ensure survival of the island's communist system once the current aging leadership is gone.

The cash-strapped government is looking for ways to cut spending while increasing income, and could

WHAT TO WATCH FOR:

- Fate of detainee Alan Gross.
- Better or worse economic performance.
- U.S. and EU reaction to Cuban reforms.

get long-term help if offshore oil exploration slated to begin in 2011 is successful.

All this occurs against a backdrop of only slightly tempered hostility with the United States, including an ongoing dispute over a U.S. contractor held by the Cubans on suspicion of spying. ■



Members of Cuba's National Assembly vote by a show of hands during a meeting in Havana. December 18, 2010. REUTERS/ENRIQUE DE LA OSA

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COVER PHOTO: Mexican soldiers stand guard outside the morgue as they wait for the body of Ignacio "Nacho" Coronel, a major Mexican drug trafficker, to arrive in Guadalajara City. Coronel was killed during an army operation, marking a major coup in President Felipe Calderon's war on drugs. July 30, 2010. REUTERS/HENRY ROMERO

