



# Americas Debt Weekly

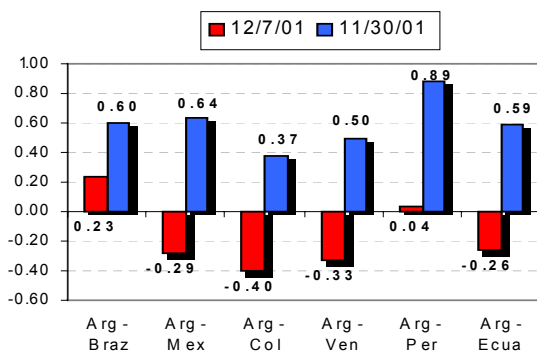
## Key Indicators

	Value	1 wk % change
Dow Jones	10032	1.8
NASDAQ	2011	4.2
S&P 500	1156	1.4
UST 5 yr Yield (%)	4.464	-1.8
UST 10 yr Yield (%)	5.158	-3.0
3 month LIBOR (%)	2.004	-1.4
6 month LIBOR (%)	2.086	2.8
EMBI+ Stripped Spread	783	-27.0
WTI Oil Price (US\$/bbl)	18.32	-5.8

## Last Week's Wrap up

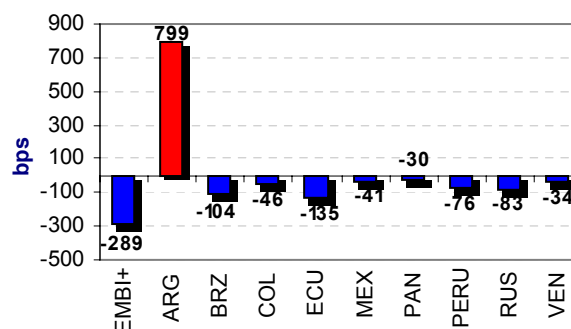
Once again, the week's headlines were dominated by Argentina. At the beginning of the week, the government imposed exchange and capital controls in a desperate attempt to stop the run on deposits from bleeding the banking system dry. The favorable outcome of the domestic debt swap (US\$52 bn were exchanged) was largely overshadowed by the new measures. The latest blow to Argentina was the IMF's refusal to disburse the US\$1.3 bn scheduled for December. As a result, FinMin Cavallo headed to Washington to meet with IMF officials. Despite the crisis in Argentina, debt from other LatAm countries showed strong decoupling and tighter EMBI+ stripped spreads. Spread correlations with Argentina have turned negative, with only Brazil, and Peru to a lesser extent, remaining positively correlated. Positive data releases contributed to the de-linking, with Peruvian GDP posting 2.2% growth in October, while US economic releases showed better than expected results. However, Friday's release of the November US unemployment rate was a disappointing 5.7%. The significant tightening in the EMBI+ stripped spread was largely explained by the re-weighting that took place after the domestic debt swap in Argentina, which resulted in a reduction of the country's weighting from 10.64% to 5.2%.

Argentine Contagion: 10-day Rolling EMBI+ Spread Correlations



Laura Rattner  
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## EMBI+ Stripped Spread Weekly Change



## The Week Ahead

Market mood next week will continue to be predicated on the direction and magnitude of the spillover effects from the looming default in Argentina. Investors will be holding their collective breath over the weekend, as Cavallo does battle with (or humbly pleads) the IMF to reconsider releasing the US\$1.3 billion that it had decided to withhold earlier this week. Without this and other monies (there are about US\$1.1 billion in other loans from the IADB and the World Bank that are also at stake), Argentina will not be able to service its external debt payments, which would then result in the realization of the seemingly inevitable conclusion at this point - a full-blown default. Spread levels of the Argentine EMBI+, which have reached nose-bleed levels of 4150 bps at the time this report was being written, are implying a risk-neutral default probability of about 35%, way above the EMBI+ default probability of just 8.6%.

Kicking off the week, Monday's national strike in Venezuela - a country that has been largely immune to regional volatility up to now - will command some attention. We don't expect the heightened political tensions resulting from *Chavez Risk* to spillover into the rest of the region. Significant decoupling from Argentine contagion by the end of last week heralds the beginning of a consolidation phase, as markets grope for new supports amid dwindling year-end trading activity, the re-balancing of portfolios to the new EMBI+ weightings, and the rising realization that the end of Argentina's debt crisis draws near. The FOMC meeting on Tuesday in the US is likely to be non-event, given that the Fed's irrelevancy in confronting the US recession has been rising as fast as interest rates are falling. The December fed funds futures contract is implying an 84% chance that the Fed will cut rates by 25 bps down to 1.75%, and only a 42% probability that the Fed Funds rate will drop to 1.50%.

## Data Releases to Watch:

Watch out for Brazil's flurry of inflation reports next week, particularly the IGPM on Monday, and the FIPE, IPCA and INPC reports on Wednesday. Also, Mexico's Industrial Production for October will be released on Wednesday.

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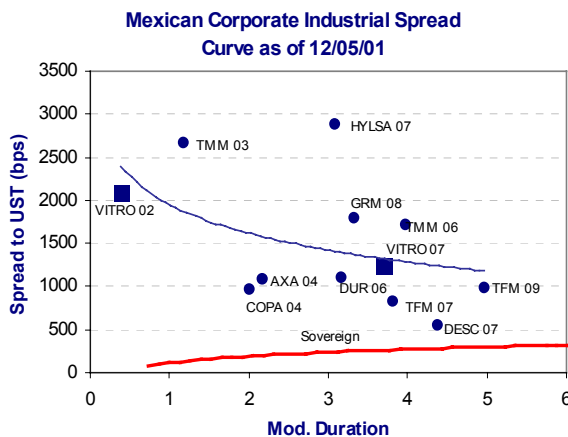
**US Outlook**

It appears that the US Treasury yield cycle has seen its lows. For the 30-year this was just below 4.8% recorded after the rally following the decision to suspend auctions of 30-year paper. More recently, the spectacular rebound of the NAPM New Orders index back into positive territory signaled that the interest rate cycle may be bottoming out. And despite Friday's data showing another increase in unemployment, Treasuries sold off again, with the 30-year shooting through overhead resistance of 5.52% like a knife through butter. We can expect retracements and the low inflation environment means that Treasuries are unlikely to sky-rocket but this week's market action points to an end to the two-year Treasury yield downcycle. Next week the Fed is likely to cut 25bp - this is expected - but what the market will be looking for is Greenspan's tone. It is possible we will see a move to a neutral bias. This would seal the Treasury's fate.

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**Corporate Commentary**

**Vitro Value Trade**



We believe the value of Vitro's Vicap (financing entity) 10.25% May 02 bond does not fully reflect the relatively high probability that the company will be successful in its refinancing efforts. As illustrated in the chart above, the inverted Mexican corporate credit spread curve has been reflecting a significant amount of perceived default risk since the September 11 terrorist attacks and the shock of the Sanluis default on September 20. However, recent improvements in the investor risk perceptions – Enron and Argentina notwithstanding – have driven a moderate move toward a less steep inversion in recent weeks.

The spreads on the Vitro 02 and Vitro's Vicap 11.375% bond due in May 07 largely define the fitted curve for the Mexican industrial corporate spread curve illustrated above. In the past month, the Vitro 02-07 spread has narrowed by 427.7 bps to 845bps. By comparison, over that same time period, the TMM 03-

06 spread has narrowed by only 133.8 bps and has actually widened in the most recent week. Despite the fact that a significant dis-inversion has already occurred, we recommend entering the spread trade, or switching out of the 07 and into the 02. We expect that the Vitro 02-07 spread will continue to narrow sharply as the company completes various elements of its refinancing plans and disinvert completely upon completion of the \$175 million refinancing. The spread trade offers a measure of downside protection in the event that the company is subject to negative news. If successful asset sales were the source of refinancing revenue, then a spread trade would have even more momentum due to the improvement in overall leverage.

With the shortest duration of all the Mexican industrial bonds that we track, Vitro's 02 yields 22.8%, for a spread of 2,099.6 over US Treasuries (UST) - close to the levels that Sanluis' 08 bond yielded before it defaulted - compared to Vitro 07's 16.8% YTM and spread of 1,254.5 bps over UST. The Vitro 07 bond offers a higher current yield at 14.0% and a lower price at 81, compared to the 02's 10.8% and 95, so that this is a pure spread compression trade, with negative carry.

Another point of comparison can be made with TMM's 9.5% bond due in May 03, which has significantly greater duration, at 1.2 and a YTM of 29.4%. With significantly lower coverage and higher leverage ratios of 1.2x and 6.7x respectively, and significant uncertainty regarding corporate structure and regarding subsidiary TFM's eventual dividend payment, the spread/modified duration of TMM's 03 is only 2,268, less than half of Vitro 02's 5,356. We believe that the return/risk profile favor Vitro's 02 and we expect that this misalignment will be corrected once Vitro completes some elements of its refinancing plans in the coming months. As another point of comparison, highly leveraged Hylsa's 9.25% 07 bond, CCC+ with the company on parent-provided life support offers a spread/modified duration of only 935bps per unit of risk. Given the array of spreads on offer in the Mexican industrial universe, we believe that on a relative value basis, Vitro's 02 bond offers good value, though clearly this is a trade that requires a high risk tolerance on the part of investors.

The risks to our recommendation include any negative events that would delay Vitro's asset sales and/or other refinancing initiatives, leaving the company vulnerable to a liquidity squeeze as May 02 approaches. In addition, high profile defaults by other Mexican and/or US high yield corporate issuers, or new terrorist attacks, if they arise, could cause renewed steepening of the Mexican corporate spread curve inversion. Finally, worse than expected Mexican fundamentals, worse than expected Q4 01 earnings results and/or a negative rating action would likely cause short-term spikes in yields and spreads.

**Denis Parisien**  
**305-349-0520**

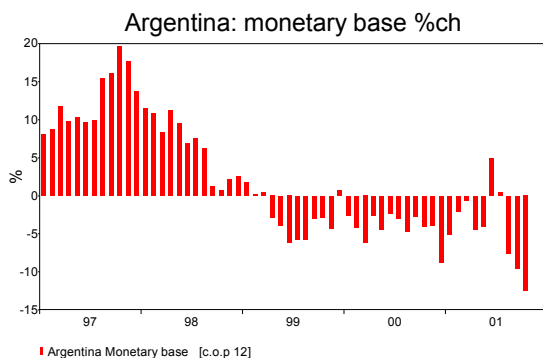


**Issue of the Week**

**Argentine Debt Prices: More Downside Ahead**

Blaming “vulture funds” for the systemic bank run, Cavallo announced controls to restrict capital flows from the domestic banking system and the country. The measures have had the adverse effect of undermining investor confidence and liquidity.

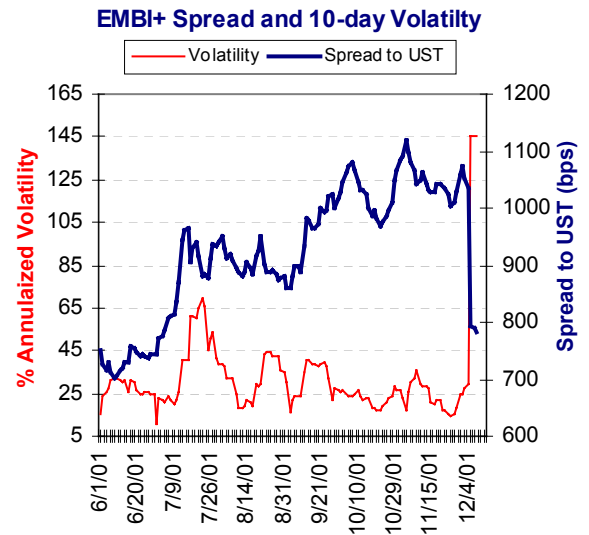
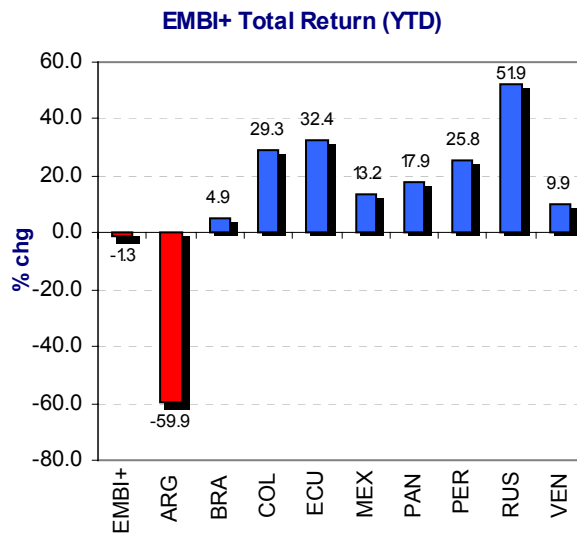
The deposit outflow will surely continue, although at a slower pace, as the risk of devaluation looms large. With close to 5 million (4 million workers and 1 million corporate) accounts, and considering the maximum cash withdrawal of \$1,000 per month, outflows could feasibly reach \$5bn per month on central bank reserves of less than \$15bn and a deposit base of less than \$70bn. Thus we should not discount further capital restrictions.





**Emerging Market Debt Analytics**

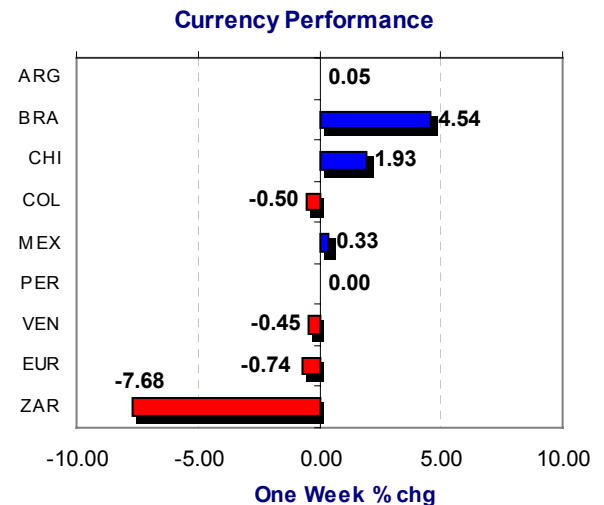
Americas Debt Weekly



The re-weighting of the EMBI+, which brought Argentina's representation from 10.64% to 5.2%, catalyzed a significant reduction in stripped spreads to below 800 bps (see upper right chart). Thus, the spike in 10-day volatility for the EMBI+ is both misleading and ephemeral. However, Argentine 10-day spread volatility remains high (at an annualized rate of 125%) and it could still pose a threat to Emerging Markets in the days ahead.

**Currency Corner**

	12/7/01	YTD % Chg
ARG	0.9995	-0.1
BRA	2.3900	-18.4
CHI	673.1500	-14.8
COL	2310.0000	-3.2
MEX	9.1935	4.7
PER	3.4325	2.7
VEN	750.0000	-6.7
EUR	0.8898	-5.6
S. AFR	11.1085	-31.8



The Brazilian real strengthened to a 5 month high, having appreciated by 4.54% over the past week, and lending further evidence to Brazil's decoupling from Argentine contagion. Brazilian corporate bond sales are expected to bring a torrent of cash into the country, helping to strengthen the currency as a result. Falling interest rates and borrowing costs are compelling companies like Cia. De Bebidas das Americas, Banco Bradesco, and Petrobras to raise about US\$2 billion in the international capital markets in the days and weeks ahead. (AS)

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 305-349-0507



**Technical Analysis: Brazil C Bond**



Source: Bloomberg

The C bond has decoupled from Argentine contagion - but not completely - and is now consolidating between 73.5 and 76.5. This consolidation is confirmed by the leveling-off in the MACD (see bottom graph above) and the tightening of the Bollinger Bands (not shown) around the 20-day moving average (yellow line). The 14-day RSI (not shown) is showing the C Bond is still close to crossing up into overbought territory, which leads us to conclude that the balance of risks are still skewed toward the downside in the days ahead.

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**Weekly Pricing and Analytics**

7-Dec-01	Close		Weekly Chng		Strpd. YTM	Mod Dur	Sov. Spread	7-Dec-01	Close		Weekly Chng		Strpd. YTM	Mod Dur	Sov. Spread
	Offer	Net	Net	Dir					Offer	Net	Net	Dir			
<b>ARGENTINA</b>								<b>ECUADOR</b>							
FRB	41.170	-2.281		↓	76.66	0.86	7292	Ecu 30	46.000	3.000		↑	18.04	6.26	1245
Arg 08	41.000	3.000		↑	31.91	3.51	2714	<b>MEXICO</b>							
Par	49.500	-4.490		↓	34.67	8.05	767	Par	92.190	-1.295		↓	8.46	10.26	168
Arg 27	30.000	2.000		↑	27.86	3.16	2445	UMS 26	126.936	1.286		↑	8.78	9.52	331
<b>BRAZIL</b>								<b>PERU</b>							
EI	87.470	1.641		↑	11.53	2.01	735	PDI	77.170	1.732		↑	9.96	5.86	468
C	75.620	2.776		↑	13.61	4.58	839	<b>RUSSIA</b>							
Par	67.505	0.055		↗	14.99	9.87	411	Rus 30	55.691	2.216		↑	12.90	7.64	738
Braz 08	86.2723	1.410		↑	12.58	4.42	791	<b>VENEZUELA</b>							
Braz 27	72.680	2.480		↑	13.91	7.05	849	DCB	77.880	0.442		↗	15.46	2.24	1086
<b>COLOMBIA</b>								Par	73.810	-1.898		↓	17.72	8.94	452
Col 27	72.340	0.577		↗	11.84	8.04	633	Ven 27	66.340	1.070		↑	14.03	6.93	857

Source: Bloomberg; Note: All prices and analytics are as of 5:00 p.m. Friday.



**Economic Data Releases**

Date	Country	Indicator	Period	Market Forecast	Previous
<b>Mon, Dec 10</b>	Brazil	Preview CPI (IGP-M)	Week to Dec 3	-	1.10%
	Mexico	Trade Balance	Oct	-	-US\$479 mn
	Peru	Government Balance	Oct	-	-NS\$119 mn
<b>Tues, Dec 11</b>	Brazil	CPI (IGP-DI)	Nov	-	1.45%
	Brazil	WPI (IPA-DI)	Nov	-	1.88%
	Brazil	Construction Cost Index (INCC)	Nov	-	0.93%
	Brazil	CPI (IPC/FGV)	Nov	-	0.71%
	US	Wholesale Inventories	Oct	-0.3%	-0.1%
	US	FOMC Meeting	Dec 11	1.75%	2.0%
<b>Wed, Dec 12</b>	Brazil	FIPE CPI	Week to Dec 7	-	0.61%
	Brazil	IPCA Inflation	Nov	0.78%	0.83%
	Brazil	INPC Inflation	Nov	-	0.94%
	Mexico	Industrial Production	Oct	-5.15%	-5.40%
	US	Imports (Commodity Price Index)	Nov	-1.1%	-2.4%
	US	Current Account Balance	3Q01	-\$94.2 bn	-\$106.5 bn
<b>Thurs, Dec 13</b>	Argentina	Consumer Confidence Index	Dec	-	34.9
	Argentina	Unemployment Rate	Oct	-	16.4%
	US	Producer Price Index	Nov	-0.3%	-1.6%
	US	Advance Retail Sales	Nov	-2.9%	7.1%
	US	Initial Jobless Claims	Dec 8	-	475 K
<b>Fri, Dec 14</b>	Venezuela	Oil Basket	Week to Dec 13	-	US\$15.02 p.b.
	US	CPI	Nov	-0.1%	-0.3%
	US	Core CPI (ex Food & Energy)	Nov	0.2%	0.2%
	US	Real Earnings	Nov	-	0.2%
	US	Business Inventories	Oct	-0.4%	-0.5%
	US	Industrial Production	Nov	-0.5%	-1.2%
	US	Capacity Utilization	Nov	74.2%	74.6%

Source: Bloomberg; Note: Bloomberg is the data source for all indicators, graphs, charts, tables and analytics in this publication.



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