

# Emerging Markets Outlook

**Technicals and declining risk aversion have been driving market performance more than fundamentals since early November, even as Argentina sinks deeper into crisis.** While Argentina is unlikely to avoid a messy debt restructuring and is coming closer to an end game on the currency, the fact that this crisis has largely played out as a non-event for the rest of the market has resulted in increased allocations back to the emerging markets debt asset class for the first time since the beginning of the year. At the same time, emerging markets debt has benefited from the search for yield, downside risks specifically related to 11 September appear to have abated, and Fed easing continues to be supportive for spread product.

**The level of decoupling since early November also reflects the important structural changes that have occurred in the asset class since the Russia crisis.** Crossover investors, now the single largest group of investors, had reduced emerging markets exposure steadily during the course of 2001, leaving little room for the market to sell off further. With little element of surprise or leverage involved in Argentina and an improvement in the performance of broader financial markets, the EMBI+ excluding Argentina has rallied by 6.3% since early November.

**The upward trend is likely to continue into 2002, and we foresee total returns for the EMBI+ in excess of 10% on a one-year horizon, even under aggressive assumptions for the haircut imposed on Argentine assets remaining in the index. However, we recommend only selective buying into the current market strength.** We are concerned that the market may be getting overly complacent too quickly. Argentina is coming closer to an end game on the currency—whether it be dollarization or a change in FX parity—and an additional bout of contagion may occur. At the same time, the risk of an outright default remains high given a financing shortfall that could be as wide as US\$5 billion this month. We believe that the current US\$20-30 price range on Argentine Globals could fall as low as US\$15-20.

**Although we do not disagree with the emerging consensus view that Brazil will likely be one of the top performers of 2002, we would not add exposure at current levels and recommend a modest underweight position.** The potential for a noisy 2002 election campaign and consequent spillover into economic policy has not been fully discounted, while the deterioration of financial conditions in Argentina and the accompanying contraction of the economy will worsen the cash flow position of Brazil, which possesses the highest external financing needs in the region at US\$45 billion for next year.

**We continue to reiterate our overweight recommendations on high yielding diversifiers such as Algeria, Bulgaria, Peru, and the Ivory Coast and still favor high-quality defensive credits such as Chile and Qatar.** We also added to higher-rated credits such as Mexico, South Africa, the Philippines, and Malaysia this month. We keep a core position on Russia going into 2002; it remains our largest overweight position.

While this is not the time to be making bets in corporate bonds, we anticipate that improving demand side technicals could support strong performance in the mid- to upper-tier names in Mexico for 2002. In the Asia region, selected high yield paper will outperform high grade credits as progress continues on corporate restructuring and corporate governance improves.

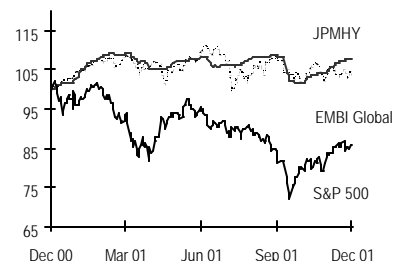
## Joyce Chang

(1-212) 834-4203

joyce.chang@jpmorgan.com

## EMBI Global, JPMHY, S&P 500

Index, December 2000=100



## Spreads and Yields - Actual and Forecast

	Year		Forecast for		
	Current	Aug	Jan 02	Mar 02	Dec 02
EMBI Global	742	758	800	800	750
EMBI+	796	783	850	850	800
Fed Funds	2.00	6.50	1.75	1.50	2.00
10-year bond	4.97	5.32	4.65	4.50	4.95

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*Please see our special report also published with this Emerging Markets Outlook: "Emerging Market Credit Derivatives," by Eric Beinstein.*

## Market Overview

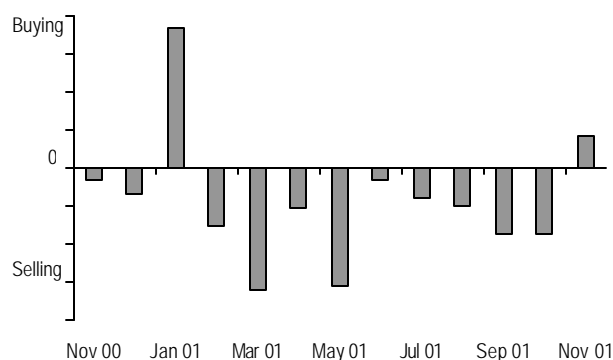
### Positive Momentum Likely to Continue but Little Room for Complacency

- The EMBI+ excluding Argentina is on a roll, returning 6.3% since early November
- Investors are in risk-seeking mode; November marks the first month of net buying since January, with Brazil the key beneficiary
- We believe that investors are now neutrally positioned against the market after months of being underweight
- The crisis will likely deepen in Argentina as the financing gap between now and year-end could reach US\$5 billion and official resources are not forthcoming; remain underweight
- Current levels, excluding Argentina, offer relatively few opportunities; we have added to higher-rated credits such as Mexico, South Africa, the Philippines, and Malaysia this month
- The intra-month index rebalancing following Argentina's US\$41.1 billion debt exchange has resulted in a modest underweight for Brazil in our model portfolio, which we deem appropriate following such a strong rally
- Risks of a change in FX parity and of a deeper haircut in Argentina's second debt exchange remain high and some spillover to Brazil cannot be ruled out
- Oil prices now look better supported following Russia's announcement of a 150,000 b/d cut in oil exports in the first quarter of 2002, but weakness remains a risk; we stay overweight Russia, Algeria, Nigeria, and Qatar

**Is the market poised for a sustained rally as the search for yield intensifies and market participants focus on a recovery scenario for 2002?** Or will the rally run out of steam as fundamental considerations return to the forefront and worst case scenarios play out in Argentina? Market sentiment shifted in November with almost all technical indicators showing a move toward less risk aversion. For the first time in nine months, JPMorgan internal client flows showed small net buying, with buying coming from almost all investor categories. At the same time, broader financial

markets have responded positively to perceived fading political and economic risks.

Chart 1: JPMorgan Client Activity: Net Buying/Selling



Note: volume numbers have been removed due to the proprietary nature of the data.  
Source: JPMorgan

### **There is room for disappointment and we recommend only selective buying into the current market strength.**

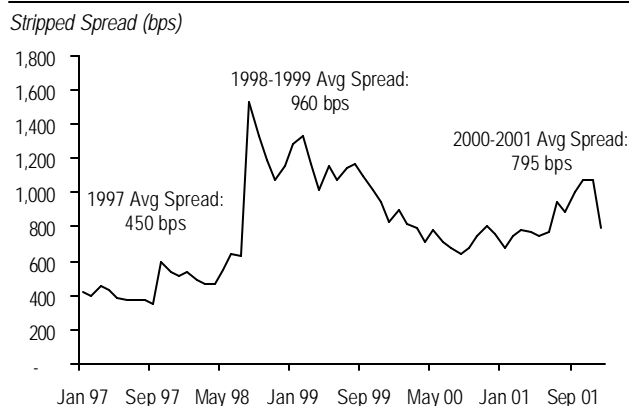
In the following section, we review the drivers of the market's recent strong performance and conclude that there is little room for complacency. JPMorgan continues to feel that growth indicators in the United States and elsewhere suggest that it is too early to say that the recession is over. The US recovery will likely come later and less vigorously than the consensus expects, with two additional Fed easings likely by March. JPMorgan's equity strategists are forecasting zero growth in corporate profits next year. Although JPMorgan's below-consensus views on growth and corporate earnings have negative implications for spread product, our global strategists acknowledge that spread markets could outperform going into the new year as the downside risks specifically related to 11 September appear to have diminished and Fed moves continue to be supportive for spreads.

**Technical factors specific to the rebalancing of the EMBI family of indices also played a major role in driving the recent rally.** Argentina weights in the indices decreased dramatically as a result of the Argentina local debt exchange, which exceeded initial expectations when US\$41.1 billion in sovereign bonds were accepted. The new loans from the exchange are currently not eligible for inclusion in the index. As a result, the Argentina weight in the EMBI+ decreased to 4.97% from 10.64% and in the

EMBI Global declined to 4.12% from 8.89%. As recently as the first quarter of this year, Argentina represented more than 20% of the weighting of the EMBI Global. The biggest beneficiaries of the rebalancing were Brazil, Mexico, and Russia, with their respective weights increasing by 1.3, 0.8, and 0.8 percentage points in the EMBI Global.

**Spreads for the EMBI+ excluding Argentina are now 115 bps tighter than at the beginning of the year.** That said, current levels (796 bps) for the overall EMBI+ remain attractive on a historical basis and we do not foresee a major correction even with greater downside likely to be felt in Argentina. We note that current spread levels are still in line with the average for the EMBI+ during 2000 and 2001 (*Chart 2*). In addition, at the end of December, a second index rebalancing for Argentina will decrease its weighting even further in the EMBI+. At the end of December, bonds that fall below the US\$500 million minimum size requirement will be removed, as well as those that fail the Liquidity Ranking criteria for the EMBI+.

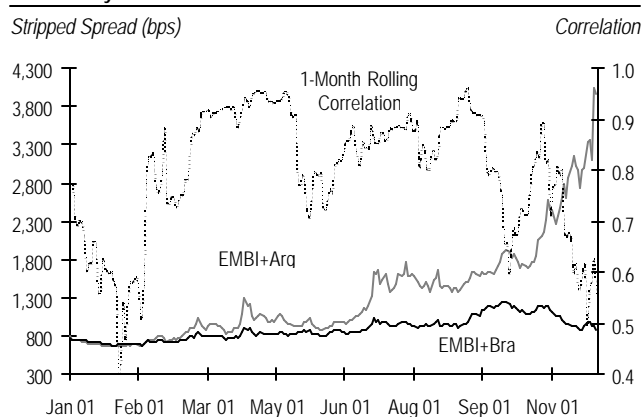
**Chart 2: EMBI+ Historical Spreads**



Source: JPMorgan

**Both Brazil and Russia have returned more than 11% since early November.** We remain overweight Russia but now recommend a slight underweight position in Brazil at current levels (*Chart 3*). We note a sharp drop in the correlation between Argentina and Brazil over the past month. We nevertheless believe that some spillover to Brazil is still likely although it could be relatively contained. The deterioration of financial conditions in Argentina and the accompanying contraction of the economy will worsen the cash flow position of Brazil.

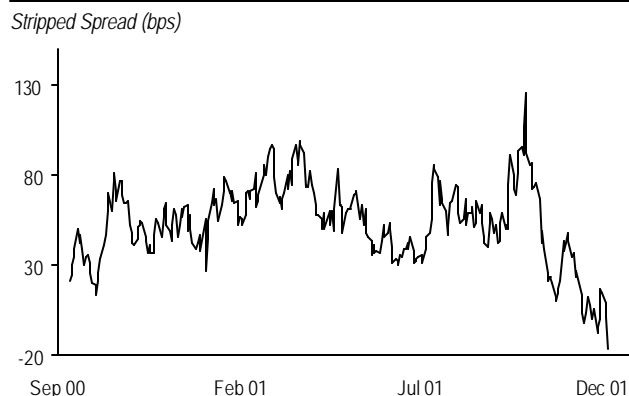
**Chart 3: Correlation between EMBI+ Argentina and EMBI+ Brazil Drops Dramatically**



Source: JPMorgan

**We added Mexican exposure at the time of the index rebalancing to remain at a neutral weighting; we would not increase exposure at current levels.** The sovereign is for the first time trading tight to similarly rated US corporate bonds (*Chart 4 on the following page*). We continue to reiterate our overweight recommendations on high-yielding diversifiers such as Algeria, Bulgaria, Peru, and the Ivory Coast and high-quality credits such as Chile and Qatar. We note that for the second consecutive month, Asian dollar bonds have rallied across the board. We add positions to selected Asian credits, notably the Philippines and Malaysia. JPMorgan's economics group sees signs of output stabilization in emerging Asia as exports have held steady while industrial production has increased by over 3%. In the case of Malaysia, we believe that the gap that developed between Malaysian and Korean spreads will narrow going forward as Malaysia proceeds with corporate restructuring and continues to build reserves. We have been constructive on the upside for the Philippines since the new government took over and find that, despite market skepticism on growth and the budget deficit, a determined Macapagal-Arroyo administration has delivered results on both fronts.

Chart 4: Mex10 versus 10-Year "5B" US Corporates



Source: JPMorgan

While much attention has been focused on the high external financing needs for Latin America next year, which we estimate at US\$78.2 billion, we point out that public sector external debt issuance needs look manageable at US\$14.1 billion. This should support the technicals going into 2002, particularly with some US\$19 billion due to come back to the market in amortizations and coupon payments from just the current components of the EMBI Global, of which almost 64% are Latin American credits. Of the US\$14.1 billion in programmed 2002 sovereign issuance in Latin America, US\$4 billion has already been prefinanced from this year's borrowings. In Table 1, we outline estimated emerging markets debt issuance for 2002 for all regions. Once again, we expect the major sovereign borrowers to focus on external debt swaps. During the first eight months of 2001, debt exchanges by Argentina, Brazil, and Mexico exceeded US\$30 billion, compared with only US\$13 billion during 2000.

Given the current spread of 796 bps, the EMBI+ would offer an annual return of 10% over a one-year horizon, even if further spread compression is minimal through next year and a 65% haircut is imposed on the remaining Argentine assets in the index. If spreads are unchanged from now until year-end, the EMBI+ would return an additional 1%, bringing the 2001 return up almost into positive territory. Excluding Argentina, the projected total return for 2001 would rise to around 19%. We point out that December has been one of the best-performing months for the EMBI+ historically, with average returns in December exceeding 2.4% over the past five years.

Table 1: Emerging Markets Estimated External Debt Issuance for 2002

US\$ billion

Country	Estimates of 2002 External Debt Issuance*	2001 YTD Net Issuance	2001YTD Net Issuance Minus 2001 Debt Issuance Estimates**	% of 2002 External Needs in 2001	2002 Principal Amortization of External Bonds+	2002 Government Total External Debt Amortization++
Algeria	0.5-1.0	-	-	-	0.7 (4)	2.4
Brazil	5.00	6.69	0.69	13.8	2.3	6.8
Bulgaria	0.22	0.22	-	-	0.1	0.6
Chile	-	0.65	-	-	-	1.2
China	1.00	1.48	-	-	0.2	13.5
Colombia	2.20	4.19	1.49	67.9	0.5	2.7
Czech Republic	0.45	-	-	-	-	1.8
Ecuador	-	-	-	-	0.4	0.4
Egypt	1.00	1.50	n.a.	n.a.	-	1.4
Hungary	-	0.85	-	-	1.0	4.0
Malaysia	0.50	1.00	-	-	-	1.2
Mexico	3.60	4.21	2.60 (3)	27.7 (3)	3.6	9.5
Morocco	0.67-0.90 (1)	-	-	-	1.1 (4)	2.2
Nigeria	-	-	-	-	0.0	1.0
Pakistan	-	-	-	-	-	1.9 (6)
Panama	0.75	1.00	0.34	45.3	0.37	0.6
Peru	0.50-0.75	-	-	-	0.0	1.0
Philippines	2.48	1.38	0.41	16.0	0.4	2.2
Qatar	1.00-2.00	-	-	-	-	0.9
Romania	0.70	0.66	0.16	-	0.3	1.2
Russia	4.60 (2)	-	-	-	4.0 (5)	10.8 (7)
South Africa	1.50	0.92	-	-	-	n.a.
Turkey	2.00	1.64	-	-	2.5	12.1 (8)
Venezuela	2.00	0.85	-	-	0.2	1.8

Notes:

1. 750-1,000 million issuance expected in euros.
  2. This amount represents new bonds issued, of which US\$2.6 billion could be used in exchange for about US\$4.0 billion of FTO loans made Soviet era.
  3. From the US\$2.6 billion issued in excess of 2001 needs, we estimate that around US\$1.0 billion will be used to prefinance 2002 debt issuance.
  4. Include all commercial obligations.
  5. Soviet era foreign trade organization debt plus loans from COMECON banks.
  6. Before Paris Club reschedule.
  7. Includes US\$4.0 billion of principal repayment of Soviet-era debt and US\$6.8 billion to official creditors.
  8. Includes repayment of US\$5.2 billion to IMF.
- \* Either official estimates or JPMorgan projections.  
 \*\* Calculated as residual of net issuance in 2001YTD minus estimated issuance in 2001. Zero means external debt completed or data non-representative.  
 + Estimated repayments of principal of external debt bonds (Eurobonds) and/or comparable debt.  
 ++ Includes payments to official creditors and principal repayments of external bonds.  
 Sources: Official sources and JPMorgan estimates

Oil prices have declined by 30% since the beginning of the year and volatility will remain high, although JPMorgan maintains a 2002 price forecast for WTI at US\$25.80 per barrel. With Russia's announcement earlier this week of a 150,000 b/d cut in oil exports in the first quarter of 2002, OPEC appears likely to go forward with a 1.5 million b/d cut. However, we expect oil prices to be very volatile in the first half of next year as we see no advance in global demand then relative to this year. Demand increases will be concentrated in the second half

and critically dependent on the start of an economic upswing.<sup>1</sup> At current prices, the oil price baskets of a vast majority of emerging market oil-exporting countries are well below the average price of oil that governments have assumed in their 2002 budgets (*Table 2*), with the exception of Colombia and Qatar, where we retain marketweight and overweight recommendations, respectively.

**Table 2: 2002 Oil Price Assumptions Are Below Current Levels for Most Emerging Markets Countries**

	2002 Oil Price Assumption in Budget (US\$/b)	Current Oil Price (US\$/b)	Estimated 2002 Oil Output (mbd)	2002 Fiscal Government Target (% GDP)	Estimated Effect of US\$1 Change on Fiscal Balance (% GDP)
Algeria	22.0	18.4	0.8	-0.5	1.0
Colombia	18.0	18.6	0.7	-2.4	0.1
Ecuador	19.0	12.8	0.4	0.0	0.6
Indonesia	22.0	17.0	1.4	-2.5	0.2
Mexico	17.0	14.6	1.8	-0.7	0.1
Nigeria	19.0	18.2	2.2	-2.5	0.9
Qatar	16.0	18.3	0.6	4.0	1.1
Russia	18.5	17.4	6.6	0.0	0.3
Venezuela	18.5	15.0	2.9	-4.5	0.5

WTI Current Price 19.4

Notes: mbd = millions of barrels per day. Last prices as of December 6, 2001.  
 Source: Official sources, OPEC, and JPMorgan estimates

**Over the past month, a number of rating actions—both positive and negative—have influenced market sentiment as well, providing trading opportunities. We do not foresee further positive rating actions between now and year-end.** South Africa’s rating was upgraded to Baa2 by Moody’s on 29 November, while Russia was upgraded by two notches to Ba3 and Korea was upgraded to BBB+ by Standard & Poor’s. Our model portfolio was correctly positioned to benefit from the South Africa and Russia upgrades while we were not hurt by the downgrades of Argentina and Panama, where we remain underweight. Mexico’s long-anticipated potential upgrade to investment grade by Standard & Poor’s now seems more likely to occur in the first half of next year.

**It is possible that Standard & Poor’s will meet this month to discuss Brazil’s creditworthiness, having placed the BB- external debt rating on negative outlook in early August.** We maintain that both domestic fundamentals and the external environment have deteriorated significantly since S&P upgraded the

sovereign rating from B+ almost a year ago, but it is not clear whether the agency will conclude that this is simply part and parcel of an admittedly severe business cycle, or a more serious threat to the government’s ability to service its obligations. In particular, S&P is likely to focus (as we do) on the financing challenges in 2002, on potential contagion from financial and political disruption in Argentina, and on the risks arising from the electoral process next year. We expect either an outright downgrade or a continued negative outlook for Brazil—it is unlikely that S&P will be comfortable with a positive rating action in light of the significant political and economic challenges ahead.

## What Happens Next in Argentina?

**The risks of an outright default remain high while the sustainability of convertibility looks precarious.** Our base case scenario for external debt remains that of a default/distressed exchange, with a haircut of over 50% on the total stock of debt. Absent disbursements from official creditors, Argentina’s financing needs this month may exceed US\$5 billion, including US\$331 million of bond payments and US\$1.2 billion of Letes rollovers. Until year-end, we believe that the default risk is predominantly political in nature as the government announced yesterday that it will make pension funds invest their term deposit holdings (of approximately US\$3 billion) in government obligations. We also believe that US\$1.5 billion in Treasury working capital remains available. This could meet most of this month’s financing gap. However, the financing needs in 2002 are daunting, at an excess of US\$20 billion even after assuming that the government can adhere to a zero deficit target. We estimate that domestic sources will be able to provide less than US\$5 billion in financing, and so the government would need around US\$14 billion in multilateral new lending and rollovers to make ends meet.

1. For more information, see *Oil Report: Russian Cuts*, by Paul Horsnell, 5 December 2001.

**Table 3: Argentina's Estimated Financing Needs and Sources 2002**

US\$ million	2002
<b>I. TOTAL Financing Needs Pre Debt Exchange</b>	<b>22,922</b>
A. Fiscal Deficit	0
B. Debt Amortizations (ex Letes)	21,383
Bilateral	526
Multilateral	10138
Bonds	10159
Other	560
C. Letes	539
D. Other	1,000
E. Amortization Savings from Nov 2000 Debt Swap	-2,538
<b>II. TOTAL Financing Needs Post Debt Exchange (I-E)</b>	<b>20,384</b>
<b>III. Sources of Financing</b>	<b>10,286</b>
F. Domestic Sources	4,680
Pension Funds	1,680
Rollover of bond that fulfills banks' reserve requirements	2,000
Lete demand by mutual funds	1,000
G. External Official Sources	5,606
IMF disbursements	3,856
World Bank	250
IADB	1,500
<b>IV. Scenario 1: Financing Gap (- denotes a shortfall)</b>	<b>-10,098</b>
H. Other Potential Financing Sources	8,458
Rollover of SRF from Jan 01 IMF package	2,958
Rollover of SRF from Aug 01 IMF package	2,500
IMF additional US\$3 billion from Aug 01 package	3,000
<b>V. Scenario 2: Financing Gap (- denotes a shortfall)</b>	<b>-1,640</b>

Source: JPMorgan estimates

**Even with a second global debt exchange on similar terms to the local exchange, it will be very difficult to bring 2002 interest payments below US\$7 billion, which is the government's stated aim.** The government would still need to run a primary surplus of around 3% of GDP to achieve a zero fiscal deficit. This year, we believe that the primary surplus will amount to only 1% of GDP or less, despite the government's efforts to cut spending. Concerns will persist that a second debt exchange would need to be carried out at a more significant haircut. We believe that the current US\$20-30 price range on Globals could fall as low as US\$15-20. In a credit event, we expect banks to liquidate collateral for the repo facility, which could lead to more selling. *Table 4* outlines recovery values for distressed debt within 30 days of default or distressed exchange for Ecuador, Russia, Ivory Coast, Ukraine, and Pakistan. In all cases, with the exceptions of the short maturity Eurobonds of Pakistan and Ukraine, for which the issue size was relatively small, prices fell into the teens.

**Table 4: Recovery Value History Following Default/Distressed Exchange**

Asset	Default/ Exchange Date	Value on Default or Exchange date	Price range +/- 30 days of default or exchange*		On Default Date:		
			Minimum	Maximum	Stripped Yield	Average Life (yrs)	Collateral Value
Ecuador PDI	30-Sep-99	16.5	15.8	27.3	41.0%	11.5	-
Ecuador Disc	30-Sep-99	30.5	30.0	41.0	69.4%	25.4	26.9
Ecuador Par	30-Sep-99	29.6	29.5	36.8	42.4%	25.4	24.9
Russia Principal loan	02-Dec-98	6.8	5.1	8.6	63.7%	12.6	-
Russia IANs	02-Jun-99	9.4	6.0	16.2	70.9%	10.2	-
Russia '01 Eurobond	No default	36.0	28.0	38.3	53.5%	3.0	-
Russia '03 Eurobond	No default	32.5	20.5	34.5	50.3%	4.5	-
Russia '05 Eurobond	No default	24.0	17.0	29.0	44.7%	6.6	-
Russia '07 Eurobond	No default	27.0	21.5	32.3	40.3%	8.5	-
Russia '18 Eurobond	No default	24.0	17.3	28.5	43.8%	19.6	-
Russia '28 Eurobond	No default	28.5	21.0	32.0	45.3%	9.5	-
Ivory Coast PDI	30-Mar-00	20.4	15.0	24.5	24.3%	11.7	-
Ivory Coast FLIRB	30-Mar-00	17.5	14.5	20.5	21.1%	14.8	-
Pakistan 6% 2002 Eurobond	Distressed	NA	53.8	60.4	NA	NA	NA
	Exchange 06-Dec-99						
Ukraine 16% DEM 2001 Eurobond	Distressed	50.0	55.5	67.0	NA	NA	NA
	Exchange 07-Apr-00						

\* For Russia Eurobonds represents range +/-30 days around default of Russia Principal Loan on December 2, 1998. At that time Russia's intention and ability to continue to service the eurobonds was uncertain. For Pakistan and Ukraine represents price range +/-7 days of exchange  
 Source: IMF and JPMorgan

**Argentina appears to be getting closer to an end game on the exchange rate regime—whether it be dollarization or a depreciation of the currency.** The two most obvious scenarios are:

- 1) The population pushes the dollarization of the monetary base, and any fiscal gap is closed through the issuance of the quasi-currencies already in circulation (Patacones, Lecops, etc.); or
- 2) The fall in reserves triggers the political decision to float the currency and print pesos to finance the fiscal gap.

Which of these scenarios is most likely to materialize is a close call, as it will be a political decision based on the tolerance to see reserves fall sharply and the trade-off between protecting savings in the financial system and preserving current real levels of public spending for a while longer. As of 30 November, Argentina's liquid reserves were reported at US\$14.7 billion, covering 134% of the monetary base. However, if we exclude the financial system's reserve requirements held at the central bank from liquid reserves, then this ratio falls to 96%—calling into question the feasibility of fully dollarizing at parity. The breakdown of existing claims on international reserves is therefore a crucial piece of the puzzle. We believe that sufficient liquid reserves exist to replace the peso monetary base with dollars, but this would require some degree of appropriation of bank reserve requirements and would start to constrain the central bank's already modest ability to serve as a lender of last resort. It is also possible that some of those supposedly liquid reserves already may be committed to financing the existing fiscal gap through Banco Nacion, which further constrains the authorities' room to maneuver. (For more information, see "Special Focus on International Reserves in Argentina" by Martin Anidjar on page 29).

## Market Lab

### Market Sentiment Shifted Last Month— Excluding Argentina

- Almost all our technical indicators showed a move toward less risk aversion in November
- The new issue market reopened in November, having been effectively closed for several months; however, issuance is still dominated by higher quality names
- Fund flows show inflows to emerging markets funds—the first inflow to emerging markets in nine months
- Our client survey and our client flows both show buying
- Our client survey and our flows data show a significant switch into Brazil from Argentina

### New Issuance Activity Resumed in November

As the emerging markets decoupled from Argentina in November, new issuance recovered strongly after four consecutive months of low activity. Total new issuance reached around US\$5.8 billion in November compared with only US\$2.8 billion the previous month and around US\$3.9 billion issued in the high yield market. The main issuers were again either investment grade or crossover credits (60%). However, non-investment grade issuers also tapped the market for a significant amount (*Chart 1*)—most notable was Turkey's return to the US dollar capital

Table 1: Emerging Markets Debt Issuance in November 2001

Announcement Date	Issuer	Amount of Issue (million)	Amount of Issue (US\$ million)	Coupon (%)	Maturity	Country
5 Nov 01	Republic of Guatemala	US\$325	325	10.250%	8 Nov 11	Guatemala
8 Nov 01	Republic of Panama	US\$250	250	8.250%	22 Apr 08	Panama
8 Nov 01	PDVSA Finance	US\$500	500	8.500%	16 Nov 12	Venezuela
9 Nov 01	Republic of Latvia	€200	181	5.375%	27 Nov 08	Latvia
12 Nov 01	Republic of Bulgaria	€250	223	7.250%	1 Mar 07	Bulgaria
12 Nov 01	Banco Itau	US\$80	80	10.000%	15 Aug 11	Brazil
13 Nov 01	OSJC Oil Rosneft	US\$150	150	12.750%	20 Nov 06	Russia
14 Nov 01	Republic of Colombia	US\$500	500	10.000%	23 Jan 12	Colombia
15 Nov 01	City of Moscow	€400	353	10.950%	28 Apr 06	Russia
15 Nov 01	Pemex Master Trust	US\$750	750	8.000%	15 Nov 11	Mexico
16 Nov 01	Republic of Uruguay	US\$300	300	7.625%	20 Jan 12	Uruguay
19 Nov 01	Republic of Turkey	US\$500	500	11.375%	27 Nov 06	Turkey
21 Nov 01	Republic of Lebanon	US\$250	250	9.500%	14 Dec 04	Lebanon
26 Nov 01	United Mexican States	US\$1,000	1000	8.300%	15 Aug 31	Mexico
28 Nov 01	Republic of Philippines	€500	444	9.375%	7 Dec 06	Philippines

Source: JPMorgan

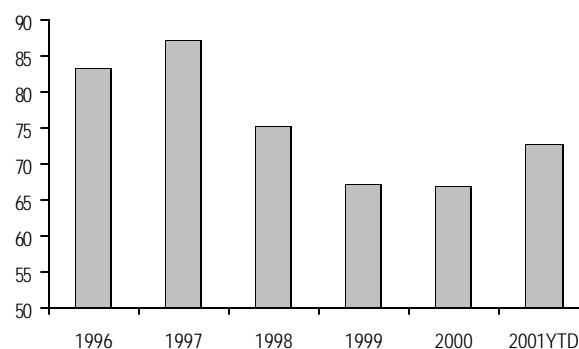
markets after nine months. US dollar issuance was larger than euro issuance at US\$4.6 billion versus US\$1.2 billion.

### New Issuance and Debt Exchanges Picked Up in 2001

Excluding the external debt swaps made by Argentina, Brazil, and Mexico during the first eight months of the year, new issuance in emerging markets reached around US\$73 billion this year (US\$104 billion including exchanges), similar to the level reached in 1998 (*Chart 1*). Investment grade and crossover credits remained the main borrowers in the year with around 55% of total net issuance. Debt retired from the market (not considering the latest Argentina local debt swap) through external debt exchanges totaled around US\$30 billion in 2001 compared with only US\$13 billion last year. US dollar-denominated

Chart 1: Net Issuance in Emerging Markets

US\$ billion



Source: JPMorgan estimates

deals prevailed as the main type of new issuance by currency, but the euro proved to be an effective alternative. Euro issuance is expected to continue gaining momentum in the primary market.

## Sovereign Latin American Borrowers Dominated the Scene in November

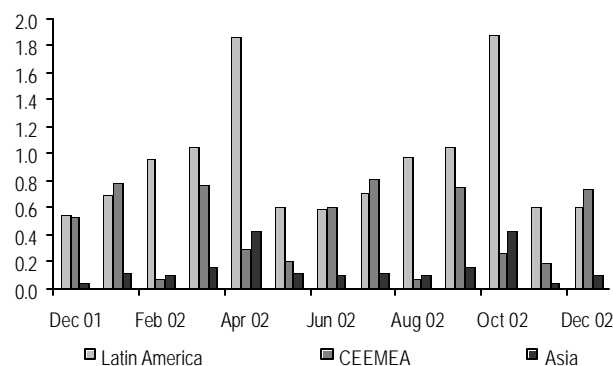
With issuance of around US\$2.0 billion, Latin America was the region with largest amount of sovereign issuance over the past month. Contrary to most expectations, the collapse in Argentina caused no contagion to other asset prices. In fact, most other countries showed a strong rally, with Venezuela being the only other EMBI+ country that posted negative returns on the month. This gave Latin American sovereigns a window of opportunity to tap the market.

Colombia and Mexico were the largest issuers in the region, prefinancing some of their external financing needs for 2002. We estimate that Colombia has covered 70% of its US\$2.2 billion financing needs for 2002 in anticipation of the presidential elections next year. Local pension funds continue to drive demand for sovereign bonds in Colombia. Mexico has prefinanced approximately US\$1.0 billion of its US\$3.6 billion of bond amortizations maturing in 2002. For liability management purposes, Mexico could remain an active issuer next year while adhering to a zero net external indebtedness limit as outlined in its 2002 economic program draft. Uruguay, Panama, and Guatemala also tapped the markets in small size during November.

**New issuance activity in the region is normally high during the first months of each year, accounting for half of full-year debt issuance.** Heavy external bond amortizations in March and April amounting around US\$3.0 billion of bonds included in the EMBIG are also likely to accelerate external financing operations early next year (*Chart 2*). However, the appetite for new issues could slow if the situation in Argentina worsens and there is contagion to other countries.

Chart 2: Amortization Cash Flows of EMBIG Debt in 2002

US\$ billion



Source: JPMorgan

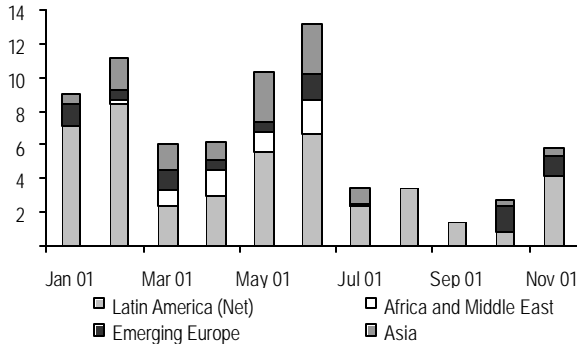
## Good Prospects for New Issuance Activity in Eastern Europe

Total sovereign issuance in Eastern Europe and the Middle East totaled US\$1.6 billion in November, with US dollar-denominated issues outweighing euro issues slightly (*see Chart 3 on the following page*). Overall, total issuance year-to-date in the two regions reached around US\$14.7 billion, mostly denominated in euros (57%). Latvia issued EUR200 million last month while Bulgaria came to the market with its first post-Brady issue. Two Russian issuers (City of Moscow and OSJC Rosneft) also returned to the market in November.

Our strategists expect significant new issuance activity next year in the Eastern Europe and Middle East region, from both new borrowers and issuers that have been absent in the market for some years. While some new issues may be illiquid, investors may be able to achieve greater diversification among emerging markets.

Chart 3: Net New Issuance by Region

US\$ billion



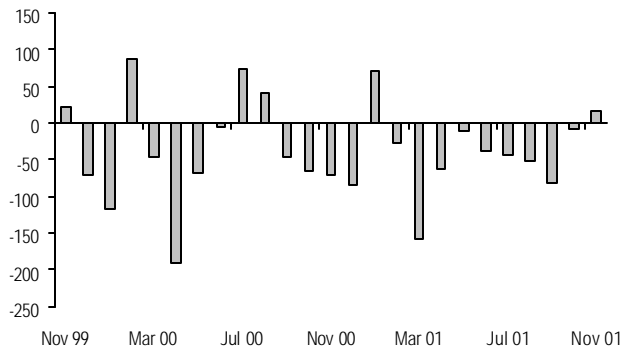
Source: JPMorgan

### Emerging Markets Debt Funds See Inflows for First Time in Nine Months

Emerging markets debt funds saw modest inflows of US\$15.0 million in November after nine consecutive months of outflows according to AMG Data Services (Chart 4). These inflows were consistent with November's rally in emerging markets debt excluding Argentina and with our internal data of client activity (Chart 5).

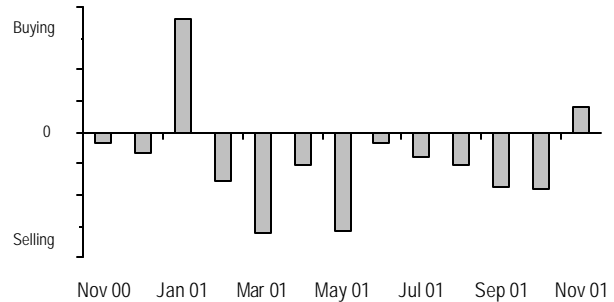
Chart 4: Emerging Market Funds Monthly Inflows/Outflows

US\$ million



Source: AMG Data

Chart 5: JPMorgan Client Activity: Net Buying/Selling

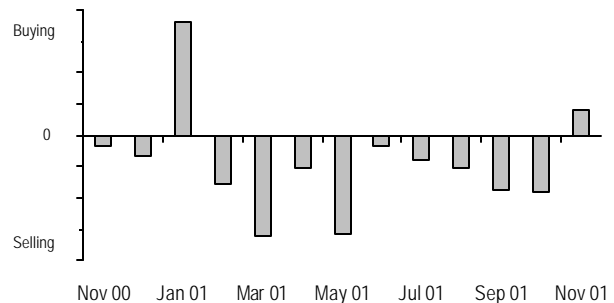


Note: volume numbers have been removed due to the proprietary nature of the data  
Source: JPMorgan

### Client Flows by Country

**Argentina:** During November we saw the biggest investor selling since we started collecting data at the beginning of 2000. The selling came from all categories of investor with the exception of local investors who were net buyers. We believe that much of the dedicated investor selling was due to investors positioning themselves ahead of the reduction in Argentina's index weight. Following this week's reduction in Argentina's index weight (see separate article), we believe that most investors have now reduced positions to very low levels. However we feel that the full capitulation trade has not yet taken place because of the overhang of collateral held under the repo facility, which we believe is likely to be sold in the event of a full Argentine default.

Chart 6: Argentina: Client Net Buying/Selling



Note: volume numbers have been removed due to the proprietary nature of the data  
Source: JPMorgan

**Brazil:** We saw very significant buying of Brazil, with the buying coming from almost all investor categories except hedge funds. We believe that part of this was due to the expected increase in Brazil's index weight as a result of the decline in Argentina's weight. However, part was also due to investors moving from an underweight to neutral position, as evidenced by our client survey. With the index rebalancing largely behind us we do not think that the technicals are as supportive for Brazil as they have been over the past couple of months.

**Mexico:** We saw slightly better selling of Mexico, all accounted for by crossover investors. Again this is supported by our client survey, which showed crossover investors increasing their Mexican underweight during the month.

**Venezuela:** Our client flows showed their eighth straight month of client selling. This agreed with our client survey, which showed investors moving to a significant underweight.

**Ecuador:** Our client flows and our survey both showed client buying in November. This is a continuation of the trend that we have seen over the past five months.

**Russia:** We saw slightly better buying of Russia during November, but this was not dominated by any particular investor group. Again, this ties in with our client survey showing a small increase in investor positions.

**Turkey:** Our client flows saw small client selling but our survey showed small client buying. Neither was significant.

**Korea:** We saw no net change in investor positions from the client flows side but saw a small increase in positions from the client survey.

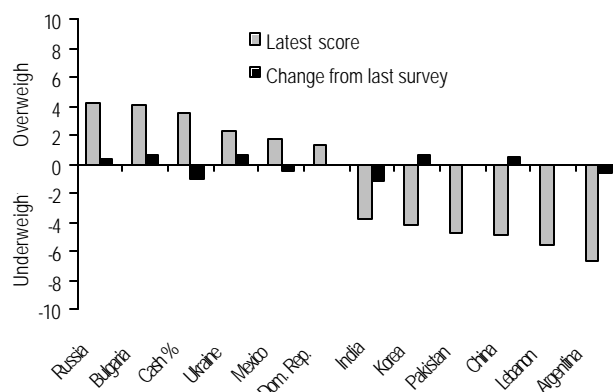
**Philippines:** The client flows and client survey both registered client buying in November. The flows have now been positive for eight straight months. The survey suggests that investors have moved from being underweight to neutral.

## Emerging Markets Client Survey **Results for 28 November 2001**

- Investors have continued the trend of the past few months, moving to a less underweight position
- They are now neutrally positioned against the market
- Cash levels have been cut to what we consider are close to normal levels
- From a positioning perspective we believe that technicals are now neutral, whereas last month we felt they were positive
- Russia, Bulgaria, and Ukraine remain the biggest overweights, all with an increase in positions from last month
- Argentina remains the biggest underweight, with an increase in the underweight from last month
- We received responses from 172 investors, managing an estimated US\$133 billion in emerging markets
- The main survey period was 26 to 28 November

**Chart 7: Largest Overweights and Underweights**

Positions are scored between +10 (everyone significantly overweight) and -10 (everyone significantly underweight).



Note: Change from last survey is from the survey of 29 October 2001.  
Source: JPMorgan

**How the data are computed.** Survey participants were asked their cash balances for dedicated emerging markets assets. For each asset, participants were asked whether they feel Significantly Overweight, Overweight, Neutral, Underweight, or Significantly Underweight. These responses were scored +10, +5, 0, -5, -10. The weighted score is weighted by our estimate of each respondent's total EM funds under management. The main survey period is over the two days prior to publication.

**Table 2: Client Survey**

	Signif Overweight%	Overweight%	Neutral%	Underweight%	Signif Underweight%	Size Weighted Score	Size Weighted Score Ch	No. of Respondents
<b>Market Exposure</b>								
Market	0	19	44	32	5	0.0	1.2	169
Cash %	NA	NA	NA	NA	NA	3.5	-1.0	92
<b>Biggest Overweights</b>								
Russia	31	42	20	7	1	4.2	0.4	137
Bulgaria	12	57	22	3	6	4.1	0.7	122
Cash %	NA	NA	NA	NA	NA	3.5	-1.0	92
Ukraine	14	31	27	23	5	2.3	0.6	84
Mexico	6	36	41	13	5	1.7	-0.4	143
Dominican Republic	3	58	13	22	3	1.3	-0.1	60
<b>Biggest Underweights</b>								
Argentina	1	3	16	33	48	-6.7	-0.6	147
Lebanon	0	0	3	79	18	-5.5	0.0	39
China	4	16	14	53	12	-4.9	0.5	49
Pakistan	0	16	13	61	11	-4.7	0.0	38
Korea	2	10	27	37	24	-4.2	0.6	98
India	0	9	23	45	23	-3.7	-1.1	22

Note: Percentage numbers show the % of respondents who gave this response. See above for an explanation of how the data are computed.  
Source: JPMorgan

## EMBI Global Model Portfolio Review

### We Move Closer to the Benchmark as Technicals Remain Supportive

- Our model portfolio outperformed the index by 3.6% in October mainly due to our Argentina underweight and increased exposure to the rest of the market
- We sold Argentina and added to our positions in Brazil, Mexico, and Russia ahead of the index rebalancing this month, which led to a decrease in the EMBIG Argentina sub-index weight by 4.8%
- Our model portfolio moved closer to the benchmark as a result of changes in the index and increased allocations to selected credits except Argentina; the beta of our portfolio increased to 1.0 from 0.93 last month and the tracking error decreased to 1.3% from 2.2%
- We are positive the emerging markets asset class going into the next year, but a likely credit event in Argentina could provide better levels to go overweight the market
- We reduced the oil bet in our model portfolio by selling Ecuador and Venezuela
- Over the past month we sold Argentina, Egypt, Ecuador, and Venezuela; we bought Brazil, Mexico, Russia, South Africa, Malaysia, Philippines, and Dominican Republic
- We have also done relative value trades in Russia, Bulgaria, and Poland
- Our largest overweights remain Russia, Algeria, South Africa, Nigeria, and Bulgaria
- Our largest underweights remain Argentina, Korea, and Turkey

### Last Month's Performance

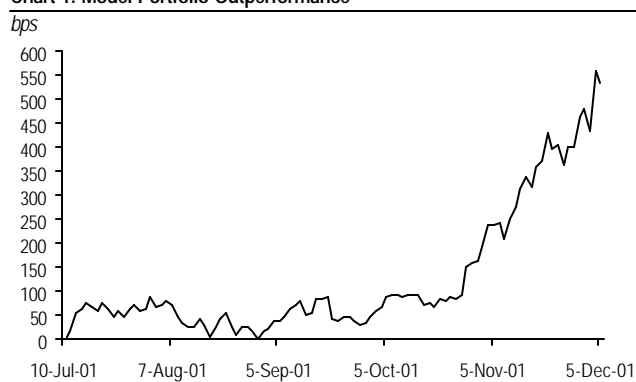
Since 1 November our model portfolio had a positive return of +3.6% versus the EMBIG. This outperformance is composed of +0.08% due to the market bet, +0.27% due to our Treasury exposure, +2.82% due to our country bets, and +0.43% due to relative value bets. Since we introduced a restructured portfolio in July it has outperformed the index by +5.23%. Our trade to position ahead of the Argentine rebalancing paid off. Our US Treasury return is due to the performance of the long '30s and '2s versus short '5s and '10s US barbell.

Table 1: Trades Since 1 November 2001

Date	Bond	Buy/ Sell	Amount	Price
13-Nov	Bul Disc	Sell	3.0	84.00
13-Nov	Bul FLIRB	Buy	2.2	85.75
14-Nov	Arg FRB	Sell	4.1	45.10
14-Nov	Arg '31	Sell	4.5	30.00
14-Nov	Bra '27	Buy	1.2	70.65
14-Nov	UMS '26	Buy	0.7	127.00
14-Nov	Rus MF '06	Buy	1.0	66.63
14-Nov	Egy '11	Sell	2.8	100.00
14-Nov	Egy '06	Buy	0.3	104.50
16-Nov	Soaf '17	Buy	2.0	98.45
16-Nov	Ecu '2	Sell	3.8	43.75
16-Nov	Bra C	Buy	1.0	73.63
26-Nov	Pol PDI	Buy	1.1	99.63
26-Nov	Pol Par	Sell	0.7	75.50
3-Dec	Arg '09	Sell	1.8	33.00
3-Dec	Arg '18	Sell	3.8	26.50
5-Dec	Phi '24	Buy	1.0	102.75
5-Dec	Mal Ten '11	Buy	0.8	100.42
6-Dec	Ven Par	Sell	2.0	75.50
6-Dec	UMS '26	Buy	0.9	127.40
6-Dec	Dom '06	Buy	0.3	101.50
20-Nov	TU01Z	Buy	44.0	105.06
20-Nov	FV01Z	Sell	26.0	107.50
20-Nov	TY01Z	Sell	33.0	107.66
20-Nov	US01Z	Buy	31.0	106.56
26-Nov	TU01Z	Buy	1.7	104.73
26-Nov	FV01Z	Buy	2.2	106.44
26-Nov	TY01Z	Buy	5.2	106.08
26-Nov	US01Z	Sell	5.6	103.47
6-Dec	FV01Z	Sell	5.0	106.72
6-Dec	US01Z	Buy	9.0	103.63

Source: JPMorgan

Chart 1: Model Portfolio Outperformance



Source: JPMorgan

Table 2: Contribution Performance versus EMBIG (%)

As of 5 December 2001

	1 Week to date	1 Month to Date	10 July to Date
Market Bet	0.36	0.08	0.25
Country Bet	0.95	2.82	3.73
RV Bet	-0.02	0.43	0.85
UST Bet	-0.02	0.27	0.39
Total	1.27	3.59	5.23

Source: JPMorgan

**Our country performance is mainly attributable to the big Argentina underweight that accounted for 2.23% of outperformance last month.** Russia, which remained our core overweight throughout this year, continues to perform well and contributed 0.9% outperformance. Our strategy of being overweight diversifiers such as Algeria, Nigeria, Egypt, Ecuador, and Bulgaria continues to perform well. Our underweight recommendations in Turkey and Brazil were less successful and resulted in underperformance of 0.35% and 0.19%, respectively. On the relative value front we made money in Russia (from the MinFin, '30-'18 and '28-'07 trades), in Brazil from being overweight Bradys versus underweight Globals, and from the curve positioning in South Africa and Egypt. Our relative value performance in Argentina was disappointing because the short end of the curve (where we are underweight) held up well because of the short squeeze.

Table 3: Attribution Analysis per Country

1-Month-to-Date Performance

	Contribution to Outperformance	
	Country and Market Bet	RV Bet
<b>Total</b>	<b>2.90</b>	<b>0.43</b>
Algeria	0.12	-0.06
Argentina	2.23	-0.09
Brazil	-0.19	0.05
Bulgaria	0.12	-0.02
Chile	-0.19	0.00
China	-0.03	0.00
Colombia	-0.01	0.11
Ivory Coast	0.00	-0.08
Croatia	0.00	0.00
Ecuador	0.16	0.01
Egypt	0.13	0.05
Hungary	0.00	0.00
Lebanon	-0.02	0.00
Malaysia	-0.01	-0.01
Mexico	-0.02	0.00
Morocco	0.00	0.00
Nigeria	0.16	0.16
Pakistan	0.01	0.00
Panama	-0.12	0.00
Peru	0.12	-0.02
Philippines	0.01	0.03
Poland	-0.06	-0.01
Russia	0.90	0.16
South Africa	0.00	0.06
South Korea	-0.16	0.00
Thailand	-0.01	0.00
Turkey	-0.35	0.00
Ukraine	0.00	0.00
Uruguay	-0.02	0.00
Venezuela	0.00	-0.03
Qatar	0.00	0.01

Source: JPMorgan

## Current Exposures

**We increased our portfolio beta to 1.0 from 0.93 and moved closer to the benchmark. The tracking error decreased to 1.3% from 2.2% last month.** This is largely due to the index rebalancing, which cut our underweight in

Argentina (which has a high beta). Our US Treasury barbell strategy is based on our view that the short end is likely to outperform as the Fed eases further. On the other hand, over the medium term we expect the curve to flatten at the long end as we approach the end of the easing cycle.

Table 4: Portfolio Summary

	Portfolio	EMBI Global	Diff
Portfolio Value	US\$123.0m		
Beta	1.00	1.00	0.00
Cash holding	4.0%	0.0%	4.0%
Tracking error (bps pa)	133		
Annualized volatility	9.12%	9.00%	0.13%
Aggregate spread duration	5.12	4.92	0.21
Interest rate duration: 2Y	0.40	0.33	0.07
5Y	1.05	1.12	-0.07
10Y	1.59	1.76	-0.16
30Y	2.14	1.98	0.16
Aggregate Interest Rate Durn	5.18	5.19	0.00

Source: JPMorgan

The biggest changes in country exposures over the past month are (numbers refer to percentage overweights):

South Africa from 0.0% to +1.9%	Malaysia from -0.1% to +1.0%
Philippines from 0.2% to +0.9%	Egypt from 2.0% to 0.0%
Ecuador from 2.0% to 0.0%	Brazil from -1.6% to -0.7%
Venezuela from 0.1% to -1.0%	Argentina from -4.8% to -2.1%

Table 5: Country Composition\*

Recommended Deviation from Index

	Portfolio weight %	Empirical overweight %	Change from last month %
Russia (Most Overweight)	19.3	6.0	0.2
Algeria	2.6	2.7	-0.1
South Africa	2.5	1.9	1.9
Nigeria	4.7	1.7	0.1
Bulgaria	3.6	1.6	-0.3
Peru	2.6	1.1	-0.2
Malaysia	3.1	1.0	1.1
Philippines	3.1	0.9	0.7
Chile	0.9	0.9	0.2
Ivory Coast	1.1	0.6	-0.1
Qatar	0.5	0.5	0.0
Pakistan	0.4	0.1	0.0
Egypt	0.8	0.0	-2.0
Mexico	18.0	0.0	0.0
Dom Ren	0.3	0.0	NA
Ukraine	0.5	0.0	0.0
Colombia	3.2	0.0	0.0
Ecuador	1.1	0.0	-1.5
Croatia	0.3	0.0	0.0
Uruguay	0.0	-0.3	0.0
Thailand	0.0	-0.4	0.0
Hungary	0.0	-0.4	0.0
Brazil	19.6	-0.7	0.9
Morocco	0.0	-0.8	0.0
Venezuela	3.8	-1.0	-1.1
Poland	0.9	-1.3	-0.1
Lebanon	0.0	-1.3	0.0
China	0.0	-1.8	0.0
Panama	0.9	-1.8	-0.5
Argentina	2.1	-2.1	2.7
Turkey	0.0	-3.3	-0.4
South Korea (Most Underweight)	0.0	-5.5	-0.2
2Y TU	0.0	0.1	0.1
5Y FV	0.0	-0.1	-0.1
10Y TY	0.0	-0.2	-0.2
30Y US	0.0	0.2	0.1
Cash	0.0	4.0	2.0

Table 6: EMBI Global Model Portfolio Instrument Composition

	Holding (US\$ million)	Port Weight	Weight versus EMBIG		Holding (US\$ million)	Port Weight	Weight versus EMBIG
AR Bontes due 03			-0.2%	MX Par bonds - A			-0.9%
AR Bontes due 04			-0.1%	MX Par bonds - B	3.5	2.7%	0.4%
AR Bontes due 05			-0.1%	MX Pemex 6 1/2% due 05			-0.3%
AR Bontes due 06			0.0%	MX Pemex Finance 9 1/8% due 10			-0.6%
AR Discount bonds	2.0	0.8%	0.6%	MX UMS 10 3/8% due 09	1.5	1.4%	0.2%
AR FRBs			-0.3%	MX UMS 11 1/2% due 26	1.6	1.7%	0.4%
AR Par bonds	1.6	0.6%	-0.1%	MX UMS 11 3/8% due 16			-1.6%
AR Republic 11 3/4% due 09			-0.2%	MX UMS 8 1/2% due 06			-0.9%
AR Republic 11 3/4% due 15	0.5	0.1%	0.0%	MX UMS 8 1/8% due 19	2.8	2.3%	0.5%
AR Republic 11 3/8% due 10			-0.1%	MX UMS 8 3/8% due 11	4.0	3.5%	2.0%
AR Republic 11 3/8% due 17			-0.3%	MX UMS 8 5/8% due 08			-0.6%
AR Republic 11% due 05			-0.2%	MX UMS 8.3% due 31	1.0	0.8%	-0.5%
AR Republic 11% due 06			-0.2%	MX UMS 9 3/4% due 05			-0.6%
AR Republic 12 1/4% due 18	3.0	0.6%	0.4%	MX UMS 9 7/8% due 07			-1.0%
AR Republic 12 3/8% due 12			-0.1%	MX UMS 9 7/8% due 10	4.5	4.2%	3.0%
AR Republic 12% due 06/31			-0.1%	MY Petronas 6 7/8% due 03			-0.3%
AR Republic 7% step-up due 08			-0.5%	MY Petronas 7 1/8% due 06			-0.5%
AR Republic 8 3/8% due 03			-0.4%	MY Petronas 7 3/4% due 15			-0.4%
AR Republic 9 3/4% due 27			-0.1%	MY Petronas 7 5/8% due 26	0.8	0.6%	0.4%
AR US Genl Debt Bocon due 07			0.0%	MY Petronas 8 7/8% due 04			-0.4%
BG Discount bonds-A			-0.7%	MY Republic 7 1/2% due 11			-0.6%
BG FLIRBs-A	5.0	3.6%	2.9%	MY Republic 8 3/4% due 09	1.3	1.2%	0.3%
BG IABs			-0.8%	MY Tenaga Nas 7 5/8% due 11	1.6	1.3%	1.0%
BR C bonds	7.5	5.8%	3.0%	NG P Notes	2.8	0.9%	-0.1%
BR DCBs	3.4	1.9%	-0.5%	NG Par bonds	7.0	3.8%	3.1%
BR Discounts-Z	7.6	4.4%	3.5%	PA IRB			-0.6%
BR Eligible Interest bonds	2.5	1.3%	0.1%	PA PDI bond (cap.)			-0.5%
BR FLIRBs			-0.3%	PA Republic 8 1/4% due 08			-0.3%
BR New Money bonds-1994			-0.7%	PA Republic 8 7/8% due 27			-0.4%
BR Pars-Z	3.0	1.7%	0.8%	PA Republic 9 3/8% due 29			-0.3%
BR Republic 10 1/4% due 06			-0.8%	PA Republic 9 5/8% due 11	1.0	0.9%	0.4%
BR Republic 10 1/8% due 27	4.5	2.7%	1.3%	PE FLIRBs	0.9	0.5%	-0.1%
BR Republic 11 1/4% due 07			-0.8%	PE PDI bonds	3.3	2.1%	1.3%
BR Republic 11 5/8% due 04			-1.7%	PH Republic 10 5/8% due 25			-0.5%
BR Republic 11% due 40			-2.2%	PH Republic 8 7/8% due 08			-0.5%
BR Republic 12 1/4% due 30			-0.8%	PH Republic 9 1/2% due 24	1.0	0.8%	0.3%
BR Republic 12 3/4% due 20			-0.5%	PH Republic 9 7/8% due 10			-0.3%
BR Republic 14 1/2% due 09			-1.2%	PH Republic 9 7/8% due 19	3.0	2.3%	1.7%
BR Republic 8 7/8% due 24	3.3	1.8%	1.0%	PK Republic 10% due 05	0.5	0.4%	0.1%
BR Republic 9 3/8% due 08			-0.6%	PL Delphes 7 3/4% due 09			-0.3%
BR Republic 9 5/8% due 05			-0.5%	PL PDI bonds	1.1	0.9%	-0.5%
CI Flirbs FRN due 18			-0.1%	PL Par bonds			-0.3%
CI PDI FRN due 18	10.0	1.1%	1.1%	RU MoF 4 due 03	1.0	0.8%	0.8%
CL Republic 6 7/8% due 09	1.0	0.9%	0.6%	RU MoF 6 due 06	1.0	0.6%	0.6%
CL Republic 7 1/8% due 12			-0.4%	RU Ministry Fin 11 3/4% due 03			-0.7%
CN Republic 6 1/2% due 04			-0.6%	RU Ministry Fin 11% due 18			-1.9%
CN Republic 6.8% due 11			-0.6%	RU Ministry Fin 12 3/4% due 28	6.3	5.8%	4.3%
CN Republic 7.3% due 08			-0.6%	RU Ministry Fin 8 3/4% due 05			-1.7%
CO Republic 10 1/2% due 06			-0.3%	RU Republic 8 1/4% due 10	4.7	3.4%	2.1%
CO Republic 11 3/4% due 20	3.8	3.2%	2.6%	RU Republic Step-Up due 30	19.0	8.8%	3.2%
CO Republic 7 5/8% due 07			-0.4%	RU Ministry Fin 10% due 07			-1.3%
CO Republic 8 5/8% due 08			-0.3%	TH Kingdom 7 3/4% due 07			-0.4%
CO Republic 9 3/4% due 09			-0.3%	TR Republic 10% due 07			-0.3%
CO Republic 9 3/4% due 09 Put 05			-0.3%	TR Republic 11 3/4% due 10			-0.9%
CO Republic 9 3/4% due 11 (WB)			-0.6%	TR Republic 11 7/8% due 04			-0.3%
DO Republic 9 1/2% due 06	0.3	0.3%	0.0%	TR Republic 11 7/8% due 30			-0.8%
DZ Algeria Tranche 1			-0.2%	TR Republic 12 3/8% due 09			-0.7%
DZ Algeria Tranche 3	4.5	2.6%	2.4%	TR Republic 9 7/8% due 05			-0.3%
EC Republic 12% due 12			-0.5%	UA Republic 11% due 07	0.7	0.5%	0.0%
EC Republic Step-up due 30	2.7	1.1%	0.4%	UY Republic 7 7/8% due 27			-0.3%
EG Republic 7 5/8% due 06	0.3	0.3%	0.0%	VE DCBs-DL			-1.3%
EG Republic 8 3/4% due 11	0.7	0.6%	0.0%	VE FLIRBs - A	5.5	1.8%	1.5%
HR Croatia Series A	0.5	0.3%	0.0%	VE FLIRBs - B	0.6	0.2%	0.0%
HU Natl Bk 6 1/2% due 03			-0.4%	VE Par bonds - A	2.4	1.5%	0.8%
KR Export Import Bank 6 3/8% due 06			-0.3%	VE Par bonds - B	0.4	0.2%	-0.1%
KR Export Import Bank 7.1% due 07			-0.4%	VE Republic 13 5/8% due 18			-0.3%
KR Hanvit 12 3/4% due 10			-0.3%	VE Republic 9 1/4% due 27			-1.5%
KR KDB 6 5/8% due 03			-0.3%	ZA Republic 8 1/2% due 17	3.0	2.5%	2.3%
KR KDB 7 1/4% due 06			-0.4%	ZA Republic 9 1/8% due 09			-0.8%
KR KDB 7 1/8% due 04			-0.6%				
KR KDB 7 3/8% due 04			-0.3%				
KR KDB 8.09% due 04			-0.3%				
KR Republic 8 3/4% due 03			-0.6%	<b>Off Index Bets</b>			
KR Republic 8 7/8% due 08			-1.9%	QA Republic 9 1/2% due 09			0.0%
LB Republic 10 1/4% due 09			-0.3%	QA Republic 9 3/4% due 30	0.5	0.5%	0.5%
LB Republic 10 1/8% due 08			-0.4%	Cash	5.0	4.0%	4.0%
LB Republic 9 7/8% due 06			-0.6%				
MA Consol A loans			-0.8%				
MX BNCE 7 1/4% due 04	0.5	0.4%	-0.1%	2Y Bond Future: TUZ1	136	0.4	0.1
MX Discount bonds - B			-0.1%	5Y Bond Future: FVZ1	95	1.0	-0.1
MX Discount bonds - C			-0.1%	10Y Bond Future: TYZ1	-64	1.6	-0.2
MX Discount bonds - D	1.2	1.0%	0.6%	30Y Bond Future: USZ1	-92	2.1	0.2

## Relative Value Trade Recommendations

### Argentina: Favor Low Dollar Priced Globals and Pars

**Our base case scenario for Argentina remains one of a default/distressed exchange, with an over-50% haircut on the total stock of debt.** For investors who still hold higher dollar priced FRBs, '08s, and '09s, we would recommend selling to take advantage of expensive valuations, which were caused by a short squeeze in repo. We still see better value in low dollar-priced '18s, '31s, and collateralized bonds, which are already pricing in a haircut above 70% and are likely to have smaller losses in a potential external debt restructuring.

**We continue to recommend the long '18 versus short '08 trade,** but the unavailability of '08s in repo may mean that it only makes sense as a switch. The long end of the Argentina curve continued to underperform shorter duration bonds last month with the price difference between '08s and '31s widening to 10 points recently.

#### The factors that affected this spread are the following:

First, local pension funds were switching out of the long end into '08s, as tendering the latter in the exchange offered accounting benefits. We expect the price difference to converge once the market starts to focus on a subsequent external debt exchange, which is very unlikely to have terms similar to the local exchange. Our base case assumption for the terms for the international restructuring remains the "par claim" scenario. Based on this scenario the fair value price difference between '08s and '18s should not be more than 4.5 points (*Table 1*).

Table 1: Fair Value of Argentina Bonds in Hypothetical Restructuring\*

	Current Price	Price + Accrued	Implied Haircut	Fair Value Price + Accrued		
				50% Haircut	65% Haircut	75% Haircut
Par	50.0	50.2	77%	62.9	55.9	51.3
FRB	45.0	45.6	41%	39.1	28.1	20.8
'08	32.0	35.3	61%	43.2	32.3	25.0
'18	23.3	23.3	71%	40.3	28.2	20.2
'31	23.0	23.0	71%	40.2	28.1	20.1

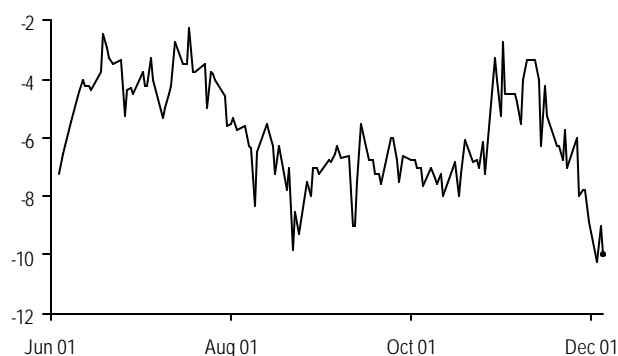
\* Assumptions: 65% haircut on the total debt stock, PDI paid in bonds, par claim scenario, post-restructuring yield of 18%.

Source: JPMorgan

Second, the short squeeze and fails in FRBs, '08s, and Bontes provided support for the short end. The recent short squeeze was not caused so much by an increase in shorting interest but rather by the demand for paper ahead of the local exchange and decreased availability as repo lines to Argentine banks have been cut. With the local exchange out of the way the repo situation could clear somewhat. If the repo facility is rolled on 11 December it could also increase availability of paper. This is likely to make '08s vulnerable to further downside.

In addition, in default the triggering of credit default swap contracts could give a significant bid for the lowest dollar price bonds. This should further benefit '18s and '31s.

Chart 1: ArgCap18 versus ArgStep08



Source: JPMorgan

**Argentina Pars continue to offer value in a restructuring scenario under the "par claim" and recently cheapened up relative to Globals.** The average spread of Pars versus '08s and '18s widened to 400 bps recently and closed at 180 bps (offer-to-bid) on Wednesday, 5 December. This relative value trade may be difficult to execute because of the unavailability of these bonds in repo. For investors who are long '08s and '18s we recommend switching into Pars.

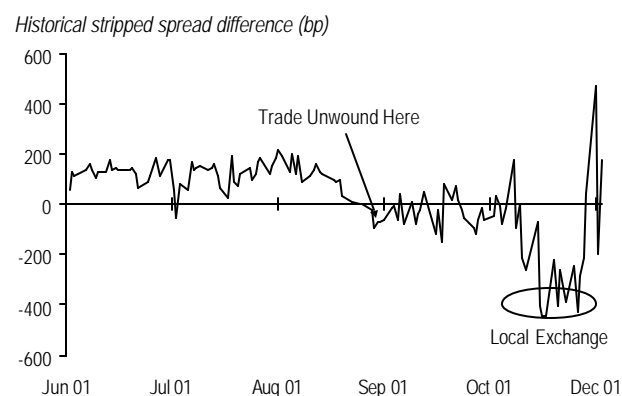
#### The rationale for this trade is the following:

First, in a likely debt restructuring Pars are likely to have smaller losses than Globals. It so happens that the 10 million Par versus 1.8 million '08 and 1.0 million '18 structured DV01-neutral is also likely to have a small positive default P&L.

Second, Wednesday’s level of 180 bps represents a relatively attractive entry point—at the time of the local debt exchange Pars traded 300-400 bps through the average of ’08s and ’18s. In a rally this trade stands to benefit from spread tightening versus Globals. We unwound this trade in our model portfolio on 20 September, but we do not go the other way because we do not have any ’08s to sell.

The main risk for Pars is in the event of restructuring treatment other than “pull-to-par.” Also, in default, investors maybe more inclined to sell Pars because of their high dollar price despite the fact that the sovereign portion of the price is only 15 cents.

Chart 2: Arg Par versus ’08 and ’18



Source: JPMorgan

### Russia: Steep Curve and Lower Spreads Benefit Extending Duration

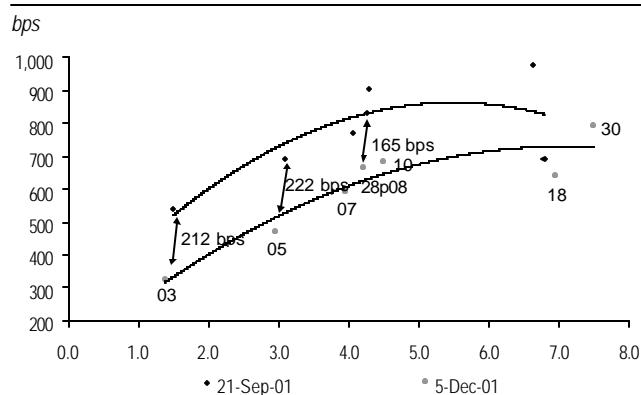
Over the past quarter we have seen a bull steepening of the Russian curve, with the front end having benefited from the 27 November redemption of the Russia ’01 and the steady bid from local investors. Going forward we expect a bull flattening because the spread pickup at the long end has become very valuable in a low spread environment.

The implications of the reshaping of the Russian curve are that it is increasingly attractive to extend duration and to look for the wide spreads of the MinFins, particularly the MinFin4 and MinFin6. In our EMBIG model portfolio, we position ourselves accordingly with overweights in the MinFin4, MinFin6, ’28, ’10, and ’30.

As can be seen in *Table 2 and Chart 3* the front section has outperformed the middle of the curve with the ’03s

and ’05s having tightened by 212 bps and 222 bps, while ’07s and ’28s have tightened by only 179 bps and 165 bps, respectively. The combination of a steeper curve and lower absolute spreads means that the proportional spread pickup of extending duration along the steep curve is increasingly valuable.

Chart 3: Russian Curve has Steepened since 21 September



Source: JPMorgan

It is not surprising that the percentage spread pickup of the ’07 and the ’28 as compared with ’03 has increased substantially (from 43% to 81% and from 56% to 104%, (*Table 2*). What is surprising is that assets that actually tightened to the front end—MinFin4s, MinFin6s, and Russia ’10s—also had a percentage spread pickup. For example, the MinFin6, which has tightened the most on the Russian spread curve (351 bps since 21 September), has seen its percentage spread pickup increase from 76% to 98%. Furthermore, despite tightening by 129 bps to the Russia ’05, the MinFin6 on a proportional basis is essentially unchanged with a 49% spread pickup to the ’05.

Table 2: Changes in the Russian Spread Curve

	Spread Level			Percentage Spread Pickup to Rus ’03	
	21-Sept	5-Dec	Change	21-Sept	5-Dec
Rus03	540	327	-213		
Rus05	692	470	-222	28%	44%
Rus07	772	593	-179	43%	81%
Rus28/08	833	668	-165	54%	104%
Rus10	905	685	-220	68%	109%
Rus18	692	638	-54	28%	95%
Rus30	977	792	-185	81%	142%
RusMinF4	953	648	-305	76%	98%
RusMinF6	1047	696	-351	94%	113%
RusMinF5	1067	850	-217	98%	160%
RusMinF7	977	754	-223	81%	131%

Source: JPMorgan

## Relative Value Trades

### Outstanding Trade Recommendations

Trade	What To Do	Entry Date	UST Hedge	Entry Spread	Current Spread	Spread Change	P&L	Total Return	Target Spread	Stop Loss
Long 10m Rus '28 vs Short 11.6 m '07s	Add	01-Nov-01		57	57	0	\$2,698	0.0%	25	90
Long 10m Arg '18 vs Short 8.9m '08s	Add	11-Oct-01	Short 1.5m UST10 & 1m UST 30	-677	-1366	-689	-\$693,349	-13.7%	-2pt price	-15pt price
Long 10m Bra Disc vs Short 4.3m NMBs and 2.4m '24	Hold	28-Sep-01	Long 5.2 UST10 & Short 4.7m UST 30	246	206	-40	-\$64,645	-1.0%	100	350
Long 10m UMS10 vs Short 16m UMS06	Hold	27-Jun-01		67	97	30	-\$327,419	-2.8%	30	100
Long 10m Ven Par vs Short 3.4m '27	Hold	09-Aug-01	1.3 UST10 & 4m UST 30	367	309	-58	-\$75,983	-1.0%	300	450
Long 10m Tur '30 vs Short 12.5m '10	Hold	07-Aug-01		-35	10	45	-\$278,805	-3.5%	-80	0
03-Jan-00	Hold	29-Aug-01		-19	10	29	-\$130,294	-1.5%	-80	0

### Closed Trade Recommendations

Trade	What To Do	Entry Date	UST Hedge	Entry Spread	Exit Spread	Spread Change	P&L	Total Return
Long 10m Rus '30 vs Short 5.7m '18	Close 12/04	28-Jun-01		186	167	-19	\$92,188	1.9%
Long 10m Rus '28 vs Short 11.7 mm Rus '07	Close 9/26	31-Aug-01		41	16	-25	\$109,288	1.0%
Long 10m Arg Par vs Short 2.2 '08 & 1.1 '18	Closed 9/20	10-Jul-01	4m UST 30	156	1	-156	\$248,597	4.0%
Long 4.4m Arg '08 vs Short 4.1 FRB & 1.6 '18	Closed 8/21	19-Jul-01		188	185	-3	\$17,602	0.7%
Long 18.5m Rus03 vs Short10m '05	Closed 7/11	12-Jun-01		-7	-33	-26	\$210,287	1.1%
Long 7.9m Rus 07 vs Short 10m '05	Closed 7/11	06-Jun-01		131	86	-45	\$192,947	2.5%
Long 8.3m Ven Par vs Short 10m DCB	Closed 6/5	14-May-01	Sell 9.2m UST 10	363	334	-29	\$117,947	1.9%
Long 23.7m Arg Par vs Short 10m '17	Closed 6/4	14-May-01	Buy 1.7 UST 10 & Sell 10.2 UST30	272	54	-218	\$940,005	6.4%
Long 21m ArgPar vs Short 10m '27	Closed 6/4	14-May-01	Buy 1.8 UST10 & Sell 8 MM UST30	349	204	-145	\$486,704	3.7%
Long 12m Mex Pars vs 10m '05s	Closed 9/5	02-May-01	Buy 8m UST5 & Sell 15.3 UST30	200	190	-10	\$173,573	1.6%
Long 28m Bra Par vs Short 10m '27	Closed 5/10	02-May-01	Buy 2m UST 10 & Sell 13.6 UST30	191	158	-33	\$411,574	2.2%
Long 10.1m Rus10 vs Short 10 m '07	Closed 6/5	02-May-01		58	112	54	-\$214,032	-3.1%
Long 8m Rus '28 vs Short 10m '03	Closed 6/19	02-May-01		263	211	-52	\$358,671	4.9%
Long 21m ArgPar vs Short 10m '27	Closed 5/8	02-May-01	Buy 2m UST 10 & Sell 10m UST30	412	337	-75	\$399,193	3.1%
Long 13m Tur '09 vs Short 10m '30	Closed 4/25	25-Apr-01		141	102	-39	\$301,622	2.9%
Long 8m Bra24 vs Short 10m '09	Closed 6/5	20-Apr-01		-11	15	26	-\$192,389	-3.6%
Long 11m Bul FLIRB vs Short 10m Disc	Closed 7/11	20-Apr-01	Buy 3.6m UST10	188	178	-10	\$83,426	1.0%
Long 11m Bul FLIRB vs Short10m IAB	Closed 7/11	20-Apr-01		39	38	-1	\$7,925	0.1%
Long 10 m Bra C vs Short 20 m Par	Closed 4/24	04-Apr-01	Sell 5.2m UST10 & Buy 12.5m UST 30	-91	-234	-143	\$270,752	3.5%
Long 9m Rus '30 & 4.3 M '03 vs Short 10 m '07	Closed 5/2	04-Apr-01		-24	2	26	-\$65,181	-0.8%
Long 4.6m Bra '24 vs Short 10m Par	Closed 5/2	04-Apr-01	Sell -9 m UST 10 & Buy 5.1 UST 30	-111	-194	-83	\$399,193	3.1%
Long 11.5m MexPar vs Short 10m Disc	Closed 6/19	04-Apr-01	Sell 7.1m UST 10 & Sell 2.7 M UST30	12	-58	-70	\$330,280	3.2%
Long 14.2m Phi24 vs Short 10m '10	Closed 7/11	04-Apr-01		-10	-29	-19	\$147,174	1.4%
Long 16.5m Pan 29 vs Short 10m '11	Closed 7/10	04-Apr-01		-20	-31	-11	\$159,737	1.4%

## Euro Debt Trade Strategy

- Strong outperformance of EUR versus US\$ debt in Argentina illustrates low volatility
- EUR EMBIG Constrained returned 2.1%, with Latin debt outperforming non-Latins
- Capital markets have reopened for EUR debt over the past six weeks
- But demand for convergence credits remains strong
- Poland sovereign EUR debt expensive; Switch out of Poland '11 into PGNIG '06 or Slovakia
- Brazil: Take profits on BNDES '05 versus Brazil '04 switch; Buy '06 and '11 against '07s
- Colombia EUR debt still cheap to US\$ debt: Buy the EUR for the carry

**The performance of EUR-denominated debt since the beginning of November generally mirrored that of the dollar market.** The five-month trend of European debt outperforming the Latin assets was reversed as the EUR EMBIG Constrained gained 1.4% compared to the 3.4% return of the Latin subcomponent, paced by Brazil, which had a positive return of 7.1% since 1 November. The striking exception has been the outperformance of Argentine EUR debt with prices essentially unchanged since 1 November, while US\$ debt prices fell 20 points. The retail ownership of Argentine EUR debt in particular, and for EUR debt in general, highlights the impact on volatility that this investor base has.

Since mid-October, the capital markets have reopened for EUR-denominated debt with EUR4 billion of emerging markets issuance, of which sovereigns accounted for EUR2 billion. Looking forward, we expect the pace of new issuance to remain strong in the near term and to increase following the New Year. With continued strong inflows to crossover funds, we expect future supply to be well absorbed.

Table 1: Recent EUR Issuance

Ann date	Issuer	Amount		
		EUR Mil	Coupon	Maturity
16-Oct-01	City of Moscow	300	10.25	25-Oct-04
19-Oct-01	PGNiG Finance BV	800	6.75	30-Oct-06
23-Oct-01	Republic of Turkey	500	11.00	7-Feb-05
9-Nov-01	Republic of Latvia	200	5.38	27-Nov-08
12-Nov-01	Republic of Bulgaria	250	7.25	1-Mar-07
15-Nov-01	City of Moscow	400	10.95	28-Apr-06
15-Nov-01	Singapore Telecom. Ltd	500	6.00	25-Nov-11
27-Nov-01	Republic of Poland	250	5.50	14-Feb-11
28-Nov-01	Republic of the Phil.	500	9.38	7-Dec-06
4-Dec-01	Republic of Turkey	300	11.00	7-Feb-05

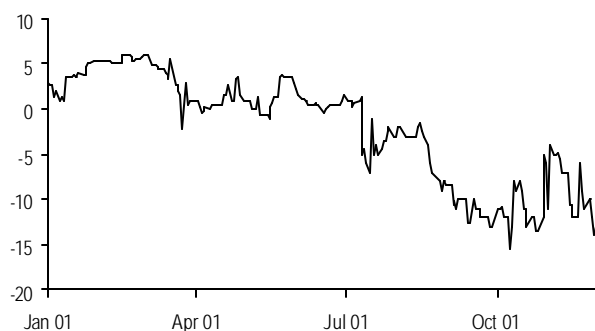
Source: JPMorgan

### Argentina: Retail Hands Remain Steady

**Argentine EUR-denominated debt continues to decouple from the US\$ debt as demand from retail investors remains fairly strong.** The lack of supply of Argentine paper, particularly at the front end, has created a demand/supply imbalance resulting in buy-ins, and led prices of EUR paper to trade as much as 20 points above US\$ debt at the front end of the curve. While this technical dynamic may continue for some time, we continue to recommend avoiding Argentine EUR debt for fear of an effective default. For those investors who want to hold Argentine EUR debt, we recommend swapping into the lower-priced Arg 8.5% '10 and the 11.75% '11 DEM from shorter-dated assets.

Chart 1: Arg11.75-11D versus Arg9-03E

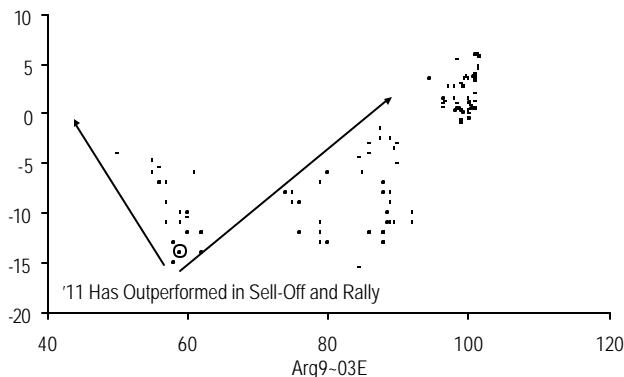
Price Diff., 1-Jan-01 to 4-Dec-01



Source: JPMorgan

Chart 2: Arg11.75-11D versus Arg9-03E

Price Diff., 1-Jan-01 to 4-Dec-01



Source: JPMorgan

### Poland: Sovereign Expensive, Buy PGNIG and Slovakia over Poland '10

At a spread of 38-43 bps over the EUR swap curve we find the Poland EUR sovereign debt expensive relative to alternative ways of taking Polish risk, such as PGNIG. We have recommended the PGNIG '06s since early November when they traded as much as 226 bps wide of the '11. Since that time PGNIG has tightened to the sovereign by 62 bps, and despite this outperformance we continue to recommend PGNIG over the sovereign. Since issuance, the EUR800 million issue has traded somewhat loosely, but we expect that as the paper becomes better placed the issue should tighten further. Moreover, the sovereign has indicated that it will issue up to EUR2 billion, more than doubling the existing stock of EUR-denominated debt. We target a 120-bp spread difference to the sovereign.

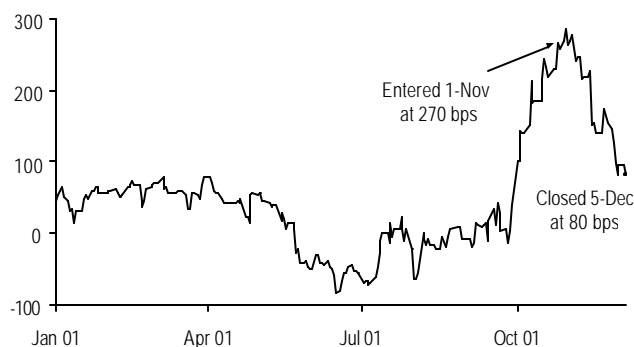
In addition to favoring PGNIG, we also view the sovereign as expensive to other Eastern European credits, in particular the Slovak Republic. In our view, the Slovak Republic is better positioned for EU entry than Poland. The rating agencies have taken notice, with Moody's upgrading it to Baa3 from Ba1 in mid-November. With the Slovak '10 trading at 138 bps over Bunds it remains 68 bps wide of the Poland '10 and represents value.

### Brazil: Unwind Long BNDES 9% 2005 versus 11 1/8% 2004

Over the past month, the rally in Brazil has led to a convergence of the BNDES '05 to the sovereign curve. Although the BNDES remains 80 bps wide to the sovereign curve and is still somewhat cheap, the BNDES '05-Brazil '04 spread differential has compressed by 190 bps since we recommended the position on 1 November, and we prefer to take profits.

Chart 3: BNDES9-05E versus Bra04E

Spread-to-Swaps Diff., 1-Jan-01 to 4-Dec-01



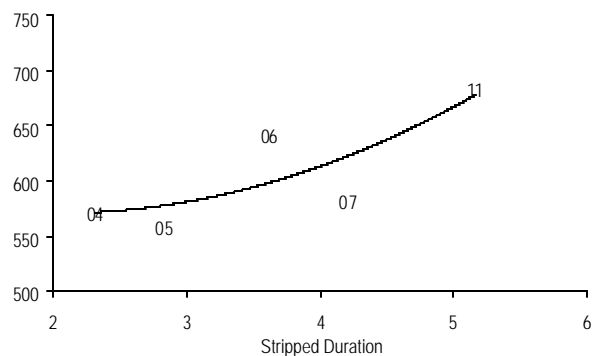
Source: JPMorgan

### Buy Brazil '06 and '11 Against '07s (5.4 million '06 and 4.1 million '11 x 10 million '07)

The strong performance of Brazilian debt has led to a reshaping of the EUR spread curve. In particular, the '07 has outperformed, tightening by 325 bps since 1 November, while the '06 and '11 tightened by 292 and 230 bps, respectively. This has led the weighted average spread difference of the dv01- and cash-neutral barbell to increase to 92 bps from -6 bps in mid-November. As Charts 4 and 5 on the following page show, this level has been near the top of the trading range and represents an attractive entry point. We like the barbell position for the following reasons: 1) At a spread pickup of 92 bps to the '07, the '06/'11 barbell is cheap to the '07, 2) The position has positive carry of 23 bps over 3-months, and 3) the barbell position is long convexity, which is valuable given the volatility of Brazilian debt prices.

**Chart 4: Brazil**

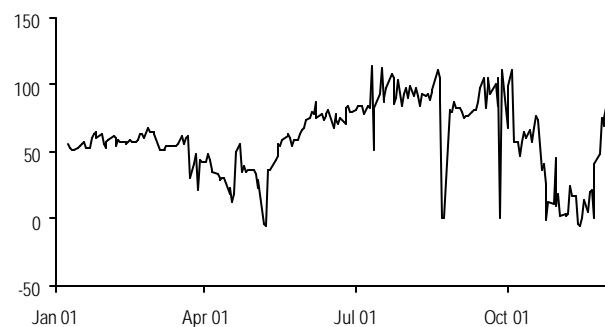
*Sprd-to-Swaps versus Stripped Duration, 4-Dec-01*



Source: JPMorgan

**Chart 5: Bra06E and Bra 11E versus Bra07E**

*Sprd-to-Swaps Diff., 1-Jan-01 to 4-Dec-01*



Source: JPMorgan

**Table 2: EUR Debt Recommendation Summary**

New Trade						
Action	Trade Date	Buy	Sell	Entry Spread	Current Spread	Target
Add	5-Dec-01	Slovak '10	Poland '10	68	68	25
Add	5-Dec-01	0.5 Brazil '06 and 0.4 Brazil '11	Brazil '07	92	92	40
Previous Trades						
Action	Trade Date	Buy	Sell	Entry Spread	Current Spread	P&L
Hold	4-Oct-01	Arg8.5-10E	Arg9-03E	-21	-16	5
Hold	2-Aug-01	Cro11E	Pol11E	136	145	9
Hold	2-Aug-01	Cro11E	CroA	58	49	-8
Unwound 1 Nov	2-Aug-01	0.4 Bra '11 & 0.6 Brazil '04	Brazil '07 EUR	63	-18	-81
Hold	2-Aug-01	Col11E	Col09	198	208	10
Hold	2-Aug-01	Col05E	Col09P05	179	147	-31
Hold	7-Nov-01	PGNIG '06	Pol11E	226	164	-62
Unwound 5 Dec	1-Nov-01	BNDES9-05E	Bra04E	270	80	-190

## Credit Derivative Trade Strategy

Table 1: Credit Default Swap Mid-Market Levels

*Basis points over swaps*

	Tenor	Current 05-Dec-01	Previous 01-Nov-01	Change
Argentina (Indicative)	1 Yr	7,858	8,039	-181
	2 Yr	7,149	7,020	129
	5 Yr	5,560	5,747	-187
Brazil	1 Yr	290	475	-185
	2 Yr	700	995	-295
	5 Yr	855	1190	-335
Colombia	1 Yr	245	285	-40
	2 Yr	380	445	-65
	5 Yr	525	610	-85
Mexico	1 Yr	100	125	-25
	2 Yr	155	205	-50
	5 Yr	235	320	-85
Venezuela	1 Yr	605	550	55
	2 Yr	855	820	35
	5 Yr	1,100	1,105	-5
Russia	1 Yr	165	275	-110
	2 Yr	400	545	-145
	5 Yr	575	790	-215
Turkey	1 Yr	465	680	-215
	2 Yr	595	770	-175
	5 Yr	690	900	-210
Bulgaria	1 Yr	75	100	-25
	2 Yr	160	200	-40
	5 Yr	350	475	-125
Poland	1 Yr	20	22	-2
	2 Yr	30	32	-2
	5 Yr	54	57	-3
Philippines	1 Yr	200	300	-100
	3 Yr	400	475	-75
	5 Yr	500	575	-75
Malaysia	1 Yr	53	98	-45
	3 Yr	98	148	-50
	5 Yr	128	183	-55
Korea	1 Yr	33	68	-35
	3 Yr	63	83	-20
	5 Yr	88	108	-20

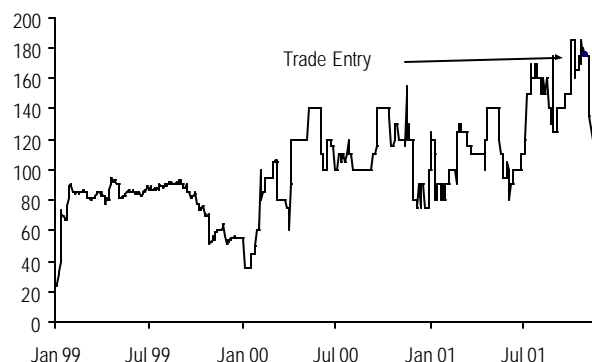
Source: JPMorgan

**Since our previous publication in early November spreads have rallied dramatically in most markets.** The exceptions are in Venezuela, where spreads are wider in the short tenors, and in Argentina, where the market remains illiquid. The market rally has reduced the steepness which prevailed over the past few months in some markets and we take profits on curve trades in Bulgaria and Russia.

### Unwind Bulgaria 5-year-3-year Curve Flattening Position

**On 31 October we recommended a spread neutral curve flattening position in Bulgaria, which we now unwind as the curve has flattened and the position no longer looks attractive.** The entry spread difference including bid/offer was 150 bps. The unwind including bid/offer was executed on 6 December at 120 bps. The P/L on the trade was 0.8%.

Chart 1: BG 5 year-3 year Spread Difference-Mid Market Levels

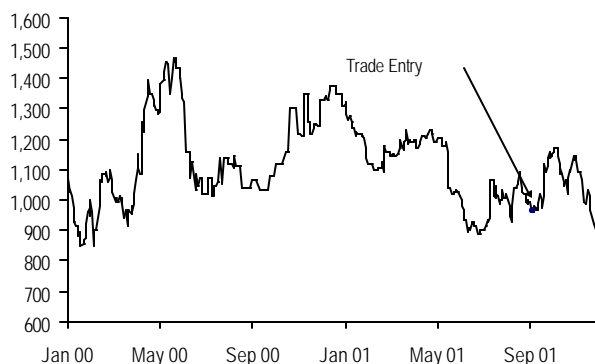


Source: JPMorgan

### Unwind Russia 7-year-2-year Forward Spread Trade

**On 6 September we recommended a position short 7-year protection—long 2-year protection equal weight.** We recommend unwinding the position. The entry forward spread was 911 bps and the exit spread is 820. The P/L is 3.0%.

Chart 2: RU Short 7 year-Long 2 year Fwd Spread-Mid Market Levels



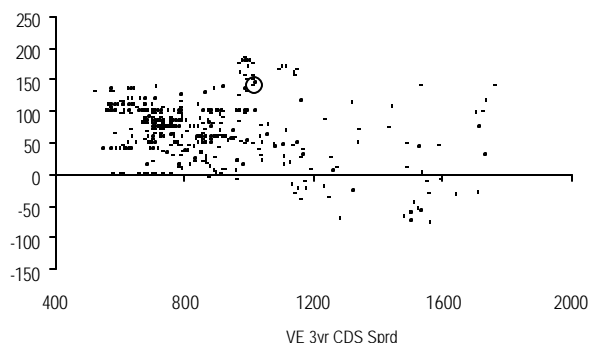
Source: JPMorgan

## Hold Venezuela Curve Flattening Positions

We continue to recommend holding the curve flattening positions in Venezuela we first recommended in September. At current spreads a position short 7-year protection versus long 3-year protection looks attractive. The duration neutral weight on the 7-year leg is 0.6. The chart below illustrates that the spread difference is near its 3-year high. Moreover, should conditions deteriorate further in Venezuela, the historical pattern suggests that the curve is unlikely to steepen further and may invert. The position is net long protection so it will likely perform well in an extreme negative scenario. Alternatively, in a rally, history suggests that the curve will flatten. The downside to the positions is the negative carry of 320 bps/year, but given the volatility of the market and the current position of the relationships versus history we believe this cost will be

recovered. Also one might sell 0.75 of the 7-year leg to reduce the negative carry to 150 bps/year, while maintaining the net long protection position to protect the downside.

Chart 3: VE 7 year-3 year Diff versus Outright Z-score=2.1



Source: JPMorgan

Table 2: Credit Default Swap Trade Recommendation Summary

Trade Date	Exit Date	Credit	Short Leg			Long Leg			Entry Spread	Current Spread	P/L
			Tenor Years	Face	Spread	Tenor Years	Face	Spread			
<b>Previous Trade Recommendations</b>											
31-Oct-01		Russia: Short 2-yr prot. - Long 3-yr prot., spread neutral	2	100	555	3	56	655	100	70	0.7%
31-Oct-01		Brazil: Short 5-yr prot. - Long 3-yr prot, spread neutral	5	70	1,150	3	100	1,085	65	50	0.0%
31-Oct-01		Venezuela: Short 5-yr prot. Long 3-yr prot, spread neutral	5	56	1,085	3	100	980	105	85	-0.3%
3-Oct-01		Brazil: Long 1-yr default protection outright				1	100	595	595	290	-3.0%
3-Oct-01		Short Thai 5-yr protection, Long Malaysia 5-yr protection	5	100	180	5	100	175	-5	-5	-0.2%
06-Sep-01		Bulgaria: Short 3-yr default protection 2 yrs forward	5	100	410	2	100	215	580	513	2.2%
20-Jul-01		Poland: Short 5-yr default prot. 5 yrs forward	10	100	56	5	100	46	70	81	-0.4%
13-Jul-01		Russia: Short 2-yr default prot. 1 yr forward	2	100	670	1	100	480	886	680	3.9%
<b>Closed Trades</b>											
06-Sep-01	03-Oct-01	Brazil: Short 3-yr default protection 2 yrs forward	5	100	875	2	100	685	1068	1,555	-5.5%
31-Oct-01	06-Dec-01	Bulgaria: Short 5-yr prot. - long 3 yr prot., spread neutral	5	66	450	3	100	300	150	120	0.8%
06-Sep-01	06-Dec-01	Russia: Short 5-yr default protection 2 yrs forward	7	100	730	2	100	450	911	820	3.0%

## New Reports Covering the Credit Default Swap Market

This month we launch several new daily reports to assist in the identification of trade opportunities and to better quantify the basis between the bond and cash markets. Our approach to analyzing opportunities in the credit default swap market is described in a research note issued on 26 October entitled *Emerging Market Credit Derivatives*. This report and the daily reports described below are available by e-mail and will soon be available on [morganmarkets.com](http://morganmarkets.com).

- 1) *Credit Default Swap Forward Spread Z-Score Report*: a chart package that illustrates the forward spread history for six pairs of tenors for each country. A Z-score giving the number of standard deviations by which the current forward spread differs from the predicted level based on the historical pattern is also included.
- 2) *Credit Default Swap Spread Difference Z-Score Report*: a chart package similar to the one above but illustrating the spread difference between pairs of tenors (rather than the forward spread).
- 3) *Credit Default Swap Z-Score Report*: A ranking by Z-score of the forward spread relationships most out of line with the historical pattern.
- 4) *Credit Default Swap Basis Report*: A table in which the components of basis between default swaps and cash bonds are analyzed. In this report we present our calculation of adjusted basis, which we believe is a better measure of the relative value between default swaps and cash bonds than the standard basis calculation because it prices repo and the cheapest-to-deliver options.

## Equities Outlook

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- We think zero EPS growth next year would be an optimistic outcome
  - Marginal consumption is falling
- 

**The final pieces of the profits puzzle have fallen into place for the third quarter with the publication of the national income accounts.** Total corporate profits were down 8% QOQ and 22% YOY. Clearly, the future and not the past is important for the equity market, but decomposing why profits have crumbled since the summer of 2000 may help us gauge what needs to happen for profits to recover in the quarters ahead.

**Remember the equation from your college macro textbook**—total income [Y] equals consumption [C] plus investment [I] plus government spending [G] plus net exports [X-M]. Another way to represent total income [Y] is the sum of personal income [W] and corporate profits [P]. So we can write a new equation:  $W + P = C + I + G + [X-M]$ . And then we can subtract personal income [W] from both sides and isolate profits [P]. So  $P = [C-W] + I + G + [X-M]$ . Now, in the past 12 months, government spending has gone up, and imports have fallen faster than exports so [X-M] has become less negative. But investment has gone down, and consumption has risen more slowly than personal income despite a cut in personal taxes that translated into a 7% jump in after-tax personal income. So [C-W] fell, or in economist jargon, the marginal propensity to consume fell. More simply, personal savings rose by US\$230 billion during the past 12 months.

**So the problem for profits (looking backward) is simple—a decline in investment spending and an increase in personal saving overwhelmed the pickup in government spending and the improvement in net exports.** So now what? Well, despite Mr. Greenspan's best efforts to drive down interest rates and make saving less attractive, the marginal propensity to consume could fall further as the unemployment rate rises. So personal savings will probably grind higher as we move into 2002. And given the huge financing gap of corporate America, we don't see investment growing anytime soon. So that leaves net exports, the government, or an increase in inventories (a volatile part of investment) as the three potential sources of higher spending that could push economy-wide profits higher, but they do not look big enough to offset current trends in personal saving and business investment. We therefore see zero growth in corporate profits next year as an optimistic outcome.

## Global Fixed Income Outlook

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- The government bond sell-off is overdone, but expect only modest retracement into the first quarter of 2002
  - Spread markets will sustain their outperformance
- 

**The past month's US data trail has reinvigorated recovery trades (short bonds, long risky assets). The sell-off in government bond markets is overdone and will be reversed, but only partially.** We retain the view that the US recovery will come later and less vigorously than the consensus expects, which will motivate two additional Fed eases (to 1.5%) by March 2002. Treasury yields will decline, though only slightly, as valuations (whether measured in real yield terms or relative to equities) are stretched, and investors' focus is on recovery trades. Accordingly, we target 4.6% on the US 10-year by month-end, and a trough of 4.5% in March 2002. The 10-year US-Euro area spread will remain directional, as has been the case all year. We forecast a modest narrowing to 15 bps by month-end and to 5 bps by March 2002.

**The short ends of curves in the US and Europe hold slightly more upside.** Neither Fed funds nor Euribor futures fully discount our central case on policy rates (1.5% Fed funds and 2.5% refi by March 2002). Accordingly, look for modest curve steepening (particularly in 2s5s) over the next quarter.

**JGBs will remain the only real diversifier within the G-7 markets.** The economy continues to deteriorate, which leaves JGBs sandwiched between a prospective supply shock and a lack of alternative investment opportunities. We expect a 1.3-1.4% range on 10-year JGBs to hold into year-end.

**Credit spreads should narrow slightly in the current environment.** Our below-consensus views on growth and corporate earnings are negative for spread product, but expectations of an imminent recovery will continue to drive flows into riskier markets. We remain particularly positive on swaps and agencies, where the combination of lower policy rates and rising government deficits should sponsor spread tightening. We target 60 bps on US 10-year swap spreads, but roughly unchanged Euro area spreads.

## G3 FX Outlook

- While our LCPI shows mixed signals, sentiment remains positive—stay long carry trades for now
- JPMorgan economic and stock market forecasts suggest US\$ weakness in the first quarter

**The dollar has held its ground in recent weeks, though supports appear to be shifting.** The positive sentiment spillover from massive post 11 September liquidity injections is shrinking; however, credit-related sentiment has been improving, keeping our LCPI on a positive track overall.

**The experience of the past year shows that the US\$ holds up as long as there is optimism for an economic recovery or the Fed is easing aggressively.** The dollar has stumbled twice against the euro in the past 15 months, both times related to a combination of pessimism regarding US economic prospects and a Fed that was not delivering enough stimulus to overcome that pessimism.

**Given the JPMorgan forecasts for both the economy and the stock market, we believe that a combination of renewed pessimism regarding economic prospects and a slower pace of Fed easing will once again cause the dollar to weaken, most likely in the first quarter of 2002.** Our forecast for first-quarter US growth is well below consensus. Meanwhile, JPMorgan expects the S&P to give up more than all of its gains since the September lows. The Fed will undoubtedly have to slow the pace of monetary easing, having already moved from 6.5% to 2% in less than a year. Our forecast for EUR/US\$ at parity in the first quarter may appear bold, but that forecast implies a 12%+ euro appreciation against the dollar, well within the range of euro gains during the last two episodes under similar circumstances (the end of 2000 and summer 2001).

**While the yen is the worst-performing currency in risk-seeking mode, we have probably seen most of the losses that will occur in the present episode:** US\$/JPY is up 2.2% since the LCPI entered risk-seeking on 13 November, roughly the average move in that mode. We would not buy the yen while the LCPI remains risk-seeking. If our index shifts to neutral, however, US\$/JPY would probably start to slip. Any drop would be limited, however, by Japanese officials (via verbal intervention or even action should the US dollar threaten to move below 120).

## Oil Market Outlook

- We maintain a 2002 price forecast of US\$25.80 per barrel
- The path of prices depends on how production is managed in the first quarter of 2002

**We maintain a 2002 price forecast of US\$25.80 per barrel.** The most immediately important development for the oil market outlook this month is Russia's announcement on 5 December of a 150,000 b/d cut in oil exports in the first quarter of 2002. A few more steps in the diplomatic dance still have to be made, but the Russian decision appears to be enough to trigger OPEC's 1.5 million b/d cut. On 6 December, following preliminary statements by Norway, Mexico, and Oman pledging production cuts in cooperation with Russia, Secretary-General Ali Rodriguez told press he saw a deal "in principle," and was "optimistic" on a final deal before 15 December. However, as we went to press there was as yet no firm guarantee that the combined cuts (440,000 b/d) would satisfy OPEC, which had asked for a cut of 500,000 b/d from non-OPEC producers.

**Now there will be at least some restraint from non-OPEC nations, and the bout of vigorous sabre rattling seems to have stiffened backbones within OPEC. From this point the path of prices lies in the hands of the producers and depends on how production in the first quarter of 2002 is managed.** However, overall, the demonstration of OPEC resolve, plus the contribution of volcanic international politics, Middle East tension, prolonged uncertainty over Iraq, and the prospect of economic recovery in the second half of next year should all combine to support prices in 2002. The difficult quarter remains the second quarter of next year—seasonal lows in demand combined with the economic cycle will require producer cuts now to start eating into inventories in advance of the April-June period.

We continue to see no advance in global demand in the first half of 2002 relative to this year, with demand increases concentrated in the second half and critically dependent on the start of an economic upswing. Together with the level of rhetoric over direct action on Iraq, we have revised our view on the prospects for a continuation of Iraqi exports throughout all of 2002 from "unlikely" to "highly improbable."

## Latin American Regional Overview

### Back to the Future, Almost

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- Market action shows a clear decoupling of Argentina fueled by index rebalancing effects
  - 2002 issuance will look modest compared to previous years even with new participants
  - Meanwhile, the outlook for the US economy and the oil market will remain key drivers
- 

**The De La Rúa administration faces tremendous challenges in Argentina, and looks unlikely to avoid further severe disruption to the local economy.** As the market capitalization of the country's debt stock shrinks, however, these travails will likely retain greater significance for fixed income investors through their impact on neighboring economies and their contribution to the case book of emerging market lore than through the price action of Argentine assets themselves. We estimate that the index rules on amount outstanding and liquidity could force sufficient bonds out of the EMBI Global to leave Argentina in eighth place with less than 3% of the total market capitalization at the end of this year.

**We believe, however, that the impact on neighboring economies warrants caution that has so far been overwhelmed by the reallocation of dedicated funds out of Argentina and into Brazil in particular.** It will therefore be important to refocus attention on the pending fundamental developments once the technical consequences of the Argentine restructuring have been absorbed. The partial freeze of deposits in Argentine banks last weekend appeared to be met with surprising calm in the local financial system, but anecdotal evidence suggests that retail activity plummeted as shoppers hoarded scarce cash. Such behavior will have a negative impact on Brazil's admittedly modest exports to the south, and stimulate reorientation of Argentine output toward exports at a time when Brazil already faces a dramatic current account adjustment next year.

Meanwhile in the capital account (for the region as a whole but particularly for capital-hungry Brazil), it is hard to conclude that either the Argentine experience or discussion at the IMF and among G-7 governments of measures to facilitate sovereign restructurings can do anything but raise the risk premium for lending to emerging markets and therefore further ration flows.

**In this context it is encouraging that public sector issuance needs for the region look manageable in 2002.**

Total planned issuance by countries currently in the EMBI Global is only US\$14.3 billion, and we estimate that governments have already pre-financed around a quarter of those needs. We further note that Brazil's issuance plans account for more than a third of the regional total but are notoriously flexible, and the deep domestic market could instead be used to limit incursions in the international markets if necessary.

**The gradual reopening of the sovereign issuance market, led by the Dominican Republic and Chile in October, again featured infrequent borrowers from the region last month such as Guatemala and Uruguay (see "Market Lab," on page 8).** We expect this trend to continue into 2002, stimulated by a continued desire for diversification made all the more compelling by the effective default of the dominant component in the indices over the last few years.

**As the year draws to a close, we are staying close to the benchmark in Latin America in our model portfolio, thereby locking in outperformance over the last few months.** We are marketweight in Mexico, Colombia, Ecuador, and the Dominican Republic (a new addition to our portfolio this month). Our core underweight recommendations in Latin America remain in the Southern Cone. We allowed our switches and the subsequent index rebalancing to leave us 2.1% underweight in Argentina and just 0.7% in Brazil. We sold our Par holding in Venezuela to take profits on the grounds that the deterioration in the political environment may outweigh the impact of a near-term recovery in oil prices. We are also underweight in Panama, where we remain concerned by the fiscal outlook. Our only overweight recommendations in the region are Peru and Chile, where we see diversification value, sound economic policy plans, and limited 2002 financing needs.

## Latin American Local Market Overview

### Market Outlook

While Brazil seems to have decoupled from Argentina, the latter continues to be the key driver in the region. Brazilian markets have rallied independently of the Argentine woes, while the Chilean and Mexican markets have also held steady. Still, as Argentina comes closer to reaching an end game—whether it be dollarization or a depreciation of the currency—an additional bout of contagion may occur. Thus, we opt for a balanced set of trades that does not result in a high cost of carry, but should still yield profits in case Argentina deteriorates quickly.

**Argentina:** This past weekend the government imposed capital controls and a restriction on bank deposit withdrawals. It also set up rules favoring the dollarization of the banking system. The initial signal extracted by the NDF market was that devaluation in the very short term (days) was less likely, leading to a compression of points at that end of the curve. The initial concern was whether the monetary base remained freely convertible into dollars at 1-to-1, which it appears to be if the Central Bank resorts to selling its bond holdings or appropriates banks' reserve requirements. The focus is now on what kind of monetary endgame results. The two most obvious scenarios are: 1) the population pushes the dollarization of the monetary base, and any fiscal gap would be closed with the issuance of the quasi-currencies already in circulation (Patacones, Lecops, etc.); 2) the fall in reserves triggers the political decision to float the currency and print money to finance the fiscal gap. Which of these scenarios is most likely to materialize is a close call, as it will be a political decision based on the tolerance to see reserves fall sharply, and the trade-off between protecting savings in the financial system and preserving current real levels of public spending for a while longer. The scenario that the market seems to discount as unlikely is one in which the current efforts to change economic behavior toward banking cards materializes, the informal economy is absorbed into the formal economy, and tax revenues rise, as Cavallo hopes. A monetary event seems broadly expected, while the two most likely would have severely different implications for the short end of the NDF market.

**Brazil:** Local markets have been trying to communicate two different messages. The decoupling from external turbulence, especially Argentine gyrations, is

unambiguous. Asset prices occasionally go beyond that and suggest trajectories compatible with a virtuous circle of declining country risk, appreciating currency, lower interest rates, resuming growth, and so forth. However, the Central Bank has made it clear that there is no room for euphoria as inflation readings remain well above targets set for 2002 and that in our view should prevent the benchmark Selic rate from falling until the second quarter of next year. We see continued market volatility on the heels of steady improvements in the balance of payments, especially the trade balance and FDI flows, sometimes leading to excessive domestic optimism and subsequent frustration.

**Mexico:** The Mexican market remains hostage to the fiscal reform debate. As year-end approaches, we will finally see an end to the discussions. We still expect a diluted version of the government's tax reform to be approved. Meanwhile, the trade deficit continues to widen, reaching almost US\$1 billion in November. The slowdown of the US economy, the frailty of its equity market, low interest rates locally, and a possible event in Argentina all suggest that a weaker peso is likely. In terms of interest rates, overnight rates and short-dated Cetes all reached all-time lows today. We expect to see lower rates in the three-to-six month area of the curve, but lower rates in the very short end are unlikely. Inflation should pick up for seasonal reasons, placing a floor on rates in the weeks to come.

**Chile:** The Chilean economy will get a short-term boost from Trade Promotion Authority being approved by the US Congress. Locally, the December congressional elections should be a non-event for the fixed income and currency markets.

### Local Market Strategy

**Argentina. Remain squared.** The implied yield curve remains inverted, even though the short end has come off significantly since capital controls were imposed. Liquidity remains extremely poor, which makes any recommendation non-credible. Moreover, the probabilities we attach to any of the two potential scenarios are close enough to make the risk-reward trade-off of any position unattractive, given the level of volatility and size of bid-offer spreads.

**Brazil.** We squared our previous trades, overlent April 2002 x overborrowed July 2003 BRL rate and short coupon January 2007 x long C-bond. In both cases, we reached our targets. We now suggest a directional trade with local “coupon” rates (also known as US\$-adjusted rates). Decreasing concerns on external financing needs are reducing demand for hedging. Yields implied in this curve are thus edging down, except for selected points that entail arbitrage. The recommended trade is a FRA comprising overborrowing 1-year “coupon” and overlending 2-year coupon that currently yields 11.3% one-year equivalent. We find this return excessive and the trade bets on convergence toward “normal” yields for the tenor, which is in the 10% territory. The suggested stop loss is 11.8% and target is 10.3%. We also suggest keeping the 2-month risk reversal established last week. It is flat compared to inception, but traded at a 4% profit a week ago. We believe that the position provides a good hedge for the “coupon” position and is a cheap way to position for a deterioration in Argentina.

- Overborrow 1-year “coupon” and overlend 2-year “coupon” to yield FRA of 11.3% p.a.
- Keep risk reversal.

**Mexico.** Interest rates, except in the very short end of the curve, should continue to grind lower. Our TIIE swap position was very volatile intra-month, but we still advocate keeping the position for its four remaining months. In spot, we did not reach our entry level. We advocate establishing long US\$/MXN positions at the current MXN 9.20 level. Set a top at MXN 9.10 and a target at MXN 9.40.

- Remain overlent through TIIE swaps.
- Establish long US\$ positions.

**Chile.** The Chilean position is currently trading close to its inception level. We still like the position, despite the fact that the fast track vote may have potentially bullish peso implications. Reestablish the position at opening levels on Friday morning. Set a 1% stop, and a CLP 700 target.

## Special Focus on International Reserves in Argentina

*The current discussion on the plausibility of dollarization has focused intently on the level of reserves, and the various claims on reserves. Here we present some facts about international reserves and how different operations of the Central Bank (BCRA) affect them and other monetary aggregates.*

**Investors tend to focus on the coverage ratio of the peso monetary base to assess the plausibility of full dollarization—regardless of whether it is market or government driven.** The normal operations of the central bank are already reflected in either the monetary base or the reported level of international reserves. The main source of uncertainty for that analysis is speculation that some reserves have been used for fiscal purposes through Banco Nacion.

The following are a few important facts:

- Repo financing provided by BCRA to domestic banks, if in US dollars (US\$2.6 billion on 30 November, and US\$2.8 billion on 3 December), is deducted from reported reserves; if the repo is in pesos (ARS30 million on 30 November), it is added to the reported monetary base. Thus, when computing coverage ratios for the monetary base, reserves and pesos in circulation already reflect repo operations.
- Discount windows (*redescuentos*), which are similar to repos, but backed by promissory notes of domestic banks, are also reflected either in international reserves (a subtraction of those dollars handed out), or in the monetary base (an addition to the monetary base of those pesos handed out).
- Total international reserves have the following claims on the other side of the balance sheet of BCRA (broadly): the monetary base, reserve requirements of the financial system denominated in US\$, and the US\$4 billion Supplemental Reserve Facility (SRF) disbursement from the IMF. Alternatively, these can be seen as sources of the current stock of reserves.

**The table shows that without taking into consideration bonds in possession of the BCRA, the level of coverage ratios depends on whether the government is willing to use part of the international reserves from sources other than the monetary base.** Most of the international reserves in Argentina's financial system are now in the Central Bank, as shown in the first part of the table. Of

those reserves in the BCRA, US\$14.7 billion are reported as liquid. The monetary base is US\$11 billion. The monetary base could therefore be converted into dollars, but there would not be enough liquid reserves left over to repay the SRF or return all reserve requirements to the financial system. The liquidity provided by the BCRA to banks (the memorandum item in the table) is the sum of peso and US dollar amounts (as expressed by BCRA). The dollar amounts explain the difference between assets and liabilities shown in the table. This table does not incorporate any assumption of non-reported erosion of reserves.

### Monetary and Financial Data

US\$ million, as of 30 November 2001

Total International Reserves	18,861
In BCRA	18,468
International Reserves in BCRA	18,468
Liquid (Gold, bills, etc.)	14,740
Government Bonds	3,728
Monetary Liabilities of BCRA	15,201
Monetary Base	11,019
Bills in Circulation	10,151
Reserve Requirements in US\$	4,182
Supplemental Reserve Facility	4,000
Liquid Coverage of Monetary Base	
Without Deducting Reserve Req.	134%
Deducting Reserve Req.	96%
Deducting IMF-SRF and Reserve Req.	65%
Memorandum Item:	
Liquidity Provision	
Repos ( <i>Pases activos</i> )	3,983
Discount Windows ( <i>Redescuentos</i> )	2,339

Source: BCRA

**There are not enough international reserves to back the monetary base without using the banks' reserve requirements in dollars or selling the bonds held by the BCRA. Full dollarization would reduce the central bank's capacity to provide liquidity through a massive reduction of reserve requirements.** Obviously, the deeper the incursion into reserve requirements necessary to effect full dollarization, the higher the risk/cost.

Even though reserves have different roles to play in different FX regimes, there seems to be a general aversion to having a central bank operate under a low level of international reserves. Investors seem to echo this concern. In the current situation, satisfying the mechanics of Convertibility to the extreme would mean giving up the policy option of preserving reserves by breaking the currency regime, and would also prevent the Central Bank from triangulating reserves into deficit financing by placing them on deposit in state-owned banks to be lent on to the treasury.

## Argentina

Caa3/SD

### No Longer the Pivotal Asset in EM

- Argentina's weight in the EMBI+ and EMBIG dropped to fifth and sixth place, respectively
- Risks of a deeper haircut in a subsequent debt exchange or of a change in FX parity persist
- There is potential for more selling in a default from the liquidation of repo collateral

### Market Outlook

**We maintain our underweight recommendation in Argentine external debt, since the risk of worst-case scenarios unfolding remains considerable.** The outstanding external debt remains at risk of being refinanced at a deeper haircut, given the challenging fiscal and financing prospects of the public sector and the fact that the savings from the local debt exchange are only marginal (US\$1.8 billion in interest payments and US\$2.5 billion in amortizations). Furthermore, we are concerned about the sustainability of the exchange rate parity amid a fragile political environment and persistent financial pressures, which the partial freeze on deposits will likely reduce but not eliminate. Devaluation would make a deeper haircut on external debt necessary in order to secure debt sustainability. This increased risk is not yet fully reflected in Argentine external debt bonds, in our view, with Globals still trading in a US\$20-40 price range. Technicals remain supportive resulting from a massive short squeeze and decreased availability of paper. However, more selling could be triggered if the repo facility collateral had to be liquidated in a credit event.

**A further key factor underpinning our recommendation is the decision by the IMF to halt the US\$1.2 billion third-quarter disbursement.** Although this decision comes as no surprise given the concerns that Fund staff had been expressing recently over Argentina's 2002 fiscal outlook, it does increase the probability of a near-term straight default on the outstanding debt. The World Bank and the IADB have also stated that their non-project lending to Argentina will be interrupted until the program with the IMF resumes.

**December default risks, however, remain predominantly political in nature, since pension fund resources could be channeled to cover the financing gap, which we estimate may exceed US\$5 billion by year-end.** The government has announced that it will make pension funds invest their

term deposit holdings (of around US\$2.7 billion) in government obligations. With these funds, and assuming that US\$1.5 billion in Treasury working capital remains available, the government could cover most of its financing requirements for this year (*see table*). The largest payment is US\$1.2 billion of Lete amortizations, while foreign investors will focus on the 19 December ARG '08 coupon payment of US\$87 million.

**In any event, Argentine external debt will no longer be a pivotal asset in emerging markets.** Following the post-debt exchange rebalancing on 4 December, the Argentina weight in the EMBIG fell to 4.12% from 8.89% and in the EMBI + to 4.97% from 10.64%. A second end-of-the month rebalancing will reduce the weights even further. Until the first quarter of this year, Argentina represented more than 20% of the EMBIG. Currently, Argentina's weight is sixth, while Brazil, Mexico, and Russia will account for more than 55% of the EMBIG. Thus, the Argentina call will lose relevance for overall index performance.

#### 2001 Estimated Quarterly Financing Schedule

US\$ millions

	Oct	Nov	Dec	Q4
<b>FINANCING NEEDS</b>				
<b>I. Total Financing Needs post exchange</b>	<b>2,684</b>	<b>2,270</b>	<b>1,998</b>	<b>6,952</b>
Fiscal Deficit	700	900	400	2,000
Amortizations (ex. Letes)	944	459	331	1,734
Lete Amortizations	990	861	1,217	3,068
Other	50	50	50	150
<b>FINANCING SOURCES</b>				
<b>II. Sources of Financing</b>	<b>1,170</b>	<b>-1,214</b>	<b>-3,334</b>	<b>1,620</b>
A. Domestic Sources	800	300	150	1,250
Local Pension Funds	300	300	150	750
Letes Issuance	500	0	0	500
B. Pre-financing Carried over from Prv.s. Prd.	370	-1,514	-3,484	370
<b>III. Scenario 1: Accumulated Cash Surplus/Cash Shortfall</b>				
	<b>1,514</b>	<b>-3,484</b>	<b>-5,332</b>	<b>-5,332</b>
<b>IV. Other Potential Financing Sources</b>				
Pension Funds' CD holdings	0	0	2,700	2,700
Letes	0	0	500	500
Treasury Working Capital	1,500	0	0	1,500
<b>V. Scenario 2: Accumulated Cash Surplus/Cash Shortfall</b>				
	<b>-14</b>	<b>-1,984</b>	<b>-632</b>	<b>-632</b>

Source: JPMorgan

### External Debt Investment Strategies

**Underweight.** We recommend that investors sell higher dollar priced FRBs, '08s, and '09s, taking advantage of expensive valuations caused by a short squeeze in repo. We hold collateralized bonds, Pars, and Discounts, and Global '15s and '18s, which are already pricing a severe haircut and are likely to have smaller losses in a potential debt restructuring.

## Brazil

B1/BB-

### Decoupling Leaves Search for Fair Value

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- The trade-off between fundamental risks and index rebalancing will fuel further volatility
  - We continue to see risks biased slightly to the downside as the Argentine economy contracts
  - Political tensions will increase as the 2002 budget is voted and parties push for nominations
- 

### Market Outlook

**The technical relationship with Argentine asset prices seems largely played out.** The events of November show that the historically close relationship between Brazil and Argentina has now changed dramatically. Over the course of the whole month, the Argentine sub-index of the EMBI Global lost 33.6%, while the Brazilian component was the second best performer, returning 7.7%.

**Ahead of this week's intra-month rebalancing, the Brazil sub-index of the EMBI Global was trading marginally tight to the overall index for the first time since early 2000, with the rally driven mainly by the rebalancing trade surrounding the completion of the local tranche of Argentina's debt restructuring.**

However, we see two technical reasons that mitigate against further aggressive outperformance. First, the decline in Argentina's weight in the index (to date and post restructuring) means that the rest of the index enjoys increasingly better creditworthiness than Brazil. Second, Argentina's effective default, like Russia's in 1998, is likely to result in a repricing of sovereign risk for countries with deteriorating debt/GDP ratios and poor historical payment records—Brazil falls squarely in the first camp and is in the relatively early stages of emerging from the second.

**We nevertheless also see room for renewed deterioration in Brazilian fundamentals arising from continued stress on the Argentine financial system.** The main transmission channel for this strain of contagion would again be the exchange rate, as disruption to the Argentine payments chain undermines the modest market there for Brazilian exports and prompts more aggressive pricing of imports from the south, thereby exacerbating

the challenge inherent in Brazil's need to undergo a current account adjustment in 2002.

**Perceived resilience to these and other tests has supported the currency and debt prices in recent weeks, but we see room for renewed concern near term.** We maintain that the full impact of potentially widespread economic and social disruption in Argentina has not yet been reflected in sentiment in Brazil, where some see economic relations between the two countries as a zero-sum game. Other threats to the credit outlook could likewise be dormant rather than extinct (see "Brazil: Too Early for Euphoria" in *Emerging Markets Today* dated 16 November 2001), including the energy crisis, the impact of the global economic slowdown, and local political tensions.

**Our base-case scenario remains that the 2002 election campaign will be noisy but will result in victory for the current government coalition.** We now sense growing local concern, however, that a significant element of the PMDB will abandon the government, and an increasing risk that even a successor coalition administration would be palpably less reform-oriented than the Cardoso government. Tensions within the coalition parties will be out in the open this month as Congress debates the 2002 budget, with government supporters already pushing to cut income tax revenues against the wishes of the economic team.

### External Debt Investment Strategies

**Underweight.** Having gone into November underweight Brazil in our model portfolio, we added half way through the month to go marketweight ahead of the post-exchange index rebalancing. That intra-month operation last Tuesday left us with a modest underweight in Brazil again of around 1%, and we retain that position. Our holdings in Brazil are concentrated in Bradys—we remain overweight Cs, Discounts, and Pars, and hold a marketweight position in EIs. We expect the Brady-Global spread tightening to persist, supported by potential buybacks.

## Chile

Baa1/A-

### Safe Haven Status Is Enhanced

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- Chile can easily weather stresses from across the Andes and still deliver solid fundamentals
  - Inclusion of the new '12 in the EMBIG should attract additional interest
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### Market Outlook

**Chile is by no means immune to the renewed downturn in the global economy, but the outlook remains relatively benign.** Solid credit fundamentals will continue to limit potential pressure from global risk aversion less easily digested by other emerging economies. Even the proximity of the storm in Argentina holds little fear for Chile. The exchange rate has successfully borne the brunt of the adjustment, with little impact on inflation, and this should serve to underpin buoyant export growth even as global demand slows further. Political risk is also minimal, with this month's congressional elections unlikely to cause any meaningful shift in the balance of power. After over a year of marked local pessimism, we now perceive a turnaround in local sentiment evident also in the recovery of the currency during November. It seems likely, for example, that the success of the October bond issue has contributed to a reduced sense of vulnerability among local investors and even consumers.

**Two factors suggest that the technical backdrop for Chilean bonds should be favorable over the coming months.** First, the new '12 has been included in the EMBI Global, raising Chile's share of the index from 0.27% at the end of October to 0.66%. Second, experience suggests that Chile offers useful diversification away from Argentina, despite geographical proximity, since the high grade investor base correctly differentiates between the risks at the opposite ends of the emerging market credit spectrum.

### External Debt Investment Strategies

**Overweight.** We still see value in Chile's greater weight in the index and defensive qualities.

## Colombia

Ba2/BB

### Last Call for Reforms

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- Pension reform looks unlikely to pass but reform of the use of territorial transfers may fare better
  - Pre-financing of 2002 borrowing requirements now reaches 70 percent
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### Market Outlook

**The government may send a pension reform draft to Congress before it adjourns in mid-December, but its prospects for approval are dim.** The version of the pension reform under discussion includes changes in key parameters that aim to place the pension system on a more sustainable footing—including higher contributions and lower benefits. But the draft also has important flaws: it establishes a mandatory enrollment of new public workers to the public social security system, and does not address the problem of the generous special pension regimes. Amid a lack of consensus among the interested parties (government, labor unions, and employers), there is mounting pressure on the government to postpone the submission of the bill until next year and miss one of the conditions stipulated in the IMF program.

**But no law is probably better than a bad law for now.** A reform of the social security system is certainly needed to address the mounting under-funding of pension liabilities (which according to the government exceed 200% of GDP in net present value terms). But given the difficulty of garnering political support for a sound reform, it may be better to let a new government, with more political capital to spare, push for a good pension reform rather than have a watered down version approved now. In any case, whether or not the bill is submitted before Congress adjourns on 15 December, its chances of approval when sessions resume in March appear to be nil given the election process that will dominate activity at that time.

**By contrast, there is a high probability that changes to the law that rules the allocation of territorial transfers (the so-called *Law 60*) are approved by year-end.** The bill, which complements the reform of territorial transfer limits passed earlier this year, is already under discussion in Congress and appears to have good prospects of being

approved before legislators go into recess. The bill aims to improve the efficiency of the allocation of resources transferred from the central to the local governments, and is expected to reduce the need for supplementary transfers—especially to the health and education sectors.

**Prefinancing of 2002 external market borrowing requirements now reaches 70%.** Colombia has already raised US\$1.5 billion of the US\$2.2 billion targeted for next year. The government announced that it had permission to issue an additional US\$250 million by the end of the year. If this were done, 2002 prefinancing would reach nearly 80%. This proactive strategy aims to insulate Colombia from the potential volatility that could surface around the elections in May 2002—and is certainly insulating it from Argentina-led market jitters. The strategy, however, comes at the cost of a negative carry of nearly US\$100 million that in the end gets deducted from the public investment bill. The sustainability of the debt dynamics is also a concern. Official fiscal figures for the year to September show that the primary balance of the consolidated public sector was almost flat. However, at the current pace of real GDP growth below 2% and the average real interest rate of 7%, the primary surplus would need to exceed 2% of GDP to stabilize the debt to GDP ratio. Further fiscal consolidation is therefore needed going forward.

### External Debt Investment Strategies

**Marketweight.** The outperformance of Colombian debt continues unabated despite the new supply and its relatively tight spreads, which have all but ignored the economic deceleration made evident by recent data releases. However, we maintain a neutral position given the country's diversification value and the strong local demand. Local support will likely be maintained until pension funds collect the once-a-year contribution for unemployment insurance (*cesantias*) in February.

## Ecuador

Caa2/CCC+

### IMF Disbursement on the Way

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- Payment of arrears to the Paris Club clears the way for the pending IMF disbursement
  - Negotiations for a new IMF standby program will start this month
  - An oil price assumption of US\$19 per barrel in the 2002 budget will likely force expenditure cuts
- 

### Market Outlook

**Ecuador will successfully complete the IMF stand-by program that expires at the end of this month—for the first time in 17 years.** Authorities confirmed that Ecuador has cleared its arrears with Paris Club creditors (around US\$100 million) with the help of the US\$60 million disbursement approved by the IADB this week. The payment to the Paris Club was the last remaining condition to secure approval of the pending US\$96 million disbursement from the IMF when its board meets on 10 December. Finance Minister Emanuel said that negotiations for a new program for 2002 would start this month; an IMF mission is now expected to visit Ecuador for this purpose in January. There are no specific terms for the new program yet, but it will most likely entail the strengthening of fiscal accounts and the banking system. The ongoing relationship with the IMF convinced S&P to move the outlook on its CCC+ rating from negative to stable this week.

**The government has yet to unveil the details of the revamped program to restructure private sector debts to intervened banks.** The program, which applies to debts above US\$50,000 (representing nearly US\$1.7 billion or 10% of GDP), is expected to preserve the case-by-case procedure to set the terms of each debt restructuring. The novelty is that the decision on such terms will likely rest with a foreign firm in order to avoid political interference. Some production sectors are still demanding a uniform treatment of nonperforming loans, with predefined terms and rates, but authorities appear willing to push for the above restructuring scheme, as agreed with multilateral institutions.

### **The assumptions embedded in the approved 2002 budget raise questions about next year's fiscal outlook.**

The budget assumes an average oil price of US\$19 per barrel for 2002, which corresponds to a WTI forecast of US\$25 per barrel given the current discount at which the Ecuadorean basket trades. Although such a price could materialize following Russia's decision to cut 150,000 b/d (in fact, JPMorgan's house view still sees this as the most likely scenario), the potential shortfall could be substantial. If prices were to stay at the current US\$14 per barrel, the fiscal hole would reach US\$300 million (around 1.7% of GDP).

### **In recognition of this downside risk, the 2002 budget law included a provision to adopt spending cuts in the first quarter if oil prices remain low.**

The areas to cut expenditures, however, are not obvious—or at least not politically palatable, especially in an election year. There is talk of cutting the defense budget, reducing the subsidy on cooking gas, and clipping the investment bill, in addition to pursuing a new tax reform. A more promising avenue appears to be Emanuel's proposal to give the administration of the customs authority in concession to a private entity, in order to curb the evasion of custom duties that reportedly exceeds 50%. Obviously, the dollarized FX regime and the country's lack of access to capital markets mean that spending cuts would need to occur de facto if oil revenues falter. The one factor that could relax this restriction is an oil-backed facility. The government has announced its intention to secure one for non-budgetary purposes, but social demands and weak oil prices could put authorities under pressure to use part of these resources to cover any fiscal gap.

### External Debt Investment Strategies

**Marketweight.** Ecuador rallied a strong 9% in the first two weeks of last month as the market priced in the positive prospects for the IMF disbursement, which prompted us to take profits on 16 November. We remain marketweight for now until further clarity on the oil market and the negotiations for a new IMF program for 2002 emerge.

## Mexico

Baa3/BB+

### Still an Attractive Medium-Term Bet

- Comfortable 2002 amortizations and sound economic prospects are in store
- 2002 budget and tax reform approval will remain a dominant theme this month
- We remain marketweight post EMBIG rebalancing after increasing our allocation 1.2%

### Market Outlook

**To keep our marketweight allocation to Mexican external debt post EMBIG rebalancing, we increased our Mexico exposure by 1.2% in our model portfolio on 6 December.** We expect Mexican debt to continue to perform well in the near term, while it remains an attractive medium-term holding. Our latest investor survey shows a significant level of cash being held by investors. We expect Mexico to be a beneficiary of year-end flows seeking EMBI exposure, especially from cross-over funds. Dedicated funds are also expected to remain supportive since Mexican assets should remain a safe haven away from a likely volatile Southern Cone. Finally, further EMBI rebalancing at month-end should again increase, albeit more marginally, Mexico's weight in the indices.

**We are not recommending an overweight allocation, however, since valuations remain relatively expensive.** Medium- and long-term Globals are trading at spreads of 290-370 bps, and just a few basis points above similarly rated US corporates. We believe, however, that on balance risks associated with Mexico at present are likely to be lower than those of 5-B rated US corporates. Separately, our latest survey shows an increase in investor overweights in Mexico over the last month.

**Furthermore, uncertainty over the approval of tax reform is likely to linger until the end of the year.** A potential delay or a very diluted version of the reform would reduce the probability of an S&P upgrade to investment grade. According to S&P it could even result in a change in the rating outlook from positive to stable. We view passage of a diluted tax reform during an extraordinary session after 15 December as the most likely scenario, which may not be enough to warrant a rating upgrade. In any event, fiscal prudence is expected to prevail through a conservative budget.

**The 2002 amortization profile looks very manageable, with at least 28% already prefinanced.** As occurred this year, the government is expected to limit its 2002 external debt issuance to covering external bond amortizations (US\$3.6 billion) and to undertake debt liability management operations. We estimate that the government has already prefinanced at least US\$1 billion, mainly from the November reopening of the UMS '31. We also estimate that liability management operations in 2001 could have provided the government with around US\$2 billion from the release of collateral, which could be used to support new debt exchanges.

#### Public Sector Amortization Schedule

	Stock at Sept-01	2002	2003
<b>Total External Obligations</b>	<b>82,697</b>	<b>9,625</b>	<b>6,517</b>
<b>Capital Markets</b>	<b>43,289</b>	<b>3,602</b>	<b>2,881</b>
Bonds	43,289	3,602	2,881
<b>Restructured Debt</b>	<b>12,146</b>	<b>882</b>	<b>495</b>
Brady Bonds	9,237	0	0
Paris Club	7	0	0
Other	2,902	882	495
<b>Banks</b>	<b>3,255</b>	<b>850</b>	<b>788</b>
Direct Loans	1,880	676	255
Syndicated Loans	1,024	174	183
Commercial Paper	350	0	350
<b>Multilaterals</b>	<b>15,932</b>	<b>1,812</b>	<b>1,681</b>
IADB	5,753	497	500
World Bank	10,179	1,316	1,181
<b>Foreign Trade</b>	<b>7,001</b>	<b>1,589</b>	<b>672</b>
EXIMBANK	2,793	455	432
Bilateral Bank Lending	3,503	1,134	240
Syndicated Loans	275	0	0
Commercial Paper	430	0	0
<b>Other (inc Pidiregas)</b>	<b>1,075</b>	<b>890</b>	<b>0</b>

Source: SHCP

### External Debt Investment Strategies

**Marketweight.** Pars remain rich to Globals on a call option-adjusted basis. The recent spread widening between Pars and Globals is the result of a rally in US Treasuries and is associated with an increase in the option value. Despite expensive valuations we do not go underweight Pars, because of potential for further buybacks. Within the Global curve the long end now appears cheap to '11s and '19s, both on a yield and spread basis. We recently bought UMS'26s in our model portfolio.

## Panama

Ba1/BB

### Setbacks Prompt Only Dialogue So Far

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- The government still has not prepared a 2002 budget acceptable to the legislature
  - Downgrade and opposition determination has forced the government to the negotiating table
  - 2002 external financing needs are half-met but uncertainty persists over buybacks
- 

### Market Outlook

**Fiscal challenges are moving up the agenda.** As expected, the budget committee of the National Assembly rejected the government's draft 2002 budget in early November on the grounds that the revenue assumptions are too optimistic, and even the projected deficit would place an excessive strain on available financing sources. At the heart of opposition objection is the fear that the debt-to-GDP ratio would rise again under the government's proposal. Government leaders have until the end of the year to submit a revised budget for approval (which they have not yet done), or they can operate under the 2001 budget, with automatic provision for debt service and other contracts. The administration initially threatened the latter, along with cuts in the Assembly's pork barrel spending, while claiming that the opposition's stance threatens perceptions of Panama in international financial circles.

**As we had warned, Standard & Poor's downgraded Panama's long-term rating to BB from BB+ on 20 November.** S&P cited the prospects for higher fiscal deficits and for a continued legislative stalemate as the key drivers for the downgrade. The press release mentioned that Panama's ratings are constrained by the high public sector debt (the recent progress in reducing the debt-to-GDP ratio may be reversed this year); the inflexibility of fiscal accounts; the deteriorating growth prospects; and the duality of the economy's structure. S&P keeps a stable outlook on the new rating.

**These twin warnings from the legislature and the rating agency appeared briefly to prompt a more conciliatory tone from the Moscoso administration toward the opposition, but no concrete progress has**

**yet been made.** After a month of sporadic meetings, the broadly bipartisan working group convened by the finance ministry announced in late November that it was going into permanent session to finalize agreements on reform of the US\$1.24 billion Fiduciary Fund as well as new legislation to limit public sector spending and borrowing. Those discussions since appear to have degenerated into renewed wrangling along political party lines, complicated by the continued refusal of the opposition PRD to approve an administration nominee to the Supreme Court.

**The fate of the Fiduciary Fund will be a major driver for asset prices.** It is not clear, however, whether resources will in fact be freed up to buy back debt. The working group is discussing five options: using 70% of the Fund for social spending and infrastructure investment (and buying no debt); restructuring US\$5 billion of sovereign debt using the Fund as a guarantee; investing the whole Fund in sovereign debt; using three-quarters of the Fund to cancel debt; and using the whole Fund to cancel debt. We note that previous efforts to revise the rules of the Fund have been arduous, and the opposition is again insisting that any revision be conditional on submission of a realistic 2002 budget, as well as strict laws to limit public spending and new borrowing. The government has not yet given ground on these demands.

### External Debt Investment Strategies

**Underweight.** Near-term financing needs look manageable. Having raised US\$250 million in early November to add to US\$91 million of previous prefinancing, the government is almost halfway to its planned external debt issuance of US\$750 million for 2002 and, crucially, should be able to pay down the outstanding US\$342 million of the '02 maturing in February without returning to the markets if necessary. Nevertheless, we fear that extended dispute over the 2002 budget and the Fiduciary Fund, along with continued economic weakness, will deter crossover interest and weigh on prices. PDIs and FLIRBs outperformed in the recent rally but we believe this is premature and continue to hold '11s.

## Peru

Ba3/BB-

### IMF Agreement Reached

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- The government attempts to present a united front, but Congress remains unpredictable
  - The new IMF program signals disciplined policy intentions, but political support is uncertain
  - Congress approved the 2002 budget; the deficit target depends on privatization revenues
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### Market Outlook

**Criticism of faltering leadership and a sharp decline in popularity prompted President Toledo to seek more coordination within his government.** This was positively demonstrated by the cabinet's support of Finance Minister Kuczynski in his quest to prevent Congress from eliminating the possibility of arbitration in a dispute between the tax authority and previously privatized electricity companies. Unfortunately (and disturbingly), Congress continues to push a series of populist initiatives—like the resurrection of an agrarian bank and the reintroduction of rigidities in the labor market—that directly contradict the more orthodox policy line that Kuczynski is trying to implement. The next challenge for Toledo will be to improve coordination among the members of his own Peru Posible party, many of whom appear to be closer to the opposition's camp during key votes in Congress.

**The government has reached agreement for a new two-year program with the IMF, which should be approved by the Board in January.** The stand-by program targets a fiscal deficit of 1.9% of GDP in 2002 (approximately US\$1.1 billion), down from the 2.4% of GDP gap projected for this year. As such, beyond the specific numbers, the objective to reduce the fiscal deficit amid the mounting pressure for a stimulative fiscal stance is a positive signal of the economic team's commitment to disciplined fiscal management. The key question is whether the government will have enough political support to implement the program, especially because Peru has consistently missed the fiscal targets agreed with the IMF since 1999.

**The fiscal deficit target for 2002 could be widened from 1.9% of GDP to 2.2% of GDP if privatization revenues exceed US\$700 million.** This clause of the IMF program, along with the earmarking of 50% of privatization proceeds for the construction of roads and for rural electricity, is intended to create incentives to support the privatization program, which is mired in political opposition. An important ingredient for the achievement of the fiscal target will be a reduction in some of the multiple tax exemptions approved in recent years. The IMF program envisages several measures to reduce these exemptions, which cost 1.6% of GDP annually.

**But the fiscal deficit could exceed the base target even if privatization revenues fall below the US\$700 million threshold.** To begin with, tax collection could fall below the official projections if GDP growth matches our 3% forecast instead of the 4% rate assumed in the budget. Another issue will be the political resistance that the elimination of tax exemptions is likely to meet, especially for those that affect the border regions. But the bottom line is that Peru could finance a larger deficit taking into account that multilaterals will probably disburse US\$1 billion, privatizations could reach US\$500 million, and debt issuance in both the domestic and the external markets could total an additional US\$1 billion. Altogether, these resources would suffice to finance the US\$1.1 billion of amortizations and a fiscal deficit equivalent to nearly 2.5% of GDP. JPMorgan maintains its 2002 fiscal deficit forecast of 2% of GDP for now.

### External Debt Investment Strategies

**Overweight.** Peru outperformed the market once again in November, with a return of 4.65% versus -1.28% for the EMBI Global. Although some profit taking may take place at these levels, Peru will likely still benefit from its diversification value and from its relatively low external market borrowing requirements for 2002. FLIRBs widened 20 bps to PDIs last month. We recommend a switch at a spread differential of 40 bps.

## Venezuela

B2/B

### Oil Market May Test Fiscal Flexibility

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- Political tension rises as private businesses call for a national strike on 10 December
  - The Supreme Court stripped the government of its powers to decree capital controls
  - The 2002 budget will likely be approved with an oil price assumption of US\$18.5 per barrel
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### Market Outlook

**Confrontation between the government and the private sector is heating up as various sectors join the call for a strike on 10 December.** The work stoppage called by Fedecamaras, the largest business association, is in protest against the content and procedure of some of the 49 bills approved by decree under the Enabling Law. The more controversial laws are the land reform, which regulates the use of plots of land, and the hydrocarbons law, which raises royalties. Part of the controversy, however, appears to stem from confusion over the implications of the laws in question. The hydrocarbons law, for example, has been criticized for placing an apparently restrictive limit of 49% on private sector participation in exploration and production projects. The current law, on the other hand, allows no such participation at all outside the Orinoco Belt where just one private operator has a 51% stake in a project and will not be affected by the reform. In an attempt to defuse tensions, President Chavez admitted for the first time this week that the Assembly or the Supreme Court could modify the laws. But the widespread adherence to the strike by various groups—including industry, commerce, transportation, agriculture, and labor unions—is signaling the intention of the private sector to influence the policy agenda going forward.

**The impact of the strike on President Chavez's still-high popularity is the key indicator to watch.** Some fear that the declining trend in popularity shown in recent opinion polls could prompt more radical political and economic actions. But despite the various calls for a political transition, the truth is that the president still commands a high level of popular support, which makes any change in leadership unlikely anytime soon.

**The Supreme Court's decision to strip the executive of the power to enact capital controls lessens the risk that such an action will be taken unilaterally.** The ruling also stated that only the Assembly has such power. This means that unless authorized by the Assembly, the only way the executive can impose capital controls is by declaring a state of emergency to rule by decree. Meanwhile, the relative calm seen in the FX market in October is reversing, and NDF yields are again at the highs seen in September.

**The Assembly will likely approve the 2002 budget draft submitted by the government without changes.** The draft assumes an average oil price of US\$18.5 per barrel (consistent with a WTI price of US\$24.5 per barrel) and average daily production of 2.87 mb/d. But given that the Venezuelan basket currently trades at US\$15 per barrel and that production would have to be cut to 2.5 mb/d if the latest OPEC agreement kicks in, there is downside risk to both assumptions. The government expects the fiscal deficit to reach 4-5% of GDP, but even this level could be exceeded if oil prices remain at current levels and no additional measures are taken (each US\$1 drop in the average oil price increases the deficit by around 0.5% of GDP). However, authorities are discussing compensatory measures, including the elimination of some tax exemptions (which cost 1.3% of GDP per year), a revamping of the customs system to reduce evasion, and even the adoption of a more flexible FX regime.

**The wild cards to compensate a revenue shortfall could be the savings in the macroeconomic stabilization fund (FIEM) and lower spending.** FIEM resources currently exceed US\$7 billion (6% of GDP), while the implementation of the budget could follow the recent pattern of fulfilling only 70-80% of the spending plan due to logistical reasons. The political environment and mounting social pressures on the administration could, however, limit room for further spending cuts.

### External Debt Investment Strategies

Our client survey shows that investors increased their underweight positions in Venezuela in November. **We took profits on Pars, which tightened to DCBs by over 200 bps in November, and still hold FLIRBs because of its faster amortizations.** We also recommend a curve-flattening position through credit derivatives.

## Latin American Corporate Strategy

### Mexico Remains the Bright Spot

- Argentina's financial crisis may come to a head over the coming weeks and, if history is a guide, overshooting by the market is likely; better entry points lie ahead, but timing is uncertain
- It's safer to play Argentina through Brazil's quasi-sovereigns
- Although the Mexican mid-tier credits suffer from poor demand-side technicals, selectively, they represent the best values among the Latin corporates and would be the most immediate beneficiaries of a US economic recovery, expected in the second half of 2002
- The Chilean corporate market has benefited from a strong local bid and other factors; however, investment opportunities are limited

**It is widely expected that Argentina's financial crisis will come to a head within weeks, rather than months, and that asset valuations are likely to overshoot significantly on the downside.** We share these

expectations and, while we understand that there will be more attractive entry points, we also understand that a view on where bonds have value depends entirely on whether and by how much the Argentine peso could devalue; on the condition of the real economy in the aftermath; on the ability of individual issuers to support existing debt; and on the imposition or not of exchange controls, among other factors. This is not the time to be making bets in Argentine corporate bonds although we reiterate our view that there are several issuers that have very significant cushion to absorb even a shock to cash flow. The year 2002 may prove to be a great year for bets based on thorough analysis of individual credits (refer to our research report, *Argentine Corporates and Banks: Testing for Strength in Highly Negative Scenarios* dated 25 July 2001). A further concern in Argentina is that some of the short-dated paper has yet to price in the possibility of a debt moratorium.

On the question of contagion from the Argentine crisis—namely, how much will it impact Brazil and will it at all affect Mexico—there is no consensus except that Brazil will be impacted far more than Mexico. During the past few months, Brazil has been seen to de-couple from Argentina both in the sovereign and corporate markets. However, rather than thinking of Brazil as a defensive play,

we believe that, until we can judge the value of individual Argentine assets, Brazilian bonds may be a better bet on the upside once the Argentine crisis comes to a head. **In other words, there will be uncertainty about the outlook for the Argentine corporates for some time while the dust settles; it's a safer bet that Brazilian corporates will perform well once Argentine fundamentals bottom out.** Outside of Brazilian sovereign bonds, which we believe will respond best, we would expect the quasi-sovereigns to outperform most other segments of the Brazilian market, most certainly the depressed mid-tiers.

Although we do not rule out some contagion in Mexico, we would expect it to be minimal and to be fully offset by the expectation that the US economy will begin to turn around in the second half of the year, that a ratings upgrade is overdue from S&P's, and that a further upgrade from Moody's may be in the cards. As conditions in the US high yield market firm up and further monetary easing kicks in early next year, **we anticipate improving demand side technicals that could support strong performance in the mid- and upper-tier names in Mexico in 2002.** Some of the industrials stand out as promising opportunities.

The Chilean corporate market was a solid performer in 2001, benefiting from a strong local bid on limited float, and some flight to quality out of Argentine corporates. Nevertheless, the market remains small, illiquid, and dominated by several large issuers representing a limited number of sectors. Thus, even while the high-grade issuers look attractive to their US peers, it is difficult to execute anything except in small size. Furthermore, a specific concern is that the two largest issuers in Chile—Endesa and Enersis—are significantly exposed to Argentina through their operating subsidiaries in that country. Given downside potential, we recommend waiting for a better entry point.

#### A Few Bets for 2002

Issuer	Ratings	Offer	Price	Spread	Rationale
Telmex 8.25% '06	Baa1/BB+	105.5	234		Excellent credit fundamentals. Bonds may outperform the sovereign as the differential to U.S. peers narrows.
Innova 12.875 '07	B3/B-	93	1,044		Mexico's dominant DTH provider with a 73% market share will conserve its competitive advantages in the medium term. Positive event risk.
Durango 13.125% '06	B2/BB-	92.25	1,115		Reasonable cushion, good term structure, soft but relatively benign outlook, expect small debt reduction from asset sales.
TFM 11.75% '09	B1/BB-	82.5	1,123		We expect TFM's bonds to outperform the peer group due to good technicals, low dollar price, minimal refinancing needs, and a strong fundamental outlook.
Petrobras 9.875% '08	Baa1/NR	103.0	423		Defensive credit may outperform sovereign as recent developments in oil markets are favorable.
Petrobras 9.75% '11	Baa1/NR	101.375	452		

Source: JPMorgan

## Emerging Europe, Middle East, and Africa Overview

### Four Key Themes Will Dominate in 2002

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- Progress toward EU accession continues
  - The outlook for the oil price depends on cooperation between OPEC and non-OPEC nations
  - Any US expansion of its war on terrorism could be destabilizing
  - Increased sovereign and corporate issuance, mostly in euros, is likely
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**We see four main themes driving developments in this region during 2002.** The first is continued progress by EU accession candidates leading to EU expansion in 2004. The second is the extent to which OPEC and non-OPEC countries cooperate in 2002. This will have a major impact on credits in the region be they oil importers or oil exporters. Third, a potentially destabilizing factor on a number of countries could be any US expansion of its campaign against terrorism to include Iraq and other countries. Finally, we believe that the region will see an increase in the size and breadth of issuance with a number of countries making their debut sovereign issues.

**EU accession will continue to be the driving force behind economic policy and investors' risk perceptions in candidate countries.** Countries in the first wave are already trading at spreads comparable or tight to the lower-rated EU member states. In this scenario we see little room for significant tightening in most EU accession countries. With the market already pricing in early EU membership, spreads are vulnerable to any changes in expectations about the timing of EU membership. We are not forecasting any delay in EU accession but highlight the risk that any setbacks could have a dramatic impact on spreads of EU accession candidates. We continue to believe that the best opportunities for investors next year will be in the second wave of EU candidate countries such as Bulgaria, Romania, and potentially Croatia and Yugoslavia if they formally seek membership.

**The oil price in 2002 will have a major impact on most credits in the region.** The current tentative cooperation between OPEC and non-OPEC countries should prevent oil prices from falling into single figures

during the first quarter of 2002. This has had a positive impact on credits such as Russia, Algeria, Qatar, Nigeria, and Egypt. We believe, however, that further cooperation between OPEC and non-OPEC countries, especially Russia, will be an important theme throughout 2002.

**An expansion of the US military campaign against terrorism to Iraq will increase risk in the Middle East.** We see Egypt, Jordan, and Lebanon being at particular risk from a wider US military campaign—and to a lesser extent, Turkey. We believe, however, that Qatar is relatively isolated from any Iraq-induced contagion—given its small size and close links with the West. The North African countries, with their growing links to the EU, should be relatively well insulated from events in the Middle East, though the poor outlook for the tourism sector will hurt both growth and the balance of payments. Even in the absence of a direct US attack on Iraq, developments in the Arab-Israeli conflict are unlikely to be positive and will weigh on investor perceptions of the region.

**Next year is likely to see increased issuance from the region, including a number of debuts boosting diversification in the asset class.** In addition to the regular issuers such as Turkey, South Africa, Lebanon, Poland, and Romania, we expect to see new issuance from the Czech Republic, Israel, Russia, Qatar, Morocco, the Baltic States, Bulgaria, Croatia, Tunisia, and possibly even Iran. We expect the majority of issuance in the region to be denominated in euros with only the energy exporters issuing in US dollars. Quasi-sovereign corporate and bank issuance is also likely to pick up with issues coming from Eastern Europe and the Middle East. The quantity of corporate issuance will to some degree depend on the health of the syndicated loan market, where corporates have obtained most of their financing in recent years. In addition to new issuance, we expect to see London Club deals for Yugoslavia and the Ivory Coast concluded, leading to greater investor interest in both countries.

## Emerging Europe, Middle East, and Africa Local Market Overview

### Significant Currency Moves in South Africa and Turkey Drive the Local Markets

- Strong lira pushes Turkish inflation lower
- Polish bond rally still on track
- South African bonds suffer amid weak currency and increased inflation risks

**Polish** bonds, after having been hit by core fixed income markets in the first half of November, managed to rally sharply, while US\$ and EUR bond markets were stable. The decision by the National Bank of Poland to cut rates by 150 bps, more than the 100 bps consensus forecast, played a major role in that move. Also, the market technical position improved after many players reduced exposure in the earlier bond sell-off and the liquidity squeeze in the short end of the curve abated. Another hurdle for lower yields was lifted last Monday when the ministry of finance announced the issuance of a total of PLN2.9 billion (US\$712 million) of bonds in December, compared to a market expectation of over PLN4 billion. Although the May '06 is very close to its highs, we still remain bullish on the back of the benign inflation picture and weak economy. We would nevertheless temper our view by highlighting the anticipated heavy bond issuance in 2002, as outlined in the budget draft. Also, illiquid markets at year-end are a risk.

The zloty posted very strong performance in the last fortnight, appreciating by over 1% against its old basket despite much lower rates in the front end. The repo rate cut and the end of the liquidity squeeze pushed the 3-month FX implied rate down to 12%, 330 bps lower than its highs. As we have argued previously, the strength of the currency lies very much in a strong bond market and therefore should persist.

The **Hungarian** market continues to perform well amid falling inflation. The October PPI at 1.9% YOY was significantly lower than the 2.4% expected by the market. This supports JPMorgan's forecast of a 25-bp rate cut on 10 December at the NBH meeting. However, we expect the 7% level to be a good support for the 10-year yield, currently trading at 7.1%. Furthermore, with most investors overweight, the technical position is weak. Taking into account as well the potential drop in liquidity over the year-end period, we prefer to be cautious. Hence, we continue to favor a steepening strategy with no outright position.

The forint stayed strong, inside the 9-10% DTP range. As for bonds, the long-term outlook is positive but we are cautious in the near term, mainly concerned that both in terms of carry and technical position, the forint is less attractive than the Polish zloty.

On 29 November, the **Czech** National Bank lowered its official interest rates by 50 bps, rather than the 25 bps JPMorgan had forecasted. The immediate reaction was for yields to move higher, including the 2-year sector. Overall, the yield curve steepened over the last fortnight, as would have been expected. We thus remain comfortable with our steepening trade. Also, it is worth noting that asset swaps have widened by about 20 bps, which is essentially a retracement from extreme levels. Bonds were trading very expensive versus swaps before, with the 6.4% 2010 asset swap as low as 68 bps and now at 16 bps. The currency market was uneventful, with the Czech koruna still following a very gradual appreciating trend.

**Turkish** October CPI rose 4.2% MOM, less than expected, increasing local optimism. In these conditions, a rate cut becomes likely and the 6-month T-bill yields should drop below 70% by mid-January. Hence, at current levels (the last auction came out at 78%), they offer good value. We expect the currency to stay strong, its nominal depreciation barely following the inflation differential. The second half of December should be relatively quiet due to the Ramadan and Christmas holidays.

The **South African** rand took another hit this week, falling as low as 11.27 against the US dollar. We stick with our long-term structurally weak view on the rand, based on softer trade account prospects into the first half of 2002 and the dearth of capital inflows to underpin the currency. Also, US\$/ZAR will remain extremely volatile as evidenced by 1-month implied volatility, which trades at 27%. The first evidence of currency weakness filtering through to inflation came via October PPI, which was 0.9% higher than expected. The market reacted very negatively: the front end of the curve, which was pricing a 50-bp cut, is now expecting a 50-bp hike. The bond market suffered a similar fate, with bond yields moving up more than 100 bps in a few days—one of the sharpest moves in recent years. We still believe the fundamental situation is supportive of bonds, but inflation risks have clearly increased.

## Algeria

NR/NR

### Expect Continued Outperformance

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- The 2002 budget assumes an oil price of \$US22 per barrel
  - High reserves should cushion the impact of lower oil prices in the short term
  - Economic reform is gathering pace
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### Market Outlook

**The 2002 budget is based on an oil price of US\$22 per barrel, although the government has indicated that no revision will be necessary unless the oil price falls below US\$19 p.b.** Saharan blend is currently trading at around US\$19.7 p.b., compared with a year-to-date high of US\$31.1 p.b. and an average so far this year of US\$25.1 p.b. Regardless of softening oil prices, Algeria continues to benefit from increased volumes of natural gas exports, which will support the balance of payments over the next year. Natural gas prices are less volatile than oil prices, as they are generally priced on long-term contracts using a moving average of the oil price.

**In the last couple of years the Algerian government has used higher oil prices to build up reserves.** Foreign exchange reserves were US\$17.7 billion in September, up from US\$10.1 billion at the end of 2000. This compares favorably with Algeria's total external debt of US\$22 billion (48% of GDP). Foreign exchange reserves are equivalent to 19 months of import cover and over four years of external debt service. The government has also established an oil stabilization fund into which oil revenues above the budgetary target are placed in order to help stabilize the budget in times when revenue falls below target. We expect the government to react prudently to any substantial oil revenue shortfall and to make offsetting cuts in government expenditure. The official fiscal deficit target for 2002 is less than 1.0% of GDP. If the oil price does fall sharply we would expect to see the deficit to widen toward 2.5% of GDP, but this is a reasonable deficit that would not have a substantial impact on the long-term health of public sector finances.

**The government continues to make progress on economic reform.** In a relatively quiet and understated manner, the administration is reshaping the Algerian economy. The administration has made substantial progress on privatization, and recently sold its holdings in the steel and cement industries, awarded a GSM license to a foreign company, and began restructuring the banking system with a view to privatization. The government is also making progress on negotiating an Association Agreement with the EU and has opened negotiations on joining the WTO. Given Algeria's history of socialist central planning, the recent changes are revolutionary and are fundamentally changing the Algerian economy. We expect the government to push plans to integrate Algeria more closely into the world economy. In this context we expect the government to seek a sovereign rating from the major credit rating agencies sometime next year, and possibly to engage in liability management to simplify its debt structure and set benchmarks in the international market for corporate borrowing.

### External Debt Investment Strategies

**Overweight.** Despite the increased uncertainties about oil prices, Algerian assets continue to perform well. The Algerian component of the EMBI Global provided a 4.7% total return in November, compared with -1.3% total return for the index as a whole. Valuations are less attractive than they were, but we still think that the short duration of Tranche 1 and Tranche 3 (which have spread durations of 2.1 and 3.3, respectively) and decent spreads make the carry attractive. Algerian assets still provide some modest pick-up over Bulgaria, Egypt, and Morocco. In this environment we maintain our overweight allocation, though if we see any further substantial tightening we would look to take profit. Of the two relatively liquid Algerian assets we prefer the higher-yielding Tranche 3.

## Bulgaria

B2/BB-

### Electoral Surprise Puts Government on Short Leash

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- Election of Georgi Parvanov, the Socialist Party candidate, puts government on notice
  - S&P upgrade precedes a successful debut Eurobond issuance
  - Remain overweight on a strong diversification play away from Latin America
- 

### Market Outlook

**In the mid-November run-off presidential election, Georgi Parvanov from the Socialist Party defeated the incumbent President Petar Stoyanov 53.3% to 46.7%.** This was a surprising result for two reasons. First, Parvanov is a member of the party that produced poor economic results in the mid-1990s. Second, Stoyanov was supported by both the current ruling coalition (the National Movement for King Simeon II) and the previous ruling coalition (UDF). We believe this electoral result demonstrates how frustrated the population has become following years of poverty and high levels of unemployment.

**Immediately following the election, Finance Minister Milen Velchev said in parliament that the proposed 2002 budget was the government's initial effort to overcome poverty.** The substance behind Velchev's statement is that the budget is designed to keep inflation low and the current account deficit from spiraling out of control. To complement macroeconomic stability, the government will make every effort to attract foreign direct investment and to sell state assets. The final leg of the government's plans is to improve the business climate by lowering tax rates, reducing red tape, and introducing more transparent corporate laws.

**While the government's domestic popularity has faded from the heady days of June, Bulgaria has enjoyed great success internationally.** On 7 November S&P raised Bulgaria's long-term foreign currency ratings to BB- from B+, with a stable outlook. S&P said that the upgrade is supported by the political commitment to prudent fiscal policy and by the government's cooperation with the IMF. The rating is constrained by significant structural weaknesses, low domestic savings, the

influence of vested political interests, and high unemployment. Shortly after receiving an upgrade, Bulgaria issued a EUR250 million 6-year debut Eurobond that was more than four times oversubscribed.

### **The widening current account deficit has been the macroeconomic issue of greatest concern for the IMF.**

The January-September current account deficit widened to US\$493 million (3.7% of projected 2001 GDP) from US\$364 million (3.0% of GDP) in the same period of 2000. The trade deficit widened to US\$1.1 billion during this period (8.0% of projected 2001 GDP) on the back of a 7.6% YOY increase in exports and a 13.5% YOY increase in imports. The lower export growth, not surprisingly, reflects the economic slowdown in the EU and Turkey.

### **Yet foreign direct investment in the January-September period covered 98.5% of the current account deficit.**

In 2002 we expect further impressive inflows of direct investment given that the government is determined to accelerate the sale of state assets and revitalize the Bulgarian stock exchange.

### External Debt Investment Strategies

**Overweight.** During November, the Bulgarian component of the EMBIG had a total return of 7.0% compared to the 3.9% total return for the non-Latin EMBIG. We maintain our overweight because Bulgaria remains an attractive diversification play away from Latin America. The macroeconomic track record is strong and the government's commitment to joining NATO and the EU is clear. Moreover, the IMF recently said that it would likely reach an agreement with Bulgaria by year-end. Among Bulgarian assets, we continue to favor FLIRBs because they amortize more rapidly than Bulgaria's other Brady bonds, and thus are the most likely candidate for quiet government buybacks.

## Croatia

Baa3/BBB-

### IMF Supportive amid Challenges

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- The IMF gives a nod of approval while expressing the need for further reform and spending cuts
  - The IMF-endorsed 2002 draft budget calls for a budget deficit of 4.25%
  - The government faces a challenging macroeconomic environment and a growing debt burden in 2002
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### Market Outlook

**The IMF praised the government following its first review of the 14-month US\$250 million precautionary standby arrangement agreed earlier this year.** The IMF said it expects Croatia to meet or outperform key 2001 growth, inflation, and international reserve targets under the program. On the fiscal front, the Fund praised Croatia for “bold” government efforts to cut public sector wages and social benefits, while noting that more reform and cost-cutting were required for fiscal sustainability. The IMF also expressed concern about the government’s continued reliance on borrowing rather than privatization proceeds to fund budget spending, as this has prevented the government from reducing the public debt burden. Meanwhile, the World Bank approved a 15-year US\$202 million structural adjustment loan.

**The 2002 draft budget, which the IMF has endorsed, was presented to parliament.** The budget deficit is forecast to fall from this year’s official 5.3% of GDP target (which we believe is more likely to be around 6% due to delayed spending cuts) to 4.25% of GDP in 2002. All ministries are slated to face spending cuts of 7-10% and a large number of state employees are expected to be dismissed. The budget, which for the first time will consolidate pension and health insurance funds, also calls for 3.5% GDP growth in 2002, down from roughly 4.0% expected this year, on the back of the global slowdown, dampened domestic consumption, and lower tourism receipts. The government also scaled back its 2002 privatization revenue target by 70% (after twice revising downward its 2001 target).

**The government faces macroeconomic challenges in 2002 amid a backdrop of slower economic growth.** The government has forecast 3.5% GDP growth for 2002,

slightly more optimistic than our 3.1% forecast. Expected sluggish external demand and an austere budget will likely dampen private consumption. We also expect the current account deficit to widen slightly in 2001 from this year’s level of 3.5% of GDP as a narrower merchandise trade deficit (spurred by fewer imports) is offset by a smaller service surplus (due to the expected fall in tourist receipts). The unemployment rate, which currently stands at around 22%, is unlikely to improve as the government cuts back on public sector employment.

**Meanwhile, the government must contend with a growing public sector debt burden.** Accelerated issuance has boosted Croatia’s total public debt to more than 40% of GDP, around 25% of which is external public debt. We do not expect a significant improvement in the investment climate in 2002, hence the government may have difficulty attracting the necessary foreign direct investment to finance its current account and fiscal deficits. Coupled with the government’s scaling back of its privatization revenue target, we can expect to see continued debt financing, which the government forecasts to reach HRK8.5 billion (US\$1 billion) in 2002 (approximately US\$750 million of which will come from the international capital markets). While Croatia’s external debt burden remains relatively low, its growth rate is likely to receive greater scrutiny from the IMF going forward.

### External Debt Investment Strategies

**Marketweight.** As expected, the IMF’s general praise for the government in November resulted in the good performance of US\$-denominated As and Bs, which returned 0.6% versus the EMBIG’s -1.3%. We maintain our marketweight allocation for December as the IMF prepares to discuss a new stand-by arrangement, yet caution on the considerable challenges going into 2002 and reiterate that the US\$-denominated assets are capped by a call option (callable at par). We also note that the euro-denominated assets have had a good run in the last two months, but still remain wide to comparable regional assets such as Lithuania and Latvia.

## Egypt

Ba1/BBB-

### Watch for Opportunities Following Sell-Off

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- President Mubarak shakes up the economic management team
  - The central bank is given full control over the exchange rate and monetary policy
  - Moody's gives a negative outlook on the local currency rating
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### Market Outlook

**President Mubarak has announced a widespread reform of the management of economic policy in Egypt.** He has abolished the ministry of economy and appointed the reformist former Economy Minister Boutros-Ghali as Minister of Foreign Trade. He has also appointed a reformist as governor of the central bank. In addition, a new central bank law has been passed that gives it fully independent management of both monetary policy and the exchange rate. These reforms are sensible and indicate a definite break with the past, when the government regularly interfered in the operation of both monetary policy and the exchange rate.

**Regardless of these positive events, foreign exchange has been scarce in the last couple of weeks, raising the prospect of a further devaluation.** Lower oil prices and concerns about sharp falls in tourism earnings have led to a drying up of liquidity in the domestic foreign exchange market and the reemergence of a black market exchange rate. The government has responded by initiating measures aimed at reducing public sector imports. The new governor has also indicated that the central bank is looking at the feasibility of managing the currency against a basket rather than just the US dollar as is the case at present. We believe that this would be a sensible move as the EU is Egypt's largest trading partner and the largest source of tourist receipts. We believe that a new currency system is likely to be brought in after the end of Ramadan (in the middle of December) and will lead to a modest further weakening of the exchange rate.

**Moody's placed a negative outlook on Egypt's Baa1 long-term local currency rating.** The agency cited a deteriorating fiscal position and the worsening global economic environment following the terrorist attacks in the US. However, Moody's confirmed the Ba1 foreign currency rating and made no change to the stable outlook, citing the low level of external debt and relatively high foreign exchange reserves.

**S&P has a negative outlook on Egypt's BBB- long-term foreign currency rating.** While the negative outlook raises the prospect of a downgrade to a sub-investment-grade rating in the medium term, we do not believe that this will occur in the near term. We think that the government recognizes the threat of a downgrade and will take the necessary actions to prevent this from happening. We believe that the new independence of the central bank is indicative of the fact that the government remains committed to substantial economic reform.

### External Debt Investment Strategies

**Marketweight.** We moved Egypt to marketweight in the middle of November following the recovery of all its post-11 September losses. Since then Egyptian assets have sold off as concerns about increased instability in the Middle East and a shortage of foreign exchange have weighed on investors. Following the sell-off, the Egypt '11 is now trading 130 bps wide to the Mexico '11 (Baa3/BB+), 15 bps wide to the lower-rated Panama '11 (Ba1/BB), and even flat to the Colombia '09 (Ba2/BB). We view these differentials as excessive and believe they price in an imminent downgrade of the sovereign rating, which we do not believe will occur. Given current concerns about the exchange rate and the potential expansion of the US war on terrorism, we are not yet ready to move Egypt back to overweight, but if it widens further or if we see any positive developments regarding economic reform, we will probably move to overweight. We also continue to view the Egypt '11 as offering better value than the '06.

## Ivory Coast

NR/NR

### Finally on the Right Track

- Compliance with the IMF program continues
- A London Club credit committee has been appointed
- Terms-of-trade shift has boosted economic prospects

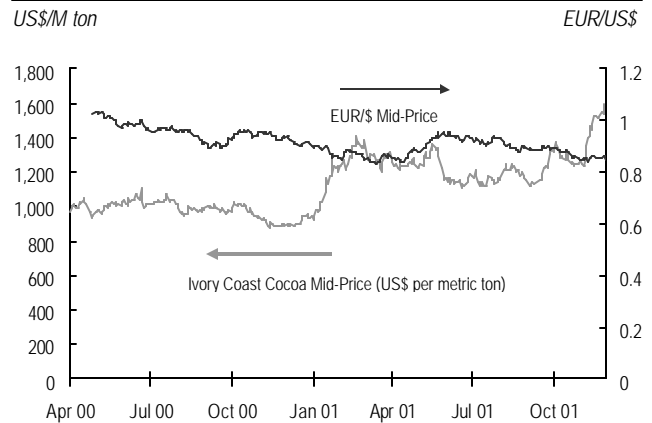
### Market Outlook

**The government is on track to sign a three-year Poverty Reduction and Growth Facility (PRGF) with the IMF in early 2002.** The IMF has indicated that the government is on track with its staff-monitored program and that the country's dire economic situation is stabilizing. The next task facing the government is to finalize negotiations for the PRGF. We think that negotiations are going well and the deal could be finalized in the first quarter of 2002, with the first disbursement at the end of March 2002. A new PRGF will restart the HIPC debt relief initiative, with a likely completion point of 2004 or 2005. Part of the HIPC process will require the government to reach an agreement with its commercial creditors.

**The government has convened a committee of bondholders to start discussions about overdue interest and principal payments on Ivory Coast's Brady bonds.** We do not believe that this signals an early clearance of arrears, since the government's fiscal resources remain constrained, and external arrears (to all creditors) are around US\$540 million or approximately 6.0% of GDP. However, we do believe that the appointment of the bondholder committee is a positive development as it shows that the government is serious in its intentions to deal with the overdue payments. We would expect some solution to the outstanding arrears problem to be put in place relatively soon after the signing of the PRGF in 2002.

**An upswing in soft commodity prices and the weak euro have shifted terms of trade in Ivory Coast's favor.** Since the beginning of the year prices for the Ivory Coast's soft commodities exports have rallied sharply. Cocoa prices are up 50% since the beginning 2000. This has coincided with continued weakness of the euro. Over 80% of the country's external liabilities (external debt and imports) are denominated in euros, whereas around 85% of exports are denominated in US\$. This has led to a sharp positive shift in Ivory Coast's terms of trade.

### Terms of Trade



Source: Bloomberg

### External Debt Investment Strategies

**Overweight.** The prospect of a new medium-term IMF loan program and the appointment of a commercial creditor committee are positive developments. Depending on the exact terms of any restructuring, including the level of a haircut, if any, that the government seeks from commercial creditors, we still see upside from current asset prices. Current market prices of around 15-17 are pricing in a 50-60% haircut, which in our view is aggressive given that an 80% haircut was provided in 1998. We do not believe that a proposal is imminent but expect to see a deal finalized toward the middle of next year. Ivorian assets trade with a very wide bid-offer spread, making the transaction costs of actively trading the portfolio prohibitive. We view our Ivorian allocation as a long-term restructuring play with significant potential upside and are prepared to hold it in the portfolio until we get a meaningful restructuring proposal.

## Lebanon

B2/B

### Debt Problems Continue to Rise

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- Public debt burden rises inexorably
  - Middle East tensions threaten domestic political stability
  - The US labels Hizbullah a terrorist organization and calls for a freeze on its assets
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### Market Outlook

**The government continues to face a mounting public debt burden.** In the year to September, public debt has risen by 18.3% to an uncomfortably large US\$26.1 billion (US\$16.8 billion domestic and US\$9.3 billion external), or an estimated 160% of GDP. We are forecasting that by the end of 2001 public debt will have risen to over US\$27 billion. The driving force behind the rising debt burden is the large fiscal deficit. In the year to October the budget deficit was 47.9% of expenditure, compared with 50.4% last year. Debt service so far this year accounted for 94% of government revenue. This situation is not sustainable and it is not clear to us that the debt spiral can be stopped. There is a growing probability of some form of credit event.

**Foreign exchange reserves have fallen as demand for government paper has waned.** The large budget deficit and rising public debt burden, which in recent months has been partially financed by central bank purchases of domestic government bonds and Treasury bills, have put pressure on the balance of payments. In the year to September the balance of payments recorded a deficit of just under US\$10 billion. Gross foreign exchange reserves have fallen by US\$1.7 billion so far this year to US\$4.2 billion.

**The government's plans to cut debt through privatization look optimistic.** The government has ambitious plans to sell state enterprises such as the electricity authority, two mobile phone licenses, and other state enterprises in order to help plug the fiscal deficit. The global slowdown and the rising economic and political risks means that these sales will be difficult to achieve, in our view. Even if they go ahead, the money raised will likely be less than the government assumes.

**The US government has named Hizbullah as a terrorist organization and asked the Lebanese government to freeze its financial assets.** The decision by the US government to formally ask for the freezing of Hizbullah's assets gives the Lebanese government a serious headache. Hizbullah is a significant political and military force in Lebanon and the government has neither the power nor the inclination to attack it. Consequently, the government has rejected the US request. The US government has not yet reacted to this but given Lebanon's precarious financial situation the government can ill afford to get into an open dispute with the United States.

**The next stage of the US campaign against terrorism holds significant risks for Lebanon.** While we do not know what the US government plans for its campaign against terrorism, the focus of the campaign will in all probability shift from Central Asia to the Middle East. Lebanon is in the frontline of the ongoing Arab-Israeli conflict, with both Syria and Iran supporting Lebanese groups who target Israel. A widened US campaign against terrorism threatens to undermine confidence in Lebanon at a time when the government needs to be able to finance itself through both domestic and external debt issuance.

### External Debt Investment Strategies

**Underweight.** Lebanese Eurobonds with spreads 500-650 bps over Treasuries are very expensive, especially given the rising probability of a significant credit event. The Lebanon '09, which is the most liquid of the illiquid Lebanese assets, trades at around 638 bps over US Treasuries. This spread does not compensate for the high risks associated with holding Lebanese paper. Consequently, we see no reason to change our long-held underweight and therefore have a zero allocation in the model portfolio.

## Morocco

Ba1/BB

### View Remains Negative

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- Both major rating agencies are growing concerned
  - Government performance remains lackluster and the fiscal deficit remains a concern
  - Growth outlook for 2002 depends on weather and tourism
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### Market Outlook

**In the last month both Moody's and S&P have put Morocco's long-term foreign currency rating on a negative outlook.** The rating agencies cited similar concerns, which include a rapid buildup in domestic debt, large and persistent fiscal deficits, an excessive public sector wage bill, a dependence on privatization receipts to fund the deficit, and a slowdown in economic reform. While we do not believe that either agency will downgrade their ratings in the near term, we think that unless the government reduces the budget deficit and increases the pace of economic reform, downgrades from both agencies next year are a strong possibility. We are concerned that the government will be focused on the parliamentary election due in October 2002 and be reluctant to make unpopular but necessary reform decisions in order to put the economy on a sound footing.

**The core of Morocco's problems is weak fiscal policy.** The consolidated government deficit in 2000 was 6.5% of GDP and we are estimating that it will be close to 8.0% of GDP this year. Part of the relaxation in fiscal policy has been triggered by two years of drought, which has necessitated exceptional social spending. The government has indicated that it intends to limit the budget deficit to 3.0% of GDP in 2002, in part by adopting a program of early retirement aimed at cutting the size of the public sector (the public sector wage bill accounts for 12% of GDP). This is, however, somewhat misleading as the government includes privatization receipts as government revenue. Excluding privatization receipts we estimate that the budget deficit will be closer to 6.5% of GDP. The outlook for privatization receipts in 2002 is poor, as Morocco has already sold many of its more attractive assets. The global slowdown is likely to make those assets that remain on the government's books more

difficult to sell to investors, and any shortfall in receipts is likely to force the government to issue more debt to cover the large deficit.

**Growth in 2002 will depend on the rains in the next couple of months.** The government's official growth forecast for 2002 is 4.5%. Growth in Morocco is ultimately dependent on agriculture. The key period for the agricultural season is December-February, and good rains in this period can guarantee strong economic growth. As long as the rains are no worse than average, the government's growth target of 4.5% looks reasonable. Unlike previous years, we expect non-agricultural growth to be subdued by a combination of the slowdown in export demand from the EU and weak tourism following the 11 September attacks. As yet there are no data on tourist arrivals in Morocco after September, but data for tourist arrivals in Tunisia (which has a similar tourist profile) for October showed a 25% YOY decline, while the Egyptian government is forecasting a 50% decline in numbers of tourists.

### External Debt Investment Strategies

**Underweight.** The recent moves by the rating agencies have confirmed our long-held negative view on the current economic outlook for Morocco. Of the three North African credits, Morocco is the one that gives us the most cause for concern as we believe that the ratings could drop to the very bottom of the BB rating range. We expect assets to underperform in the coming months unless the government is prepared to significantly tighten fiscal policy and speed up the economic reform program. Consequently, we maintain our underweight recommendation and have a zero allocation in the model portfolio.

## Nigeria

NR/NR

### Some Positives, Some Negatives

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- Nigeria has finally privatized its telecom company
  - Foreign exchange reserves remain high
  - Lower oil prices threaten 2002 budget targets but should not threaten commercial debt service
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**The government has signed an agreement to sell a 51% stake in the state telephone company NITEL to a consortium of local and international investors for US\$1.3 billion.**

The sale is a positive development as it had been long promised and there had been growing skepticism as to whether the government would be prepared to overrule vested interests and proceed with the sale. In addition to this sale the government has indicated that it intends to sell its remaining 49% stake in the Lagos stock exchange early in 2002. The government has indicated that it intends to push ahead with further sales of state enterprises, including electricity authority NEPA and the country's ports. Privatization has been the ray of light in what has been a gloomy outlook for economic reform, with vested interests blocking many important measures.

**Foreign exchange reserves remain at record levels.**

Despite the recent weakness in oil prices, official foreign exchange reserves have remained at US\$10.5 billion since the middle of the year, which represents three years' debt servicing before a rescheduling by the Paris Club. Foreign exchange reserves are likely to be supported by receipts from privatization, but lower oil prices will prevent any further buildup in foreign exchange reserves.

**The relatively healthy external liquidity situation contrasts with budgetary problems in 2001 and forecast problems in 2002.**

Although the 2001 budget is based on an average oil price of US\$20 p.b. (versus a year-to-date average price of US\$24.9 p.b. for Bonny Light blend), government revenue has come in around 15% below target. We attribute this to lower output due to a combination of civil unrest in the main oil-producing region and lower OPEC quotas. The 2002 budget is based on an oil price of US\$18 p.b. and oil exports of 1.8 mb/d. Export assumptions are in line with Nigeria's OPEC quota, but we estimate that Nigeria is already producing significantly more than its OPEC quota and, as such, the 2002 budget has some slack built into it that will

ease budgetary problems if the oil price continues to fall. The failure to implement properly the 2001 budget and the draft 2002 budget is the biggest point of contention between Nigeria and the IMF. The IMF is concerned that inadequate expenditure controls have led to a surge in the monetary base, causing pressure on the currency and resurgence in inflation. Consumer prices were up 19.1% YOY in September 2001, up from a 6.7% YOY rise in September 2000.

### External Debt Investment Strategies

**Overweight.** The short-term prospects for Nigerian assets depend to a major degree on what happens to oil prices. A major decline in oil prices to US\$10 p.b. or below would have a very negative impact on Nigeria's balance of payments and budgetary situation. Nigeria is planning to make external debt payments in 2002 of US\$3.4 billion, the vast majority of which is due to official creditors. This is a large burden on the government budget and we would expect the Nigerians to seek a further rescheduling from Paris Club creditors. In this environment we expect the market to become concerned about the possibility of a Paris Club-inspired restructuring of commercial debts. We believe that these fears are unfounded. Nigeria's economic reform performance is patchy at best, and in this scenario the Paris Club will only grant a nonconcessional rescheduling as it did earlier this year and will not seek a comparable rescheduling from commercial creditors. While the risks associated with Nigeria have risen given the more uncertain oil price outlook, we continue to view Nigerian Pars as a high-yielding defensive asset.

## Pakistan

Caa1/B-

### Reaping the Benefits

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- Pakistan is on track to sign a new three-year IMF program
  - The US provides financial assistance and the Paris Club is likely to be generous
  - US success in Afghanistan has boosted President Musharraf
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### Market Outlook

**A new three-year IMF deal should be signed before the end of the year.** Pakistan has successfully completed its standby agreement—the first time the country has fully implemented an IMF agreement. The new US\$2.5 billion three-year Poverty Reduction and Growth Facility is due to be discussed by the IMF Board on 5 December. IMF approval of the new deal is a formality, especially given the vastly improved economic policy regime that has been in place over the last year and the support Pakistan has given to the campaign against terrorism. The IMF deal is likely to lead to an increase in aid from other multilateral and bilateral donors.

**Paris Club creditors have indicated that a comprehensive and generous debt rescheduling will be considered once the new IMF program is in place.** We do not know what terms the Paris Club is considering, but we expect that Pakistan will receive at least a 50% NPV reduction of its external debt. Domestic sources are indicating that a 67% NPV reduction in Pakistan's US\$12.2 billion official debt is on the cards. This would be exceptionally generous and exceed the debt relief that Egypt was given after the Gulf War. The Paris Club is likely to meet and discuss the Pakistan package immediately after formal approval of the new IMF agreement. In addition, we believe that the US government is considering substantially increased aid flows and debt relief to Pakistan over and above that provided by the Paris Club.

**The US government has announced a US\$1 billion aid package for Pakistan.** The package includes US\$600 million of budgetary and balance of payments support, a rescheduling of US\$39 million of official debt, a US\$300 million credit line with the Overseas Private Investment

Corporation, and US\$73 million for border security. We expect this package to be followed by further assistance from the United States. The US government is also considering lifting anti-dumping restrictions on Pakistan's textile exports, first imposed in 1998.

**The collapse of the Taliban regime has undermined President Musharraf's critics.** At the beginning of the US campaign in Afghanistan the Pakistani government came in for lot of domestic criticism for supporting the US. The rapid collapse of the Taliban and the tangible economic benefits that Pakistan has received have undermined many of the government's critics. Meanwhile, the government has arrested some of the leaders of the extremist groups. Overall, we think that President Musharraf's position has been strengthened by the US actions in Afghanistan and we do not believe that his rule is under serious threat. The next challenges for the government will be dealing with the new regime in Kabul and with the ongoing conflict with India in Kashmir.

### External Debt Investment Strategies

**Marketweight.** The Pakistan '05 continues to give impressive returns. In November the total return on the Pakistan '05 was 7.0%, significantly outperforming the EMBI Global. The Pakistan '05 is currently trading at a spread of around 1,350 bps over Treasuries and flat to the Ecuador '12. While this spread is still high for a very short-duration asset we feel that the rally has gone about as far as it can in the short term. Consequently, we expect the Pakistan '05 to track the market going forward, and as such, we maintain our marketweight recommendation.

## Poland

Baa1/BBB+

### Government Inherits Big Challenges

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- The incoming government faces a difficult economic environment
  - The RPP cut interest rates by another 150 bps on 28 November
  - The new government/central bank honeymoon is over but a more pragmatic relationship is expected
- 

### Market Outlook

**The incoming center-left SLD-led government has inherited a difficult economic environment.** Economic growth has slowed sharply, interest rates have remained high, unemployment has stabilized at over 16%, and structural reform has lagged. Tight monetary conditions have squeezed domestic demand, while dampened external demand stemming from the EU slowdown has reinforced the downturn.

**GDP rose just 0.9% YOY in the first half of this year, following 4.3% growth in 2000.** High real interest rates have squeezed domestic demand, and investment in particular. January–October industrial production rose just 1.0% YOY versus 9.1% YOY in the same period of 2000. Business surveys show the lowest confidence in industry since 1996, and domestic enterprises expect further deterioration in the coming three to four months. Meanwhile, inflationary expectations are at a historical low, following yet another contraction in October inflation data. Most likely, inflation will end the year around 2 percentage points below the 6-8% central bank target. We expect GDP growth to end the year at 1.1%, with some pick-up in the second half of 2002 resulting in 2.3% GDP growth next year.

**The RPP cut interest rates 150 bps on 28 November, with a neutral bias for future policy moves.** Despite a total cut of 750 bps in the benchmark 28-day intervention rate since the beginning of the year, it still is high at 11.5%—thus, the cuts have provided only modest stimulus for a recovery. Further cuts will depend to a significant degree on the implementation of an austere 2002 budget. As we believe the 2002 draft budget is conservative and supportive of further monetary easing,

we expect rate cuts in the first half of 2002, and forecast a benchmark rate of 8% by mid-2002.

**The cabinet approved the 2002 draft budget, which calls for a fiscal deficit of 4.8% of GDP.** The draft budget, which will now be debated in parliament, freezes tax brackets, eliminates tax subsidies, introduces a 20% capital gains tax, and cuts spending through social welfare reform. Meanwhile, this year's budget, which faced a second revision, looks set to be met following a new round of expenditure tightening, including Finance Minister Belka's imposed spending freeze through the end of the year.

**The SLD-led government faces the difficult task of implementing austerity measures while maintaining a cohesive coalition with the Peasant's Party (PSL).** We do not anticipate a major overhaul in economic policy—rather the government will need to tackle the usual problems of revamping fiscal policy, reducing unemployment, and fostering structural reform. With respect to EU accession negotiations (Poland has lagged behind in closing chapters in the past 18 months), we anticipate that the PSL will be generally cooperative despite occasional noise. Poland has softened its stance in negotiating with the EU, which we believe increases the probability of EU membership in 2004. In the meantime, government/central bank relations will remain at the center of the political scene, although we expect more pragmatism to prevail.

### External Debt Investment Strategies

**Underweight.** We retain our underweight recommendation as we believe recent and expected interest rate cuts have been largely priced in, with Polish US\$-denominated debt returning 0.5% during November, versus the EMBI Global's -1.3% return. We note that EUR-denominated assets remain expensive.

## Qatar

Baa2/BBB+

### Diversification Benefits

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- Rating agencies currently diverge but upgrades beckon
  - Trouble in the Middle East should not hurt the credit
  - Oil price determines the economic outlook in 2002
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### Market Outlook

**The rating agencies' views on Qatar currently diverge but we expect that to change next year.** Moody's currently rates Qatar one notch lower than S&P, and has a stable outlook compared with a positive outlook for S&P. We think that this divergence is probably unsustainable and we would expect Moody's at least to give Qatar's rating a positive outlook if not to upgrade the long-term foreign currency rating to Baa1 sometime next year.

**Qatar's small size should isolate it from the potentially negative consequences of a possible extension of the US campaign against terrorism to Iraq.** Qatar is a wealthy and relatively liberal Gulf state with a small domestic population. In these circumstances we think that it is unlikely that domestic political stability will suffer a backlash from any US actions against terrorism, although Qatar is likely to publicly oppose any US extension of the campaign against terrorism to include Iraq. However, Qatar has diplomatic ties with both Israel and Iraq and strong relations with the West, and we do not expect this to change even if the US does attack Iraq.

**Rising export volumes of oil, oil derivatives, and natural gas should insulate Qatar from lower oil prices.** Qatar continues to benefit from new investment in the oil and natural gas sectors and as such the rising volumes will provide some protection against lower oil prices. We believe that for the value of Qatari exports to fall in nominal terms, the oil price would have to fall to below US\$19 per barrel next year and remain there for a significant period of time.

**The Qatari government remains very cautious when it comes to planning its budget.** In 2001 the government planned to balance its budget based on an oil price of US\$16 p.b., compared with an average price for Qatari crude so far this year of US\$24.1 p.b. Given this disparity the government is obviously going to record a substantial surplus this year. The draft 2002 budget is based on an oil price assumption of US\$16.5 p.b. Given that OPEC and non-OPEC countries appear to be cooperating with regard to reductions in crude oil exports, we believe that the oil price will remain comfortably above the government's budget target, leading to another year of substantial budgetary and balance of payments surpluses.

### External Debt Investment Strategies

**Off-index allocation.** Both Qatari assets performed relatively well last month, with the Qatar '09 tightening by 45 bps and the Qatar '30 by 64 bps. We believe that the Qatar '30 continues to offer value against other high grade credits. The '30 US BBB1 industrial index is trading at 187 bps over US Treasuries, whereas the Qatar '30 is still trading at around 295 bps over Treasuries. Given Qatar's dependence on the hydrocarbon sector, its assets are probably the purest oil play in emerging markets. Consequently, we remain comfortable with our small Qatar allocation in the model portfolio.

## Romania

B3/B

### A European Safe Haven

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- We retain our off-index bet, as the '08 spread narrowed 110 bps in November
  - Parliament approved the budget and other important legislation
  - The fiscal picture looks good, but the population has grown tired of austerity
- 

### Market Outlook

**Our off-index recommendation for Romania paid handsome dividends last month.** The spread of the EUR-denominated '08 narrowed 110 bps during November, ending the month at 480 bps over German Bunds. European investors have been anticipating a negative credit event in Argentina and the associated contagion in Brazil, and have been looking for diversification plays. Romania has been attractive because at the end of October the IMF approved an 18-month, US\$383 million standby arrangement. Moreover, the World Bank agreed to release in two installments a US\$300 million public-sector adjustment loan to support micro-credit and worker retraining schemes. In addition, Romania's debt to GDP ratio is less than 30% and the government has been implementing measures agreed with the IMF.

**The government has made solid progress on the fiscal front.** For the first nine months of this year, the consolidated budget deficit equaled 2.6% of period GDP, and it appears likely that the 2001 deficit target of 3.5% of GDP will be reached. For 2002, the parliament approved a budget with a targeted deficit of 3.0% of GDP, which has been the government's commitment to the IMF.

**Although the fiscal picture looks solid, the population has demonstrated against poverty and corruption.** In late November a crowd of 10,000 marched in Bucharest against poverty, low wages, inadequate pensions, and corruption. One reason for this demonstration was the substantial increase in utility prices in line with the government's letter of intent with the IMF. In response, the Minister of Labor and Social Solidarity noted that the implementation of the Law on the Minimum Guaranteed Income is expected to reduce the poverty

rate by about 15% next year. We point out that the government would be under even more pressure if employment had not been growing so steadily. In September, the unemployment rate fell to 7.8%, its lowest level in four years, from 8.1% in August.

**The economy has begun to grow after performing well for most of the year.** GDP grew 4.9% YOY in the first half of 2001, and industrial production rose 8.3% YOY during January-September. However, September industrial production rose only 2.5% YOY.

**The main economic weakness has been the growing current account deficit, due entirely to the widening trade deficit.** For January-September, the current account deficit was US\$1.4 billion compared to a deficit of US\$798 million over the same period last year. Moreover, the October trade deficit was US\$398 million, suggesting further deterioration in the current account for October. During January-October, exports grew 12.6% YOY in US dollar terms, while imports were up 22.4% YOY. Note that during the first three quarters Romania had unexplained balance of payments inflows (net errors and omissions) of US\$736 million, which is one reason that the central bank's foreign exchange reserves reached US\$3.61 billion at the end of November, up US\$1.1 billion year to date.

### External Debt Investment Strategies

**Off-index recommendation.** In our view, European investors will continue to seek diversification plays away from Latin America. Even though Romanian Eurobonds have become somewhat expensive relative to their credit ratings, we maintain our overweight because we believe the government will successfully implement its commitments to the IMF and will strive to accelerate its accession negotiations with the EU. We anticipate a rating upgrade in the near future.

## Russia

Ba3/B

### Double Upgrade, yet Oil Price Down

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- Moody's upgraded Russia's sovereign debt two notches
  - Rapid growth, impressive fiscal results, and political stability support an overweight allocation
  - Russia's response to OPEC is an important key to the 2002 budgetary outcome
- 

### Market Outlook

**On 29 November Moody's raised its credit rating on Russia's foreign currency bonds to Ba3 from B2, with a stable outlook.** Moody's cited Russia's recent "period of rapid growth, combined with impressive fiscal consolidation and prudent monetary policy." In addition, Moody's noted that President Vladimir Putin's administration has created a politically stable environment and has been dedicated to introducing structural reforms and servicing its debt. In November, the Russian component of the EMBIG experienced a 8.3% total return compared to the 3.9% total return for the non-Latin EMBIG.

**Comparing Russia with other Ba3 credits, we find that it still offers considerable value.** Russia bonds recently traded 100 bps wide of Jamaica and 300 bps wide of Jordan and Peru. Moreover, the domestic bid for Russian bonds has remained strong and is likely to strengthen further with the passage of a budgetary amendment that would make it possible for the federal government's financial reserves to be invested in state liquid securities, including Russian Eurobonds.

**During the first 10 months of this year, GDP rose 5.5% YOY.** Both consumption and investment have been buoyant, and the IET industrial business survey has remained reassuringly strong through November. We expect Russia to be one of the few bright spots in the global economy over the next half year—though this too is dependent on the price of oil.

**The fiscal picture has remained encouraging.** The federal government had a budget surplus of 3.1% of period GDP and a primary surplus of 6.0% of GDP for the

first 10 months of 2001. Separately, the State Duma is expected to pass legislation on corporate governance, pension reform, and measures to rationalize budgetary expenditure over the next several months.

**Since many investors view Russia as an oil play, the key risk to Russian asset prices going forward is the downward trend of oil prices.** The latest 2002 federal budget is based on a price for Urals crude of US\$18.50, designed to lead to a balanced budget. According to the Ministry of Finance, an average price of US\$14.50 would result in a deficit of US\$7 billion (2% of GDP). That deficit could be financed with greater domestic and external issuance and expenditure cuts.

**Russia has agreed to cut crude oil exports by 150,000 barrels per day (5.2%) starting 1 January.** Non-OPEC producers Norway, Mexico, and Oman have pledged to cut 200,000, 100,000, and 50,000 barrels per day, reaching the 500,000 barrels per day requested by OPEC. Moreover, we believe Russia will implement its commitment because the government controls the state-owned oil pipeline monopoly Transneft and because a seasonal cutback in production of 100,000 barrels a day occurs in the first quarter. Consequently, Russian oil prices should remain above US\$17 p.b. during the first quarter of 2002.

### External Debt Investment Strategies

**Overweight.** During November the spreads on Russian bonds narrowed between 120 bps and 210 bps, with spreads on shorter-dated bonds narrowing more. One reason for this performance was the reinvestment into Russian bonds of the principal on the Russia '01. Another reason was the domestic bid for Russian assets. We remain overweight Russian bonds because non-OPEC countries have reached a compromise with OPEC and because the domestic bid is unlikely to disappear. In the short end of the Russian curve, we favor MinFin 4s and 6s, which trade 300-380 bps wide of the curve. In addition, the Russia '30 remains most attractive for those able to withstand volatility.

## Slovak Republic

Baa3/BBB-

### Global Downturn Takes Effect

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- Industrial confidence is on the decline but some signs of domestic confidence remain
  - The National Bank of Slovakia has left rates unchanged so far
  - Growing deterioration in the current account deficit causes some worry
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### Market Outlook

**Industrial confidence fell to its lowest level since spring 1999.** Amid a deteriorating economic environment both globally and in the neighboring Czech Republic, industrial confidence sank to its lowest level since November 1999, pulling the overall economic sentiment down 3.5 points to its lowest level since May of last year. Outside industry, however, we note that confidence has remained strong on the back of stimulative domestic fiscal and monetary policies, indicating that some positive momentum in the economy still exists.

**Meanwhile, we estimate that GDP grew 2.6% in the first nine months of 2001 versus 2.2% for full year 2000.** While domestic demand momentum appears broadly on track to deliver our 2.5% GDP growth forecast for 2001, the protracted global economic slowdown justified a modest downward revision of our 2002 real GDP growth forecast to 3.0% from 3.5%.

**The National Bank of Slovakia (NBS) has chosen to keep interest rates on hold so far.** The NBS has thus far not reacted to weaker confidence indicators and a growing disinflation trend. October saw the lowest YOY change in headline CPI since March 2001, and core inflation has reached the bottom of the NBS's year-end official target range of 3.6-5.3%. The NBS has defended its decision to keep rates unchanged by citing concerns over the deteriorating trade deficit and a weakening koruna. We do not expect the NBS to cut rates in the near term despite the regional slowdown and monetary easing elsewhere, although the NBS may decide to ease once the trade deficit begins to narrow, encouraged somewhat by the recent cut in the Czech Republic. We would not expect more than a 25-to 50-bp tightening in rates through next year, and forecast a benchmark rate of 7.25% by mid-2002.

**The current account deficit is likely to surpass 8.5% of GDP this year, up from 3.7% in 2000.** The deterioration in the current account has been driven by robust import growth, which has in turn been fuelled by foreign direct investment (FDI), reflecting ongoing business restructuring in Slovakia. Export growth meanwhile has become increasingly sluggish on the back of the EU slowdown. Looking ahead, slowing domestic industrial activity and falling energy prices may dampen import growth and prevent the current account deficit from widening much further. Moreover, FDI coverage of the current account deficit has risen strongly with coverage of 80% between January-July of 2001 versus 63% in the same period of 2000. The privatization of national gas monopoly SPP is likely to increase this coverage further in 2002.

**The government submitted the draft 2002 budget to parliament on 15 October.** The budget deficit is forecast to decline to 3.6% of GDP (the maximum allowed under IMF monitoring) from this year's target 3.9% of GDP. Notwithstanding any fiscal slippage in the run-up to the September 2002 elections, we believe the government will comfortably finance its fiscal deficit through the planned SPP privatization. Parliament plans to review the draft in early December.

**Moody's raised Slovakia's foreign currency rating to Baa3 from Ba1 in mid-November.** This follows Standard and Poor's upgrade to BBB- on 30 October. Moody's cited a stabilizing economy, continued bank restructuring, and steady progress on EU accession negotiations, where Slovakia has closed 20 of a total 31 chapters to date.

### External Debt Investment Strategies

**No allocation.** Both the US\$-denominated and the EUR-denominated '04s and '10s performed well over the month on the back of the rating upgrades. However, we believe that spreads should stabilize in the next month and therefore maintain our no allocation strategy.

## South Africa

Baa2/BBB-

### Continued Solid Progress

- Moody's upgrades the external and domestic sovereign ratings
- Economic policies remain prudent with no change likely
- But the rand takes a hammering with little sign of respite

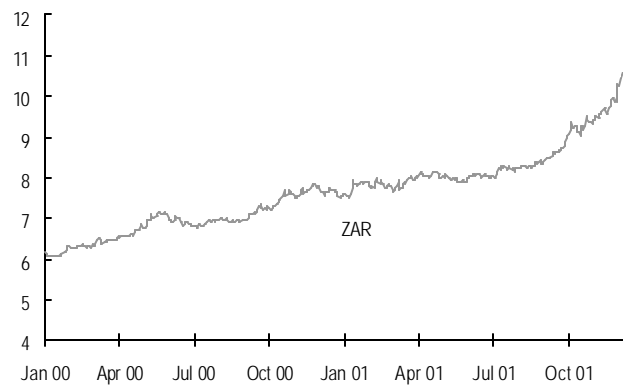
### Market Outlook

**Moody's has upgraded South Africa's long-term foreign currency rating to Baa2 and the long-term local currency rating to A2.** Moody's cited a number of macroeconomic and policy developments as the reason for the upgrade. In particular, they cited prudent fiscal policy, greater flexibility in monetary policy, and improved export performance following the signing of the Association Agreement with the EU and the US-Africa Growth and Opportunity Act. In addition, they believe that the new monetary and fiscal flexibility will allow the country to weather the international slowdown comfortably. Moody's stated that the rating was constrained by the wide income disparity, high unemployment, the high incidence of HIV, and the need for faster economic growth to boost job creation. S&P has always been more skeptical about South Africa's economic fundamentals than Moody's and as such we think that an upgrade in the near term is unlikely. We would not, however, rule out the prospect of a revision to the outlook to positive from stable when S&P conducts its annual review of the rating early in 2002.

**The rand has continued to come under sustained pressure.** The rand continues to be very volatile as concerns about the global environment, the situation in Zimbabwe, and confusion of the current state of exchange controls weigh on the currency. Since 11 September the rand has weakened by about 31%. While this sell-off looks excessive, it is hard to see where support from the currency will come from, and as such, we are forecasting that the rand will depreciate further in 2002. While the sharp depreciation in the rand may threaten a resurgence of domestic inflation, we do not believe that it undermines the creditworthiness of the country. Prudent fiscal policy and modest foreign borrowing means that both total

public debt (46.1% of GDP) and total external debt (24% of GDP—of which only 6.0% is public sector external debt) are modest and compare favorably with other high-rated emerging market countries.

### ZAR Depreciation Accelerated



Source: Bloomberg

### External Debt Investment Strategies

**Overweight.** The Moody's upgrade brings South Africa's long-term foreign currency rating in line with the agency's ratings on Malaysia, South Korea, and Qatar, and provides clear blue water between South Africa's rating and mainstream higher-rated emerging markets like Mexico and Egypt. On 16 November we moved South Africa to overweight in our model portfolio by buying US\$2.0 million South Africa '17. South African assets have rallied since then. Nevertheless, we think that South Africa still offers value versus Malaysia and Qatar. The Malaysia '09 trades at 165 bps over the US Treasuries and the Qatar '09 at 145 bps over, between 75-100 bps tight to the South Africa '09. On the South African yield curve, however, we still view the South Africa '17 as offering the most value and we maintain our overweight in our model portfolio.

## Turkey

B1/B-

### Eternal Optimism or the Real Deal?

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- Domestic confidence has increased and Eurobonds have outperformed
  - The IMF wants to maintain maximum flexibility in providing new funding to Turkey
  - Assumptions underlying the 2002 economic program seem optimistic
- 

### Market Outlook

**Domestic confidence has increased as measured by declining bond yields, a rising stock market, the lira's recent appreciation, and the slowing outflow of Turkey's foreign exchange reserves.** The annualized yields on Turkey's benchmark domestic T-bills have fallen from over 90% in early October to 76% in late November, while the Istanbul National 100 Index rose 28% between mid-October and end-November. The TRY/US\$ exchange rate moved from 1.59 million at the end of October to 1.48 at the end of November. Turkey's foreign exchange reserves were US\$17.7 billion on 23 November compared with US\$18.6 billion on 19 October, even though the sovereign met significant external debt obligations during that period and tourism receipts dried up after the events of 11 September. We believe these latter two developments suggest that exporters are now returning their export proceeds to Turkey and that the population has stopped accumulating more of their assets under the pillow.

**Upon recently approving a US\$3 billion disbursement to Turkey, the IMF executive board praised the strong implementation of Turkey's challenging economic reform program.** The Fund has been particularly impressed with the primary surplus of the consolidated budget, parliamentary passage of numerous structural measures, and restructuring of the banking sector.

**Yet for the next 13 months, the IMF has identified a US\$10 billion balance of payments gap.** The 2002 economic assumptions underpinning that financing gap include 4% growth, a 6.5% of GNP primary surplus, a moderately paced decline in interest rates, and a declining debt/GNP ratio over the medium term. Thus far, the IMF has not revealed when such new funding for Turkey is

likely to be approved nor how much of the new funding may be directed to the Treasury. Moreover, the IMF has implied that more than US\$10 billion could become available if bilateral creditors decide to assist Turkey. We believe that the IMF wishes to maintain maximum flexibility in providing new funding to Turkey for two reasons. First, next year's growth is difficult to estimate given a slowing European economy, high domestic interest rates, and uncertainty over tourism inflows. Second, the Fund is preparing for the possibility of another injection of funding nine months from now should Turkey implement the 2002 economic program yet growth fail to emerge.

**Despite these encouraging developments, Turkey has not yet turned the corner for the following reasons: dollarization has remained at all-time highs, bank lending has declined in the face of growing bad loans and unattractive borrowing rates, and the 2002 budgetary interest burden is expected to be about 17% of GDP, or over 80% of anticipated tax revenue.**

Simply put, we do not have a clear idea of how Turkey will grow when fiscal policy is expected to tighten, export growth is likely to be modest, and tourism revenue may decline substantially from this year's record level.

### External Debt Investment Strategies

**Underweight.** Turkey has outperformed the EMBIG for the last four months. During November, the Turkish component of the EMBIG had a 5.4% total return compared to 3.9% for the non-Latin EMBIG. However, we continue our zero allocation to Turkish debt because domestic support for the fiscal tightening promised to the IMF is weak, and the political coalition itself is fragile. For investors seeking Turkish risk, we favor the '30 and the recently issued '06—the latter since issuance has widened 40-50 bps to the curve.

## Ukraine

## Caa1/NR

### Parliament Remains the Question Mark

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- Parliament rejected the 2002 budget, yet passed potentially imprudent tax cuts
  - GDP rose 9.3% YOY during the first three quarters with the assistance of an agricultural rebound
  - Cooperation between Ukraine and Russia has strengthened on many fronts
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### Market Outlook

**Ukraine's Parliament rejected the second reading of the proposed 2002 state budget.** Relative to the 226 votes needed for passage, 176 MPs supported the IMF-sanctioned budget proposal. Yet parliament passed the second reading of the new Tax Code that would become effective 1 January 2003 and would reduce the tax burden on businesses and individuals. Given that parliamentary elections are scheduled for 31 March 2002, MPs in our view want to see more spending on social services and would be comfortable with a wider 2002 fiscal deficit. Yet passage of a prudent 2002 budget is needed to trigger the IMF's next disbursement. Moreover, if such a budget is not passed by the end of December, it is unlikely to be passed soon in 2002 because of the holidays and pre-election campaigning by MPs. While failure to pass the 2002 budget would not affect the December US\$100 million disbursement from the World Bank, it would halt restructuring of Ukraine's US\$850 million in Paris Club obligations.

**Thus far investors have decided to ignore the government's problems with parliament.** During November the total return on the Ukraine US\$-denominated '07 was 5.66%, well above the 3.86% total return of the non-Latin component of the EMBIG. Moreover, so far this month Ukrainian Eurobonds have remained well bid.

**One reason investors have retained confidence in Ukraine is that growth, the current account, and reserves accumulation have been excellent.** For the first three quarters of 2001, GDP rose 9.3% YOY. For the first 10 months of this year, industrial production was up 16.1% YOY. Agriculture has also contributed

significantly to growth as good weather has meant an estimated 2001 grain crop of 40 million tons versus 24.4 million tons last year. Finally, construction activity has increased on the back of an estimated 9.0% rise in real wages this year and lower unemployment.

**For January-September, the current account surplus was US\$1.12 billion, on the back of a US\$2.35 billion trade surplus.** In light of this current account surplus and the accumulation of arrears to Paris Club creditors, during the first 11 months of this year the hryvna strengthened 2.8% relative to the US dollar, and gold plus foreign exchange reserves rose US\$1.4 billion to reach US\$3.0 billion.

**Given positive trends, Moody's on 21 November revised its outlook on Ukraine's Caa1 long-term foreign currency rating to positive from negative.**

**Ukraine's improving relationship with Russia is another reason investors have ignored the possibility that Ukraine will fall off track with the IMF.** After agreeing to restructure US\$1.4 billion of debt owed by the state-owned Naftogaz Ukrainy to Gazprom, Ukraine and Russia signed a 2002 accord on Russian gas to be shipped across Ukraine. Ukraine also lowered the transit fee for Russian oil. In addition, Ukraine may complete two nuclear reactors in cooperation with Russia (rather than with Western partners). Most encouragingly, Ukraine and Russia have agreed to draft a free-trade agreement by the end of March 2002.

### External Debt Investment Strategies

**Marketweight.** We retain our marketweight stance on the US\$-denominated '07 primarily because parliament could throw the government's relationship with the IMF off track. Furthermore, from a technical perspective, Ukraine is a bit vulnerable because our clients remain overweight Ukraine. We are more constructive on the EUR-denominated '07 because there are no comparably wide EUR-denominated assets available.

## Asian Regional Overview

### Supportive Factors Just Get Stronger

- Across-the-board rally set to continue into 2002
- Korea moves from strength to strength, signaling continued support in high grade issues
- Move to overweight in both Malaysia and the Philippines

### Market Outlook

Demand for Asian dollar bonds has not been about fundamentals for quite a while, as prices have risen as persistently as economies have fallen. And since the last *Emerging Markets Outlook*, that same theme came through.

**For the second consecutive month, Asian dollar bonds rallied across the board.** In November, the EMBI Global Asia subcomponent tightened 64 bps and the JPMorgan Asia Credit Index (JACI) 27 bps. Meanwhile, although third-quarter GDP surprised on the upside in Korea and the Philippines, most of Asia's economic news remained poor.

**As we head into year-end, we think investors should add more weight to selected credits in Asia.** First, we see no reason to believe that the Asia bid will fade in the near term, so high grade external debt will remain supported. Not only are fundamentals likely to stay poor, leaving large pools of liquidity, but our local market strategists see rates turning back down and our equity strategists have no faith in the recent rally. Second, not only have our concerns over a reappearance of risk aversion proven unfounded, but risk appetite has firmly taken hold among investors, who will continue to support non-investment grade bonds.

We believe that defensive credits will continue to do well. That said, levels have gone from tight to tighter on these names, making entry levels even more unattractive for emerging markets investors. Therefore, **we remain overweight almost all of the investment grade sovereigns: China, Korea, and Thailand.** For high grade investors, though, these remain interesting names, in part because of their diversification value, but also because of their clearly positive credit stories.

No sovereign credit captures this view more clearly than **Korea.** Growth has outperformed the rest of tech-heavy Asia and external liquidity ratios have shown stunning improvement. The S&P upgrade and the positive outlook

from Moody's reinforce this view. On top of these macro data, we believe that high-profile restructurings continue to move toward constructive resolutions. But, even more important than this fundamental story, the local bid for scarce Korean dollar paper shows no sign of fading. That said, at less than 90 bps over on the Korea '08, we maintain our large underweight in Korea (though we may look to buy the Hanvit sub-debt during the month).

Our sole investment grade recommendation is in **Malaysia**, where we move to overweight from marketweight. True, the growth story this year is not nearly as impressive as Korea's, nor is local bid as strong. But our view is that the gap that developed between Malaysian and Korean spreads earlier this year will continue to narrow going forward. Rising foreign reserves lay to rest questions about the sustainability of the ringgit peg, and Malaysia's fiscal ratios are strong enough to bear the burden of the government's pump-priming efforts. On the political front, while the succession issue remains, post-11 September challenges to Prime Minister Mahathir have faded, calming a key political uncertainty. Given the surprise upgrade on Korea, we are now more open to the possibility of an outlook change back to positive by S&P, based simply on the macro data, especially reserves. Finally, critical developments in corporate restructuring provide further upside potential in the months ahead.

The prevailing risk-seeking environment has finally allowed the continuous improvement in economic fundamentals in the **Philippines** to shine through. As such, we are adding to our current position and move more decisively overweight. Despite market skepticism on growth and the budget deficit, a determined Macapagal-Arroyo administration has delivered results on both fronts. Meanwhile, slower-developing reforms, including the privatization of Napacor, are also moving forward. We have been constructive on fundamentals in the Philippines since the new government took over, so this is nothing new. What is new is that the market environment is risk-seeking and perceptions of Philippine vulnerability to Argentina have diminished.

We believe that official creditor support for **Indonesia** will not only remain firm, but that creditors will also be patient with the Megawati administration. Meanwhile, in **India**, even geopolitics cannot trump domestic woes associated with its weak fiscal health.

## Asian Local Market Overview

### Between Recovery Euphoria and Recession Risks

#### Market Views

**Foreign Exchange:** With risk appetite waning and a move into risk aversion expected early next year, if not before, the time is ripe to begin positioning for a bout of regional FX weakness. Near-term, equity driven flows are still supporting KRW, and could even trigger a spike up in TWD as the central bank loosens its grip after last weekend's parliamentary elections (in which the ruling DPP did considerably better than expected). But entry levels are now very attractive, particularly in Korea, where JPY/KRW has breached our implied BoK sensitivity threshold of 10.25. This implies that scope for further KRW upside is limited even if foreigners continue to buy equities for another week or two. They are already overweight their new MSCI benchmarks, so the chance of a snap-back if and when sentiment falters is growing.

Southern Asian FX have mapped divergent trends, with US\$/IDR off its 6 November peak by almost 4% on a steady liquidation of short IDR positions and US\$/THB lower by about 1.5% on a modest pickup in equity inflows. Both look vulnerable to a turnaround in sentiment, and so should test higher into year-end. For its part, US\$/SGD has ground 1% higher, bumping repeatedly against MAS resistance but clearly still being guided up.

**Fixed Income:** Local bonds staged a modest rally in the past two weeks after the big losses recorded in early November. Bond yields dropped 15-20 bps in Korea and Singapore, while rates in Hong Kong were more or less unchanged. Indian and Thai bonds remained the star performers, with 10-year benchmark yields down 100 bps and 50 bps respectively over the month. The recent volatility does leave some mispricings and relative value opportunities. However, we caution against building aggressive positions in the holiday period, which at best will see modest liquidity and relatively wide bid-offer spreads.

#### Market Strategies

- **Take advantage of potential near-term TWD spike.** For a zero-cost option structure, buy one US\$ put TWD call at a strike of 34.40 for 1-month and sell two units of US\$ puts TWD calls at 34.25 for 1-month, with a maximum return of 44 bps if US\$/TWD hits 34.25 in one month. The breakeven is 34.10.
- **But hold long US\$/TWD 3-month forward.** This trade lost 27 bps, but still stands to make 43 bps should we hit our target of 34.7. Entering the trade at the more attractive current levels would give 115 bps.
- **Roll short SGD 1-month forward versus basket.** A short SGD 1-month forward against an equal-weighted basket of US\$, EUR, and JPY, re-entered 8 November, lost 17 bps as sharper-than-expected yen depreciation offset gains from the dollar leg. Investors re-entering at current levels will earn 118 bps should we hit our end-December targets.
- **Roll over long US\$/HKD 3-month forward.** This trade expired up 3 bps. Given that we see a high probability of a return to global risk aversion, we strongly recommend sticking with this insurance.
- **Convert outright swap to HKD-US\$ spread trade.** Our 5-year received position in HKD swaps has performed well. We recommend paying 5-year US\$ swaps against it since we feel the steep HKD-US\$ spread of 41 bps is not justified. Pay 5-year US\$ IRS at 4.69% against the existing 5-year received position in HKD swaps.
- **Open a spread convergence trade in Singapore.** The 2/5s spread on the bond curve is very steep (134 bps) relative to the 2/5s spread on the swap curve. We recommend a convergence trade in Singapore. Open a 2/5s duration neutral flattener in bonds and a steepener in swaps. Note this trade carries positively.
- **Reduce duration in Korea.** The 5-year bond position has performed well over the past couple of weeks. But we now see better value in the 3-year segment and recommend switching from the 5-year into the 3-year KTB at 5.85%.
- **Reestablish US\$/KRW 3-month forward.** Our 1-month KRW/SGD trade expired with a gain of 292 bps. Switch into a long US\$/KRW 3-month trade, earning 290 bps if we hit our end-March target of 1,320.

## China

A3/BBB

### Defensive Bonds at the Sidelines

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- Risk-seeking sentiment reinforces our underweight allocation
  - But fundamentals should remain favorable relative to other countries in the region
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### Market Outlook

**Set to gain official WTO membership, China should ultimately benefit on both the investment and trade fronts.** The World Trade Organization (WTO) council ratified China's membership on 10 November in Qatar, as expected. Indeed, based on balance of payments data that were released on a half-yearly basis for the first time ever, sustained foreign direct investment (FDI) inflows ahead of China's formal entry into the WTO boosted the capital account surplus to US\$19 billion in the first six months of this year. Utilized FDI flows rose 18.6% YOY during the first 10 months to total US\$37 billion, in contrast to a modest decline of 3% YOY in the same year-ago period. Still, while FDI inflows should remain steady near-term, the risk that these flows may peter out cannot be dismissed given the pullback in global growth.

**China's external liquidity position continues to improve.** Surging capital inflows boosted FX reserves to a record US\$203 billion as of end-October, a year-to-date accumulation of US\$37 billion. We note however that net errors and omissions remained substantial at US\$8.5 billion in the first six months, despite stricter capital controls. Meanwhile, the current account surplus narrowed to US\$5.1 billion in the first half of 2001, from US\$6.3 billion in the same year-ago period. This reflects a combination of weaker exports and sustained import growth due to resilient domestic demand. Nonetheless, the longer-term implication of WTO membership on the current account will likely be a net positive. The World Bank estimates that China's trade surplus could potentially double to around US\$45 billion by 2005 from about US\$20 billion this year, reflecting China's increased share of global exports.

**Aggressive fiscal pump-priming will continue to provide support for growth until the downturn in global trade runs its course.** Industrial production rose 8.8% YOY in October, as public spending supported the output of heavy equipment. The outcome, which translates to a modest decline of 0.2% MOM (sa), was stronger than anticipated. However, in light of the moderating trend of general economic activity, this suggests rising stock levels, which could prompt producers to cut back output in the months ahead. Indeed, facility investment growth continued to lose momentum, as the increased outlay in public works only partly offset the slowdown in capital spending by companies. Fixed investment slid 2.3% MOM (sa) in October, representing the fourth straight month of decline.

### External Debt Investment Strategies

**Underweight.** Market sentiment has moved into outright risk-seeking mode since mid-November, amply illustrated by recent trends in the Liquidity and Credit Premia Index (LCPI). This has been constructive to our allocation shift for China to underweight from marketweight a month back. The move then reflected the shift in investor sentiment away from risk aversion, which persuaded us to drift away from the low-risk, bearish growth strategy we adopted post 11 September. Not surprisingly therefore, defensive credits such as China bonds underperformed their higher-yielding counterparts, particularly the Philippines. The China '11 narrowed just 9 bps to T+106 bps in the past month, compared to a 113-bp spread compression in the Philippines '10.

**We maintain our underweight allocation, as we expect the risk-friendly environment to persist near term, if history is any guide.** Risk-seeking periods in the past, as reflected in our LCPI, typically lasted for forty or more days. Taking this as a baseline scenario for the weeks ahead, there is little reason for us to change our recommendation. Nonetheless, we want to emphasize that China's sovereign issues remain the best defensive play within the Asian bond universe in the unlikely event that market volatility returns.

## India

Ba2/BB

### Wanted: Fiscal Reform Commitment

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- Downgrade risks will persist in the absence of meaningful fiscal adjustment
  - We do not recommend an off-index allocation
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### Market Outlook

**Our fears over India's vulnerability to sovereign rating pressure were realized in November.** Fitch downgraded the country's long-term foreign currency rating to BB from BB+ on 21 November, but moved the outlook to stable from negative. Only a day before, S&P had affirmed India's sovereign rating, but left the outlook at negative. With the latest actions, Fitch's rating is now sandwiched between S&P (BB/negative outlook) and Moody's (Ba2/positive outlook).

**Not surprisingly, the potential for fiscal slippage remains the overriding concern of rating agencies.**

- Fitch cited continued fiscal profligacy and the lack of progress on the government's beleaguered divestment program as key factors behind the downgrade. While acknowledging the country's democratic institutions as a rating strength, the lack of consensus within the coalition government has nonetheless hampered the reform progress. Based on our discussions with the rating agency, the pressure will most likely be felt on the local currency rating, which was reduced to BB+ from BBB-, with the outlook maintained at negative.
- S&P noted the government's limited progress on structural reforms, which has eroded the margin of error for policy makers to avoid macroeconomic imbalances. It highlighted the fact that the consolidated general government deficit, at 9-10% of GDP, is one of the highest of all sovereigns rated by S&P. It warned of a rating downgrade if current negative fiscal and debt trends persist.

**Hopes for a successful passage of reform legislation took a further hit only days later.** A Parliamentary Finance Committee recommended that the proposal to lower the budget deficit to 2% of GDP by 31 March

2006—as indicated under the proposed Fiscal Responsibility and Budget Management Bill, 2000—be scrapped. According to the panel of lawmakers, the numerical ceilings and the time frame set for attaining the specified levels “induce excessive rigidity into the decision making.” Ironically, Fitch had indicated in its assessment following the latest one-notch downgrade that it would “take some comfort from the successful passage of a prudent Fiscal Responsibility Act.” The panel's recommendation, if accepted, may mean an absence of any significant improvement in public finances for the foreseeable future, a clear negative for the country's long-term credit ratings. In any case, even if the bill is ultimately passed, it will likely be a highly diluted form of the original legislation.

**We want to stress that restoring investors' and rating agencies' confidence requires the implementation of medium-term fiscal consolidation plans.** That said, the September/October budget numbers were more favorable than expected, lending tentative support to the expectation that the near-term fiscal situation may be stabilizing. The cumulative fiscal deficit of INR634 billion for April-October remains close to 25% above the year-ago level. We have nonetheless revised down our full-year fiscal deficit forecast to INR1,450 billion (6.0% of GDP) from INR1,550 billion (6.5% of GDP). There is a caveat however: the government is seeking parliamentary approval for an extra package of INR34 billion to kick-start the economy.

### External Debt Investment Strategies

**No allocation.** In light of nagging fiscal worries, further downgrade risks, and the rich spread level, there is no compelling reason to recommend an off-index allocation. Despite Fitch's rating downgrade and poor headline releases, the indicative spread on the illiquid ICICI '07 tightened 13 bps over the past month to 243 bps. Still, India's dollar bonds significantly underperformed comparable sovereign credits such as the Philippines '10, which saw a 113-bp spread compression over the past month.

## Indonesia

B3/CCC

### Patience, Anxiety, and Some Hope

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- Official creditors remain patient and meet expectations on annual pledges
  - Looking ahead to Paris Club 3 makes rating agencies anxious
  - Government signals its support of global anti-terrorist efforts
- 

### Market Outlook

**For Indonesia, another volatile year filled with change is coming to an end on a relatively subdued note—and not only because of the Ramadan season.** The initial optimism that led some to forecast immediate changes for the better under President Megawati has been turned firmly back. In its place, the market is now more realistic about what her administration can achieve and when it can achieve it.

**Official creditors are clearly expressing more patience with the Megawati government, which underpins our constructive medium-term view on Indonesia.** As we have noted before, the shift in global priorities since 11 September accentuates the risks and rewards now facing Indonesia's policymakers. As such, official creditors are likely to remain supportive and (for a change) stay in the background. Evidence of this official creditor attitude in the past month includes:

- The Consultative Group on Indonesia's US\$3.14 billion pledge for fiscal year 2002, which was within the range required in the government's budget;
- Agreement over the next letter of intent at the conclusion of the IMF review, which sets the stage for the release of a US\$360 million tranche at the next executive board meeting.

**As important as the monetary support, the meetings only produced neutral-to-positive headlines (with creditors emphasizing not only the long road ahead, but also support for the government's efforts).** Indeed, IMF statements did not dwell at all on the myriad difficulties still facing Indonesia's reform program, while the World Bank stated the need for all to be realistic about progress.

**Unfortunately, this generally positive atmosphere has been hit by negative news from credit rating agencies.** During November, S&P downgraded Indonesia's rating one notch to CCC and revised the outlook to negative, and Fitch trimmed its outlook to stable from positive. In both cases, the primary focus was not on Indonesia's fundamentals, but on the treatment of the Yankee bond after the next Paris Club agreement. The current agreement will expire on 31 March 2002, and Indonesia, for the first time, will ask the Paris Club to include the rescheduling of interest payments (about US\$800 million in 2002). Whether comparability is applied to the small amount of servicing required by the Indo '06 remains an open question (we do not think that it will). But unless the flow of information about Indonesia's intentions (*vis-à-vis* official creditor relief) and the creditors' reaction are better managed, negative noise from anxious rating agencies will persist.

**We continue to believe that post 11 September, geopolitics will loom in the background of Indonesia's discussions with official creditors.** The United States made it very clear in its CGI statement that it sees participation in global anti-terrorist efforts as a part of Indonesia's program of reform and recovery. In response, the Megawati government has signaled its intention to freeze and investigate suspicious bank accounts and to revitalize efforts to pass the anti-money-laundering bill that is already in front of parliament. These are positive developments. Follow-through, with appropriate realism about what is possible in the current political atmosphere, would likely extend official creditor patience and generosity further.

### External Debt Investment Strategies

**No allocation:** The illiquid Indonesia '06 trades at 538 bps currently, making it unattractive relative to other emerging market assets. Inquiries for the sovereign syndicated loans and the Frankfurt exchange loans continue to rise, but these remain restricted to local investors and dedicated distressed players.

## Malaysia

Baa2/BBB+

### Poised to Play Catch-Up

- The macro downturn is decidedly less severe
- Government efforts to advance restructuring are likely to buoy investor confidence
- We recommend moving Malaysia to overweight

### Market Outlook

Recent data releases support our view that the extent of the economic downturn in Malaysia is less severe than in other tech-dependent regional economies. Third-quarter GDP shrank 1.0% QOQ (saar) following a 6.3% QOQ (saar) decline in the second quarter. While fiscal stimulus measures should provide some support for domestic demand, the still cloudy outlook for exports renders a near-term economic turnaround unlikely. Still, we expect full-year GDP to decline a paltry 0.2%, in contrast with declines of nearly 3% in Singapore and Taiwan.

**The external liquidity position continues to improve.** FX reserves reached an 11-month high of US\$30.2 billion as of the end of October, underpinned by trade surpluses and foreign direct investment flows. Given the steady buildup of foreign reserves since June (in contrast to declines in the preceding 13 months), we believe ringgit peg risks should abate further.

**On the ratings front, the most likely scenario would be a rating outlook change to positive from stable early next year; an outright upgrade appears unlikely for now.** Market expectations of an imminent sovereign rating upgrade for Malaysia have intensified on the back of S&P's one-notch upgrade to BBB+ and Moody's rating outlook switch to positive for Korea.

- **We would argue that Malaysia's external liquidity ratios are comparable to Korea's.** Short-term debt accounts for less than one-fifth of the total; the equivalent ratio in Korea is twice as much. Likewise, Malaysia's debt service ratio, at 7% of exports, compares favorably with Korea's 14%. We note however that Malaysia is more leveraged: the level of total external debt is 43% of GDP, compared with 28% for Korea.

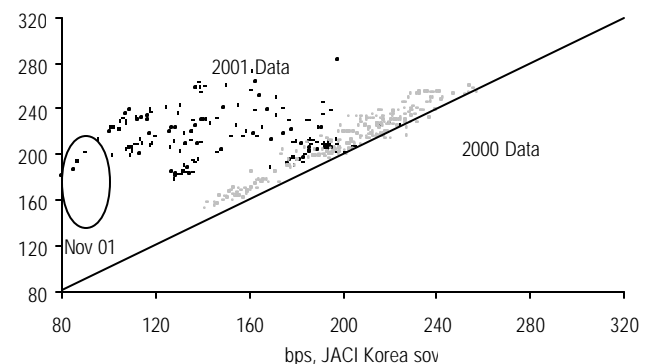
- **Developments on the corporate restructuring front continue to be encouraging.** Beginning with the government's takeover of the Renong group in late July, the subsequent actions by the authorities (including the strengthening of the restructuring framework under the Corporate Debt Restructuring Committee) do signal a tougher stance with respect to indebted conglomerates accustomed to state support.

### External Debt Investment Strategies

**Overweight: We are stepping up our allocation on Malaysia to overweight from marketweight.** Our preference for Malaysia within the high grade Asian bond universe appears justified, judging from November performance. In the EMBI Global, Malaysia returned 1.1%, outperforming China (-0.5%), Korea (0.7%), and Thailand (-1.8%). We continue to see Malaysia as having the most upside potential, both from the fundamental and market perspective. Malaysian issues still look undervalued relative to Korea, even taking into account the one-notch rating difference (*see chart below*). We express our overweight allocation chiefly through raising exposure in the Tanaga '11. At 92 bps wide of the Malaysia '11, we see upside potential given that the spread difference was just 56 on 1 November. Similarly, we remain comfortable with our exposure to the Malaysia '09, which we think has greater relative value versus the Malaysia '11.

Malaysia Still Looks Attractive Relative to Korea

bps, JACI Malay sov



Source: JPMorgan

## Philippines

Ba1/BB+

### Increase Weight on Fundamental Gains

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- Budget and economic performance once again outperform market skeptics
  - Emerging markets' decoupling from Argentina's woes extends to the Philippines
  - Local focus on the short end will intensify
- 

### Market Outlook

**The prevailing decline in risk aversion has allowed the continuous improvement in economic fundamentals in the Philippines to finally shine through.** Once again, the Philippines subcomponent of the EMBI Global produced eye-catching returns (5.7% in November after 3.0% in October). We are pleased that we bought the Phil '19 at what turned out to be the worst of the post 11 September spread widening and caught this positive move in asset prices.

Currently, that position constitutes a small empirical overweight in the EMBIG model portfolio. **Now, we look to add more to our Philippines position.** This decision is unlike our move to cut our underweight back in October, when we simply thought that the sell-off was overdone. **This move reflects our view that the market environment is ripe for a repricing of Philippines asset prices based on improving fundamentals.** Given year-end liquidity, we acknowledge that this could take several months to develop. Whatever the exact timing, we see Philippine spreads coming in further.

**Our positive view remains grounded in the belief that President Macapagal-Arroyo is leading economic policy on a fundamentally better path.** But fixing an impaired revenue collection system, restoring credibility to scandal-plagued securities markets, improving development in the south, and so on, are all reforms that take time to show tangible results. Meanwhile, she and her economic team understand the importance of passing the near-term milestones that signal progress to the market.

**Among those milestones, none is more important than keeping the budget deficit reined in.** And on that score, the Philippines has done very well. The headline deficit for the year-to-October deficit was PHP4.4 billion below

target. The result excluding privatization receipts (which are still improperly included as revenues) is even more impressive, with the deficit running PHP8 billion below target.

**Economic growth has also exceeded expectations.** Third-quarter GDP rose 2.7% QOQ (saar), leaving the level up 2.9% YOY. Growth continues to be fueled by the services sector, with agriculture now leveling off after a strong second quarter. On the back of these data, our economists have once again revised up our 2001 GDP forecast, which now stands at 3% (where it stood at the beginning of the year).

**Another major plus is that this good news has been communicated to investors by the president herself.** President Macapagal-Arroyo's state visit to the US raised the Philippines' profile among investors, heightening their awareness of the positive developments since she took office in January. At a time when emerging markets investors are looking to reallocate their portfolios, the telling of this constructive, high yield story was very opportune.

**The muted reaction to contagion from Argentina comes as no surprise.** As we noted in the last *Emerging Markets Outlook*, the battle to win over investors, given the country's past stumbles, is a protracted one. But as long as the fundamentals continue to improve—and we expect they will—that news flow will dominate any contagion from the well-anticipated troubles in Argentina.

### External Debt Investment Strategies

**Overweight:** We remain comfortable with our position in the Phil '19, taking the view that long-end support will continue to come from both fresh buying and short covering by international investors. We recommend adding short-end exposure through the Phil '24 put '06. Locals are looking to lock in profits and, into year-end, will head home (which for them is the short end).

## South Korea

Baa2/BBB+

### Time to Look Beyond the Trough?

- A sovereign upgrade boosted market sentiment
- Emerging signs suggest that the economy is bottoming
- We nevertheless maintain our underweight, given low potential returns

### Market Outlook

#### Rating agencies' actions provided an added boost to Korean bond performance in November.

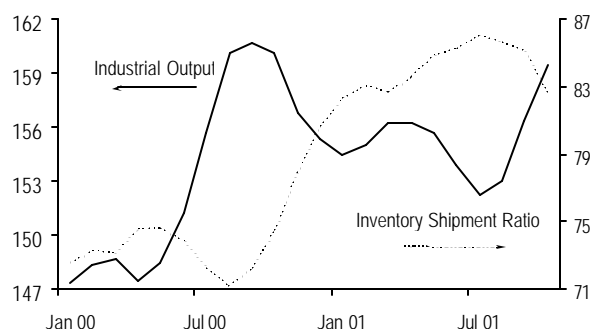
- **S&P raised Korea's long-term foreign currency rating by one notch to BBB+ on 13 November.** S&P's rating is now on par with Fitch's, and one notch above Moody's. The latest rating upgrade was driven by several factors, including continued progress on structural reforms, a strong external liquidity position, a good level of fiscal flexibility, and a diverse economy. More specifically, S&P highlighted the Corporate Restructuring Promotion Act (CRPA) introduced on 14 September, which "will accelerate the rehabilitation of the ailing large companies and the ongoing disposal of assets acquired by the state during the Asian crisis."
- **Two weeks later, Moody's revised its rating outlook to positive from stable.** Not surprisingly, the key driver was Korea's strong external liquidity position. On corporate restructuring, which Moody's described as in an "embryonic state" earlier this year, the agency is constructive on the official commitment to market-driven reforms.

**Both rating actions are consistent with our argument for greater tiering, particularly against Thailand.** The timing of these actions was nonetheless surprising, given skepticism expressed by both agencies over the quality of private sector restructuring. Indeed, S&P had raised its reservations concerning the CRPA in late September, citing the concern that the new law could distort the functioning of the domestic financial markets and create a degree of moral hazard.

**Meanwhile, headline growth performance surprised on the upside.** Third-quarter GDP rose a faster-than-expected 5.1% QOQ (saar), boosted by increased public construction outlays. Going forward, rising domestic demand should continue to buoy economic activity. Specifically, the two supplementary budgets will provide substantial fiscal stimulus, while tax cuts on some consumer items (notably automobiles) will spur consumption. Further, tentative signs that the economy is past its nadir are emerging. Business confidence rebounded sharply in November, while continued inventory correction bodes well for future production.

#### Real Sector Activity Appears to Be Bottoming

Index, 1995 = 100, 3mma sa



Source: JPMorgan

### External Debt Investment Strategies

**Underweight.** For our EMBI Global model portfolio, we are maintaining an underweight position on Korea. Favorable fundamentals, rating upgrades, and strong domestic support have compressed Korean bond spreads by an average of 25 bps in November. At the current rich levels, we are comfortable with not having exposure to Korean bonds, though we want to emphasize that bank subdebts continue to look attractive to the dedicated Asia investor (see "Asian Corporate Review" on page 68). Our recommendation also appears justified on a total return basis: Korea returned 0.7% in the EMBI Global in November. Nonetheless, we want to stress that, like China's, Korea's sovereign bonds are good defensive plays should market volatility return, given the persistently strong onshore bid.

## Thailand

Baa3/BBB-

### Upside Surprises Buoy Sentiment

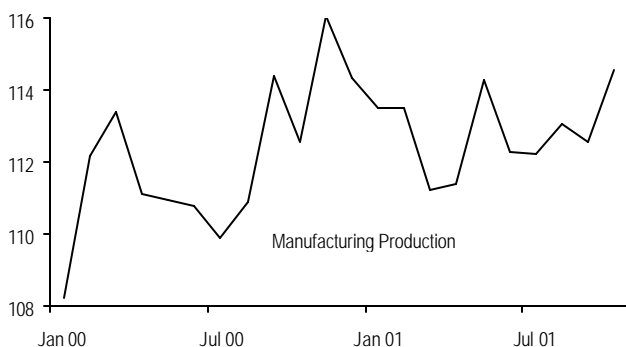
- Domestic demand, induced by fiscal stimulus, will support economic activity
- Bucking regional trends, Thailand is not expected to enter a recession
- We maintain an underweight allocation on technical factors

### Market Outlook

**The economy began the fourth quarter on a positive note.** Manufacturing output rose 1.8% MOM (sa) to reach a year-to-date high in October (*see chart below*), lifting the capacity utilization rate to a seven-month high of 55.1%. The domestic demand-led outturn reflected continued robustness in automobile production. New vehicle sales recorded a 15% YOY increase in October, representing the eighth double-digit rise in the past nine months. The buoyant vehicle sales echoed the October rebound in the consumer confidence index from September's two-and-a-half-year low. A similar trend was also observed in the business confidence index in October, reflecting easing concerns over oil prices and developments in Afghanistan.

#### October Manufacturing Hit Year-to-Date High

index, sa, 1995 = 100



Source: JPMorgan

#### Trends in external trade and flows, though still broadly uninspiring, were not as weak as previously thought.

Both exports and imports were down around 14% YOY, leaving a trade surplus of US\$275 million in October. Tourism receipts and a smaller interest payment by the public sector further boosted the current account surplus.

The overall balance of payments position reverted to a surplus of US\$500 million. Foreign reserves rose to a year-to-date high of US\$33.1 billion at the end of October.

**The Bank of Thailand (BOT) will likely adhere to its neutral monetary policy stance through the first quarter of next year.** The BOT's Monetary Policy Committee (MPC) reiterated its view that the current 14-day repurchase rate of 2.5% is appropriately accommodative, indicating that a rate cut will do little to boost the economy. Meanwhile, inflation pressure continues to abate: core inflation was up 1.3% YOY in November, well within the official target range of 0.0-3.5%. Still, the MPC said it would be open to reversing some of the 100-bp rate hike it put in place should the recovery turn out to be weaker than expected next year. The government is projecting a 2002 GDP forecast of 1-3%.

**The government will rely on fiscal stimulus and positive effects from rate cuts in other economies to support growth.** Indeed, budget disbursements have gained momentum in recent months, following significant undershooting earlier this year. The government's cash deficit surged to almost THB30 billion in October (the largest since November 1999), more than twice September's THB13.7 billion and substantially greater than THB691 million in August.

### External Debt Investment Strategies

**Underweight.** We are retaining our underweight allocation, which has continued to work well. Spread on the thinly traded Thailand '07 narrowed just 9 bps to T+145 bps over the past month, underperforming its triple-B counterparts in the region. Unlike Korea and Malaysia, we expect neither an imminent sovereign rating upgrade nor an outlook revision in the near future. While Thailand's cyclical fundamentals appear relatively steady, signs of a nascent bottoming have emerged in Korea and Malaysia. Accordingly, we see no reason to change our underweight position.

## Asian Corporate Overview

### Overview of Opportunities in 2002

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- Focus on selected paper in Malaysia, Korea, and transformed credits, and debut High Grade issues
  - Separately, selected High Yield paper will outperform High Grade paper over 12 months
- 

We believe there are five areas of opportunity among Asian corporate dollar bonds over the coming 9-12 months. **First is Malaysia, where investors have allowed paper to lag ever since Korean sovereign spreads went through Malaysian spreads.** As mentioned before, one major area of concern—the extent of corporate restructuring and improved corporate governance—now appears to be on the official agenda. In fact, it was recently reported that the 14 large situations that the Corporate Debt Restructuring Committee (CDRC) is now focusing on represent around 33% of banks' NPLs (three-month basis). Support from the Securities Commission and Bank Negara is forthcoming, and the conclusion of two or three large restructurings will also provide the impetus for other restructurings to proceed. Given the foregoing and the current economic and political environment, we have a positive view on the corporate restructuring agenda. The first quarter should see closure of the first two or three situations and improved investor sentiment driving valuations to fair value (this has partly begun). **Tenaga and Maybank bonds could benefit the most.** Debut issuance will also see a good reception.

**Second, in Korea, we anticipate possibly slower corporate reform, but continued progress.** There are two fronts to consider here—corporates and banks. For the former, one important driver will be competitive pressure in some industries where there are foreign entrants and management. Autos, building material, auto parts, and steel are among such industries. In the banking sector, we hold to our view of the past two to three months that there will be more corporate action. There are still too many government-owned banks, and others whose longer-term future survival depends on government decisions. **The biggest beneficiaries of developments on both fronts are the Korean bank sub-debts, as nearly all corporate paper in Korea is fairly valued.**

**Third, the recent spate of issuance by high grade Asian corporates could continue—by both debut and existing issuers.** Unlike the past, the issuers are not taking on currency mismatch, and the current coupon and maturity mix from the bond markets, as well as the diversification of funding sources, will encourage debut issuers. The principal benefit will be portfolio diversification, new issue premia, and good secondary market performance through the first half of next year. New issuance could also take the form of CBs or EBs. Hong Kong, Singapore, China, and Korea will likely lead issuance.

**Fourth, transformed credits, i.e., paper from restructured companies in Asia, have been among the best performers in 2001.** The key will lie in identifying the 10-15% of “good restructurings” in Asia. By this we mean companies that are strong in their chosen markets, with a restructured debt-service profile that is comfortable. Most importantly, we look for the prospect of strong bond price appreciation as the market overcomes the stigma of the previously distressed situation, or prices in the likelihood that the restructured debt could be taken out well before maturity in many cases. Both Kia Motor and GH Water are examples of transformed credits. **The total returns on TPI, TRI, TPI Polene, and Thai Oil are among the examples this year. Selected Indonesian companies could also be key (e.g., telcos and cement companies), sovereign issues permitting. The APP Group will also provide material price action in 2002.**

**Last, regional banks (including foreign ones) could see reduction in their excessive liquidity in the coming year** as the pool of acceptable credits gradually starts growing in the second half of next year, and savings are potentially deployed in other assets. Thus, while the regional bank bid will remain strong, demand could ease somewhat by the second half of next year. In addition, as confidence in a regional recovery in 2002 begins to increase, current levels of risk aversion should decline, and **high yield paper should start to benefit more than high grade paper.** This includes Philippine corporates, which in terms of fundamentals are among the best relative value in Asia. Note that a firm bid has remained for the good transformed credits in the past two to three months; we believe this is a message for high yield paper.

## Public Sector Finances and Debt Indicators

Argentina	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	125.1	141.2	145.2	146.2	150.3	152.3
Public Sector External Debt (US\$ billion)	74.9	83.1	84.7	84.6	89.6	89.6
Private Sector External Debt (US\$ billion)	50.2	58.1	60.5	61.6	60.7	62.7
External Debt (% GDP)	42.7	47.2	51.3	51.3	53.9	54.4
External Debt (% of exports)	344.0	379.3	428.3	380.6	383.6	371.5
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	17.3	21.2	24.7	27.6	30.2	31.5
Amortization (US\$ billion)	8.5	10.8	13.3	15.1	17.5	18.5
Interest (US\$ billion)	8.8	10.4	11.3	12.5	12.7	13.0
Public Sector Debt Service (US\$ billion)	9.6	11.1	13.1	15.3	16.8	18.0
Amortization (US\$ billion)	5.0	5.8	6.8	8.0	8.6	9.4
Interest (US\$ billion)	4.6	5.3	6.3	7.3	8.2	8.6
Private Sector Debt Service (US\$ billion)	7.7	10.0	11.5	12.4	13.4	13.5
Amortization (US\$ billion)	3.5	5.0	6.5	7.1	8.9	9.1
Interest (US\$ billion)	4.2	5.0	5.0	5.2	4.5	4.4
External Debt Service (% of GDP)	5.9	7.1	8.7	9.7	10.8	11.3
External Debt Service (% of exports)	47.7	56.8	72.8	71.9	77.1	76.8
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP) <sup>1</sup>	-1.9	-1.8	-3.0	-3.4	-3.5	-2.0
Public Sector Domestic Debt (% GDP)	11.4	13.1	16.1	18.2	18.9	18.8
Public Sector External Debt (% GDP)	25.6	27.8	29.9	29.7	32.1	32.0
Total Public Sector Debt (US\$ billion) <sup>2</sup>	101.1	109.1	117.7	122.9	128.4	130.0
Total Public Sector Debt (% of GDP) <sup>2</sup>	34.5	36.5	41.6	43.1	46.0	46.4

1. Central government + provinces + BCRA quasifiscal (excluding privatizations).  
2. Central government overall debt excluding provinces and including bilateral and multilateral debt.  
Source: IIF, Ministry of Economy (MECON), and JPMorgan

Brazil	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	200.0	241.8	241.6	236.3	207.9	210.9
Public Sector External Debt (US\$ billion)	85.7	95.5	100.8	92.5	91.3	92.8
Private Sector External Debt (US\$ billion)	114.3	146.3	140.8	143.8	116.6	118.1
External Debt (% GDP)	24.8	30.7	45.7	39.7	40.8	44.6
External Debt (% of exports)	305.7	378.1	406.6	345.8	286.4	298.3
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	37.4	45.5	64.0	49.8	47.4	42.5
Amortization (US\$ billion)	23.3	33.6	48.7	34.7	32.4	26.8
Interest (US\$ billion)	14.1	11.9	15.3	15.1	15.0	15.7
Public Sector Debt Service (US\$ billion)	19.5	13.9	25.8	7.9	19.3	14.7
Amortization (US\$ billion)	13.2	8.9	20.7	3.5	13.8	9.0
Interest (US\$ billion)	6.3	5.0	5.1	4.4	5.5	5.7
Private Sector Debt Service (US\$ billion)	17.9	31.7	38.2	41.9	28.1	27.8
Amortization (US\$ billion)	10.1	24.7	28.0	31.2	18.6	17.8
Interest (US\$ billion)	7.8	6.9	10.2	10.7	9.5	10.0
External Debt Service (% of GDP)	4.6	5.8	12.1	8.4	9.3	9.0
External Debt Service (% of exports)	57.2	71.2	107.6	72.9	65.3	60.1
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	-6.1	-8.0	-10.0	-4.6	-8.4	-5.0
Public Sector Domestic Debt (% GDP)	42.8	38.9	44.1	40.7	47.4	49.3
Public Sector External Debt (% GDP)	10.6	18.6	26.6	24.1	22.9	25.0
Total Public Sector Debt (US\$ billion)	431.3	452.5	374.4	385.9	358.4	351.2
Total Public Sector Debt (% of GDP)	53.4	57.5	70.8	64.8	70.3	74.3

\* Federal government only (states, municipalities, and state-owned enterprises are not included).  
Source: Finance Ministry and JPMorgan

Chile	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	31.0	35.9	38.2	40.8	42.2	44.9
Public Sector External Debt (US\$ billion)	5.1	5.7	5.8	5.5	5.5	5.3
Private Sector External Debt (US\$ billion)	25.9	30.1	32.4	35.3	36.7	39.6
External Debt (% GDP)	41.2	49.1	56.5	58.2	67.0	70.2
External Debt (% of exports)	142.0	178.6	186.4	175.6	183.0	180.8
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	3.2	3.7	4.1	5.7	5.7	6.2
Amortization (US\$ billion)	1.7	2.2	2.6	3.8	4.0	4.5
Interest (US\$ billion)	1.4	1.5	1.5	1.9	1.7	1.7
Public Sector Debt Service (US\$ billion)	2.6	0.7	0.6	0.9	1.5	1.2
Amortization (US\$ billion)	2.1	0.5	0.4	0.7	1.3	1.0
Interest (US\$ billion)	0.5	0.3	0.2	0.2	0.2	0.2
Private Sector Debt Service (US\$ billion)	0.5	2.9	3.5	4.8	4.2	5.0
Amortization (US\$ billion)	-0.4	1.7	2.2	3.1	2.7	3.5
Interest (US\$ billion)	0.9	1.2	1.3	1.7	1.5	1.5
External Debt Service (% of GDP)	4.2	5.0	6.1	8.2	9.0	9.7
External Debt Service (% of exports)	14.4	18.3	20.0	24.7	24.7	25.0
<b>Public Sector Finances</b>						
Central Government Budget Balance (% of GDP)	2.0	0.4	-1.4	0.1	-0.8	-0.2
Public Sector Domestic Debt (% GDP)	10.5	10.1	10.6	9.7	10.6	10.1
Public Sector External Debt (% GDP)	6.8	7.8	8.6	7.9	8.3	7.7
Total Public Sector Debt (US\$ billion)	13.0	13.1	13.0	12.3	12.5	12.3
Total Public Sector Debt (% of GDP)	17.3	17.9	19.2	17.5	19.8	19.2

Source: Central Bank of Chile, IIF, and JPMorgan

Colombia	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	35.3	36.9	37.7	37.8	38.2	38.6
Public Sector External Debt (US\$ billion)	16.5	19.0	19.8	21.9	23.3	23.8
Private Sector External Debt (US\$ billion)	18.8	17.9	17.9	15.9	14.9	14.8
External Debt (% GDP)	33.1	37.4	44.5	46.6	47.8	47.7
External Debt (% of exports)	233.7	257.9	256.2	229.2	228.9	225.7
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	6.8	7.0	7.2	6.3	6.9	7.3
Amortization (US\$ billion)	4.2	4.3	4.3	3.4	3.8	4.1
Interest (US\$ billion)	2.6	2.7	2.9	2.9	3.2	3.2
Public Sector Debt Service (US\$ billion)	3.6	3.8	3.6	2.0	2.9	3.0
Amortization (US\$ billion)	2.3	2.5	2.3	0.9	1.6	1.6
Interest (US\$ billion)	1.3	1.2	1.3	1.1	1.4	1.4
Private Sector Debt Service (US\$ billion)	3.2	3.3	3.6	4.3	4.0	4.3
Amortization (US\$ billion)	1.9	1.8	2.0	2.5	2.2	2.5
Interest (US\$ billion)	1.3	1.5	1.6	1.8	1.8	1.8
External Debt Service (% of GDP)	6.4	7.1	8.5	7.7	8.7	9.0
External Debt Service (% of exports)	45.2	49.0	49.0	38.1	41.5	42.7
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	-3.3	-3.7	-6.4	-3.7	-3.1	-2.2
Public Sector Domestic Debt (% GDP)	8.8	10.6	14.7	19.6	21.1	21.2
Public Sector External Debt (% GDP)	15.4	19.3	23.3	27.0	29.2	29.4
Total Public Sector Debt (US\$ billion)	25.9	28.9	32.2	37.8	40.8	42.6
Total Public Sector Debt (% of GDP)	24.3	29.8	38.0	46.6	50.2	50.5

\* Central government fiscal balances.  
Source: IIF and JPMorgan

Ecuador	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	15.1	16.4	17.1	14.1	14.1	14.0
Public Sector External Debt (US\$ billion)	12.6	13.2	14.1	11.7	11.3	11.5
Private Sector External Debt (US\$ billion)	2.5	3.2	3.0	2.4	2.8	2.5
External Debt (% GDP)	76.4	83.1	124.8	100.7	74.1	66.8
External Debt (% of exports)	243.8	322.0	322.0	243.1	190.3	171.0
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	5.9	6.4	4.7	10.4	6.0	3.8
Amortization (US\$ billion)	5.0	5.3	3.5	9.4	5.0	2.7
Interest (US\$ billion)	1.0	1.1	1.1	1.0	1.0	1.0
Public Sector Debt Service (US\$ billion)	1.9	1.5	1.4	7.7	3.8	1.5
Amortization (US\$ billion) <sup>1</sup>	1.1	0.7	0.5	6.9	3.0	0.7
Interest (US\$ billion)	0.8	0.8	0.8	0.8	0.8	0.8
Private Sector Debt Service (US\$ billion)	4.1	4.9	3.3	2.8	2.2	2.2
Amortization (US\$ billion)	3.9	4.6	3.0	2.5	2.0	2.0
Interest (US\$ billion)	0.2	0.3	0.3	0.3	0.2	0.2
External Debt Service (% of GDP)	30.1	32.4	34.1	74.6	31.7	17.9
External Debt Service (% of exports)	96.0	125.3	88.0	180.1	81.5	45.9
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP) <sup>2</sup>	-2.7	-5.7	-7.1	0.4	-0.8	-1.8
Public Sector Domestic Debt (% GDP)	8.4	14.1	24.1	20.8	16.9	16.4
Public Sector External Debt (% GDP)	63.6	67.1	102.9	83.6	59.4	54.9
Total Public Sector Debt (US\$ billion)	14.2	15.3	17.1	14.2	15.0	15.2
Total Public Sector Debt (% of GDP)	72.0	81.2	127.0	104.4	76.3	71.2

1. This amount does not reflect new issuance related to the debt exchange in 2000.

2. Consolidated public sector balances.

Source: Central Bank of Ecuador and JPMorgan

Mexico	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	152.8	164.4	168.6	137.5	167.2	173.0
Public Sector External Debt (US\$ billion)	97.4	100.7	96.8	84.1	84.6	85.5
Private Sector External Debt (US\$ billion)	55.4	63.7	71.8	53.4	82.6	87.5
External Debt (% GDP)	38.1	39.1	35.1	23.9	27.3	28.0
External Debt (% of exports)	121.0	122.7	110.5	73.8	81.2	77.3
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	29.5	30.9	32.7	27.7	30.3	32.7
Amortization (US\$ billion)	17.1	18.4	19.7	14.9	18.0	20.9
Interest (US\$ billion)	12.4	12.5	13.0	12.8	12.3	11.8
Public Sector Debt Service (US\$ billion)	18.8	20.1	17.0	12.9	13.1	15.6
Amortization (US\$ billion)	11.4	13.1	10.0	6.4	6.8	9.5
Interest (US\$ billion)	7.4	7.0	7.0	6.5	6.3	6.1
Private Sector Debt Service (US\$ billion)	10.6	10.8	15.7	14.8	17.2	17.2
Amortization (US\$ billion)	5.6	5.3	9.7	8.5	11.2	11.4
Interest (US\$ billion)	5.0	5.5	6.0	6.3	6.0	5.8
External Debt Service (% of GDP)	7.3	7.3	6.8	4.8	5.0	5.3
External Debt Service (% of exports)	23.4	23.0	21.4	14.8	14.7	14.6
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP) *	-0.7	-1.1	-1.2	-1.1	-0.7	-0.6
Public Sector Domestic Debt (% GDP)	8.6	9.8	11.0	11.2	11.5	11.2
Public Sector External Debt (% GDP)	24.3	23.9	20.2	14.6	13.8	13.8
Total Public Sector Debt (US\$ billion)	132.0	142.1	149.8	148.2	154.9	154.7
Total Public Sector Debt (% of GDP)	32.9	33.8	31.2	25.8	25.3	25.0

\* Consolidated public sector fiscal balances (does not include other contingent liabilities).

Source: Finance Ministry, Banco de México, and JPMorgan

Peru	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	29.9	30.5	28.7	28.4	30.5	32.4
Public Sector External Debt (US\$ billion)	20.5	20.8	19.5	19.2	20.5	21.2
Private Sector External Debt (US\$ billion)	9.4	9.7	9.2	9.2	10.0	11.2
External Debt (% GDP)	50.6	53.4	55.2	52.7	54.6	55.1
External Debt (% of exports)	328.6	368.2	343.8	304.0	295.2	300.6
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	3.7	4.0	3.7	4.0	4.3	4.2
Amortization (US\$ billion)	2.1	2.2	2.0	2.3	2.5	2.4
Interest (US\$ billion)	1.6	1.8	1.6	1.7	1.8	1.8
Public Sector Debt Service (US\$ billion)	1.9	1.9	2.0	2.2	2.3	2.4
Amortization (US\$ billion)	0.8	0.9	0.9	1.1	1.2	1.3
Interest (US\$ billion)	1.1	1.1	1.1	1.1	1.1	1.1
Private Sector Debt Service (US\$ billion)	1.8	2.1	1.7	1.9	2.0	1.9
Amortization (US\$ billion)	1.3	1.4	1.1	1.2	1.3	1.2
Interest (US\$ billion)	0.5	0.7	0.6	0.6	0.7	0.7
External Debt Service (% of GDP)	6.3	7.1	7.1	7.5	7.7	7.1
External Debt Service (% of exports)	41.0	48.7	43.9	43.0	41.6	39.0
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	0.2	-0.8	-3.1	-3.2	-2.5	-2.0
Public Sector Domestic Debt (% GDP)	0.2	0.3	0.2	0.6	0.7	0.7
Public Sector External Debt (% GDP)	34.7	36.4	37.5	35.6	36.7	36.1
Total Public Sector Debt (US\$ billion)	20.6	21.0	19.6	19.5	20.9	21.6
Total Public Sector Debt (% of GDP)	35.0	36.7	37.7	36.2	37.4	36.7

\* Non-financial public sector balances.  
Source: Finance Ministry and JPMorgan

Venezuela	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	40.2	38.6	37.0	34.1	32.1	30.2
Public Sector External Debt (US\$ billion)	27.2	24.3	23.2	19.5	18.7	17.4
Private Sector External Debt (US\$ billion)	13.0	14.3	13.8	14.6	13.4	12.8
External Debt (% GDP)	45.3	40.3	35.8	28.3	25.0	22.7
External Debt (% of exports)	147.1	181.0	152.6	92.7	91.7	89.3
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	4.3	4.9	5.0	5.3	5.3	5.1
Amortization (US\$ billion)	1.8	2.6	2.2	2.4	2.5	2.4
Interest (US\$ billion)	2.5	2.3	2.8	2.9	2.8	2.7
Public Sector Debt Service (US\$ billion)	2.8	3.7	3.3	3.6	3.6	3.4
Amortization (US\$ billion)	1.3	2.1	1.7	1.9	2.0	1.9
Interest (US\$ billion)	1.5	1.6	1.6	1.7	1.6	1.5
Private Sector Debt Service (US\$ billion)	1.5	1.2	1.7	1.7	1.7	1.7
Amortization (US\$ billion)	0.5	0.5	0.5	0.5	0.5	0.5
Interest (US\$ billion)	1.0	0.7	1.2	1.2	1.2	1.2
External Debt Service (% of GDP)	4.8	5.1	4.8	4.4	4.1	3.9
External Debt Service (% of exports)	15.7	23.1	20.6	14.4	15.0	15.2
<b>Public Sector Finances</b>						
Government Balance (% of GDP)*	-2.0	-6.2	-1.5	-0.1	-2.3	-3.5
Public Sector Domestic Debt (% GDP)	4.9	4.2	6.0	8.7	9.4	10.2
Public Sector External Debt (% GDP)	30.6	25.4	22.5	16.2	14.6	13.1
Total Public Sector Debt (US\$ billion)	28.2	26.9	28.9	32.4	33.2	33.8
Total Public Sector Debt (% of GDP)	35.6	29.5	28.4	24.9	23.9	23.3

\* Consolidated public sector balances.  
Source: Finance Ministry, IIF, and JPMorgan

<b>Bulgaria</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001P</b>	<b>2002P</b>
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	9.0	9.6	9.9	10.1	9.5	8.7
Public Sector External Debt (US\$ billion)	8.7	9.3	9.1	9.0	8.6	8.0
Private Sector External Debt (US\$ billion)	0.3	0.3	0.8	1.1	0.9	0.7
External Debt (% GDP)	88.1	78.4	79.3	83.9	69.3	55.9
External Debt (% of exports)	138.7	154.5	153.4	132.3	119.8	107.0
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	0.9	0.9	1.0	1.2	1.5	1.4
Amortization (US\$ billion)	-	-	0.5	0.6	1.0	0.8
Interest (US\$ billion)	-	-	0.5	0.5	0.6	0.6
Public Sector Debt Service (US\$ billion)	-	-	0.9	0.9	1.2	1.1
Amortization (US\$ billion)	-	-	0.4	0.4	0.7	0.6
Interest (US\$ billion)	-	-	0.5	0.5	0.5	0.5
Private Sector Debt Service (US\$ billion)	-	-	0.1	0.2	0.4	0.3
Amortization (US\$ billion)	-	-	0.1	0.2	0.3	0.2
Interest (US\$ billion)	-	-	-	-	0.1	0.1
External Debt Service (% of GDP)	8.8	7.3	8.4	9.7	11.0	9.1
External Debt Service (% of exports)	13.9	14.4	15.5	15.7	18.9	17.6
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	-2.1	0.9	-1.0	-1.1	-1.6	-2.0
Public Sector Domestic Debt (% GDP)	16.3	14.4	13.0	7.0	7.4	7.4
Public Sector External Debt (% GDP)	85.4	75.8	72.8	75.0	62.8	51.6
Total Public Sector Debt (US\$ billion)	10.4	11.1	10.7	9.8	9.6	9.1
Total Public Sector Debt (% of GDP)	101.6	90.2	85.8	82.0	70.2	59.0

\* General government budget.

Source: Finance Ministry and JPMorgan

<b>Croatia</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001P</b>	<b>2002P</b>
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	7.5	9.6	10.8	10.9	11.1	11.9
Public Sector External Debt (US\$ billion)	3.0	3.3	4.2	4.7	5.2	6.0
Private Sector External Debt (US\$ billion)	4.4	6.3	6.6	6.2	5.9	5.9
External Debt (% GDP)	36.7	44.3	54.0	57.2	53.7	54.6
External Debt (% of exports)	90.7	111.9	133.5	125.7	130.0	125.3
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	0.2	0.9	0.4	1.8	1.6	1.9
Amortization (US\$ billion)	0.1	0.6	0.3	1.4	1.3	1.4
Interest (US\$ billion)	0.0	0.3	0.1	0.4	0.4	0.5
Public Sector Debt Service (US\$ billion)	0.0	0.5	0.0	0.6	0.8	0.9
Amortization (US\$ billion)	0.0	0.2	0.0	0.4	0.7	0.6
Interest (US\$ billion)	0.0	0.3	0.0	0.2	0.2	0.3
Private Sector Debt Service (US\$ billion)	0.1	0.4	0.3	1.2	0.8	1.0
Amortization (US\$ billion)	0.1	0.4	0.2	0.9	0.6	0.8
Interest (US\$ billion)	0.0	0.0	0.1	0.2	0.2	0.2
External Debt Service (% of GDP)	0.8	4.2	1.8	9.4	7.8	8.8
External Debt Service (% of exports)	2.1	10.6	4.3	20.6	18.9	20.2
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-1.3	0.6	-1.9	-4.0	1.0	0.0
Public Sector Domestic Debt (% GDP)	12.6	10.9	11.7	13.5	13.0	8.3
Public Sector External Debt (% GDP)	14.8	15.3	21.0	24.5	25.0	27.5
Total Public Sector Debt (US\$ billion)	5.5	5.7	6.6	7.2	7.9	7.8
Total Public Sector Debt (% of GDP)	27.4	26.2	32.8	38.1	38.0	35.8

Source: Finance Ministry and JPMorgan

Czech Republic	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>					
Total External Debt (US\$ billion)	24.0	22.6	21.1	22.8	24.3
Public Sector External Debt (US\$ billion)	1.5	1.2	0.8	0.8	1.3
Private Sector External Debt (US\$ billion)	22.6	21.4	20.3	22.0	23.0
External Debt (% GDP)	42.2	41.5	41.7	40.5	39.4
External Debt (% of exports)	68.2	64.9	56.2	54.6	53.9
<b>External Debt Service</b>					
External Debt Service (US\$ billion)	6.5	7.2	6.6	5.4	4.8
Amortization (US\$ billion)	4.1	4.3	4.0	2.9	1.8
Interest (US\$ billion)	2.4	2.9	2.6	2.5	3.0
Public Sector Debt Service (US\$ billion)	-	-	-	-	-
Amortization (US\$ billion)	-	-	-	-	-
Interest (US\$ billion)	-	-	-	-	-
Private Sector Debt Service (US\$ billion)	-	-	-	-	-
Amortization (US\$ billion)	-	-	-	-	-
Interest (US\$ billion)	-	-	-	-	-
External Debt Service (% of GDP)	11.4	13.3	13.1	9.7	7.8
External Debt Service (% of exports)	18.4	20.8	17.6	13.0	10.7
<b>Public Sector Finances</b>					
Nominal Fiscal Balance (% of GDP)*	-1.4	-2.4	-3.4	-4.4	-5.0
Public Sector Domestic Debt (% GDP)	10.5	12.3	15.3	19.3	19.1
Public Sector External Debt (% GDP)	2.6	2.3	1.6	1.4	2.1
Total Public Sector Debt (US\$ billion)	7.4	7.9	8.6	11.7	13.1
Total Public Sector Debt (% of GDP)	13.1	14.5	17.0	20.7	21.2

\* Net of bank restructuring outlays and privatization revenues.  
Source: Finance Ministry and JPMorgan

Hungary	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	24.1	27.3	27.8	29.5	31.0	32.6
Public Sector External Debt (US\$ billion)	11.9	11.3	10.7	8.9	8.9	8.7
Private Sector External Debt (US\$ billion)	12.3	16.0	17.1	20.6	22.1	23.9
External Debt (% GDP)	52.8	58.1	57.9	64.7	61.4	57.3
External Debt (% of exports)	90.2	98.4	98.4	90.4	86.8	83.3
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	9.3	4.9	4.3	5.4	5.8	6.0
Amortization (US\$ billion)	7.0	2.9	2.8	3.8	4.0	4.0
Interest (US\$ billion)	2.3	2.0	1.5	1.6	1.8	2.0
Public Sector Debt Service (US\$ billion)	-	-	-	-	-	-
Amortization (US\$ billion)	-	-	-	-	-	-
Interest (US\$ billion)	-	-	-	-	-	-
Private Sector Debt Service (US\$ billion)	-	-	-	-	-	-
Amortization (US\$ billion)	-	-	-	-	-	-
Interest (US\$ billion)	-	-	-	-	-	-
External Debt Service (% of GDP)	20.3	10.4	9.0	11.9	11.5	10.5
External Debt Service (% of exports)	34.7	17.6	15.3	16.6	16.2	15.3
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-4.9	-6.6	-3.4	-3.6	-3.5	-3.5
Public Sector Domestic Debt (% GDP)	36.9	37.0	38.2	36.7	36.7	36.8
Public Sector External Debt (% GDP)	26.0	24.1	22.3	19.5	17.6	15.3
Total Public Sector Debt (US\$ billion)	28.8	28.8	29.0	25.6	27.4	29.6
Total Public Sector Debt (% of GDP)	62.9	61.1	60.4	56.1	54.2	52.1

Source: Finance Ministry and JPMorgan

Poland	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	49.6	59.2	64.9	67.5	68.8	72.3
Public Sector External Debt (US\$ billion)	34.4	34.1	32.1	33.0	29.5	30.3
Private Sector External Debt (US\$ billion)	15.2	25.1	32.7	34.5	39.3	42.0
External Debt (% GDP)	34.0	35.9	39.0	41.4	38.6	38.7
External Debt (% of exports)	151.0	155.1	189.8	184.2	182.4	177.9
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	2.8	4.9	4.4	4.0	4.3	4.4
Amortization (US\$ billion)	0.9	1.7	2.2	2.0	2.0	2.0
Interest (US\$ billion)	1.9	3.2	2.2	2.0	2.3	2.4
Public Sector Debt Service (US\$ billion)	1.1	1.0	1.3	2.3	2.2	2.3
Amortization (US\$ billion)	0.4	0.1	0.2	1.1	1.2	1.3
Interest (US\$ billion)	0.7	0.9	1.1	1.2	1.0	1.0
Private Sector Debt Service (US\$ billion)	0.5	0.6	0.7	1.6	2.1	2.6
Amortization (US\$ billion)	0.4	0.5	0.5	1.0	1.3	1.6
Interest (US\$ billion)	0.1	0.1	0.2	0.6	0.8	1.0
External Debt Service (% of GDP)	1.9	3.1	2.7	2.5	2.4	2.3
External Debt Service (% of exports)	8.7	13.4	11.4	9.8	10.5	10.5
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	-1.3	-2.4	-2.0	-2.2	-4.0	-5.2
Public Sector Domestic Debt (% GDP)	17.4	19.7	17.4	17.5	18.0	19.0
Public Sector External Debt (% GDP)	23.9	21.5	19.8	20.5	17.4	16.5
Total Public Sector Debt (US\$ billion)	59.5	65.4	59.2	60.8	61.2	65.9
Total Public Sector Debt (% of GDP)	41.3	41.2	37.3	38.0	35.4	35.5

\* Central government budget balance.  
Source: Finance Ministry and JPMorgan

Russia	1997	1998	1999	2000P	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	164.4	172.8	161.0	154.5	147.2	139.4
Public Sector External Debt (US\$ billion)	136.9	154.6	149.7	144.4	138.2	131.4
Private Sector External Debt (US\$ billion)	27.5	18.2	11.4	10.1	9.0	8.0
External Debt (% GDP)	38.4	64.2	88.2	61.6	47.4	41.1
External Debt (% of exports)	153.0	188.8	181.4	128.8	122.9	126.4
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	8.3	10.1	12.3	12.0	15.3	16.2
Amortization (US\$ billion)	3.3	2.8	7.0	6.7	7.3	7.8
Interest (US\$ billion)	5.0	7.3	5.3	5.3	8.0	8.4
Public Sector Debt Service (US\$ billion)	7.4	8.5	9.5	9.6	13.1	14.2
Amortization (US\$ billion)	3.0	2.2	5.6	5.4	6.2	6.8
Interest (US\$ billion)	4.4	6.3	3.9	4.2	6.9	7.4
Private Sector Debt Service (US\$ billion)	0.9	1.6	2.8	2.4	2.2	2.0
Amortization (US\$ billion)	0.3	0.6	1.5	1.3	1.1	1.0
Interest (US\$ billion)	0.6	1.0	1.4	1.1	1.1	1.0
External Debt Service (% of GDP)	1.9	3.8	6.7	4.8	4.9	4.8
External Debt Service (% of exports)	7.7	11.0	13.9	10.0	12.8	14.7
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	-7.0	-4.9	-1.6	2.3	2.1	1.9
Public Sector Domestic Debt (% GDP)	21.8	21.8	14.2	7.9	6.3	5.1
Public Sector External Debt (% GDP)	31.9	57.5	81.9	57.6	44.5	38.8
Total Public Sector Debt (US\$ billion)	230.3	213.2	175.6	164.2	157.8	148.7
Total Public Sector Debt (% of GDP)	53.7	79.2	96.1	65.5	50.8	43.9

\* Federal government fiscal balance.  
Source: Finance Ministry and JPMorgan

Slovak Republic	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	9.8	11.9	10.5	10.9	11.5	11.9
Public Sector External Debt (US\$ billion)	1.7	2.5	2.8	3.4	3.4	3.3
Private Sector External Debt (US\$ billion)	8.0	9.4	7.7	7.5	8.0	8.6
External Debt (% GDP)	47.9	55.9	53.4	56.8	56.3	53.7
External Debt (% of exports)	80.6	88.8	84.9	75.7	72.5	67.5
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	1.6	1.9	2.0	2.4	1.6	1.5
Amortization (US\$ billion)	1.2	1.3	1.4	1.9	1.1	0.9
Interest (US\$ billion)	0.4	0.5	0.6	0.5	0.5	0.6
Public Sector Debt Service (US\$ billion)	0.4	0.5	0.6	0.5	0.5	0.4
Amortization (US\$ billion)	0.3	0.4	0.4	0.3	0.3	0.1
Interest (US\$ billion)	0.1	0.1	0.2	0.2	0.2	0.2
Private Sector Debt Service (US\$ billion)	1.2	1.4	1.4	1.9	1.1	1.1
Amortization (US\$ billion)	0.9	0.9	1.0	1.6	0.8	0.8
Interest (US\$ billion)	0.3	0.4	0.4	0.3	0.3	0.3
External Debt Service (% of GDP)	7.7	8.8	10.1	12.7	8.0	6.7
External Debt Service (% of exports)	13.0	13.9	16.0	16.9	10.4	8.4
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-4.4	-4.6	-3.6	-3.4	-4.1	-4.8
Public Sector Domestic Debt (% GDP)	15.2	14.9	12.9	12.7	24.0	23.0
Public Sector External Debt (% GDP)	8.5	11.8	14.3	17.7	16.9	14.9
Total Public Sector Debt (US\$ billion)	4.8	5.7	5.4	5.8	8.3	8.4
Total Public Sector Debt (% of GDP)	23.7	26.7	27.3	30.4	40.9	37.9

Source: Finance Ministry and JPMorgan

South Africa	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	25.2	25.0	23.9	24.8	28.6	30.7
Public Sector External Debt (US\$ billion)	5.4	4.7	4.0	4.3	6.8	7.9
Private Sector External Debt (US\$ billion)	19.9	20.2	19.9	20.5	21.8	22.8
External Debt (% GDP)	17.0	18.7	18.4	19.7	23.6	24.5
External Debt (% of exports)	66.2	69.6	67.9	63.9	76.9	93.0
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	3.6	3.4	3.6	3.6	4.0	-
Amortization (US\$ billion)	2.7	2.6	2.4	2.1	2.3	-
Interest (US\$ billion)	0.9	0.8	1.2	1.5	1.7	-
Public Sector Debt Service (US\$ billion)	2.2	2.1	2.4	2.2	2.1	-
Amortization (US\$ billion)	1.6	1.5	1.6	1.4	1.2	-
Interest (US\$ billion)	0.6	0.6	0.8	0.8	0.9	-
Private Sector Debt Service (US\$ billion)	1.4	1.2	1.2	1.4	1.9	-
Amortization (US\$ billion)	1.1	1.0	0.8	0.7	1.1	-
Interest (US\$ billion)	0.3	0.2	0.4	0.7	0.8	-
External Debt Service (% of GDP)	2.4	2.5	2.7	2.9	3.3	-
External Debt Service (% of exports)	9.4	9.4	10.1	9.3	10.8	-
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-4.6	-3.8	-2.3	-2.0	-1.9	-1.8
Public Sector Domestic Debt (% GDP)	46.3	46.8	44.8	42.2	40.5	39.0
Public Sector External Debt (% GDP)	3.6	3.5	3.0	3.4	5.6	6.3
Total Public Sector Debt (US\$ billion)	74.1	67.0	62.2	57.4	55.9	56.8
Total Public Sector Debt (% of GDP)	50.0	50.4	47.8	45.6	46.1	45.3

Source: Finance Ministry and JPMorgan

Turkey	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	84.8	96.9	103.3	116.1	113.0	115.2
Public Sector External Debt (US\$ billion)	51.2	53.5	54.5	62.8	64.5	66.0
Private Sector External Debt (US\$ billion)	33.6	43.4	48.8	53.3	48.5	49.2
External Debt (% GDP)	44.7	48.4	56.5	57.9	74.0	75.9
External Debt (% of exports)	157.3	169.9	189.0	191.0	196.2	190.1
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	12.4	16.5	18.2	25.1	27.0	25.7
Amortization (US\$ billion)	7.8	11.7	12.8	18.5	21.3	20.3
Interest (US\$ billion)	4.6	4.8	5.4	6.6	5.7	5.4
Public Sector Debt Service (US\$ billion)	8.1	10.5	9.6	15.5	14.4	16.1
Amortization (US\$ billion)	4.9	7.2	6.2	10.5	10.5	12.1
Interest (US\$ billion)	3.2	3.3	3.4	5.0	3.9	4.0
Private Sector Debt Service (US\$ billion)	4.3	6.0	8.6	9.6	12.6	9.6
Amortization (US\$ billion)	2.9	4.5	6.6	8.0	10.8	8.2
Interest (US\$ billion)	1.4	1.5	2.0	1.6	1.8	1.4
External Debt Service (% of GDP)	6.5	8.2	10.0	12.5	17.7	16.9
External Debt Service (% of exports)	23.0	28.9	33.3	41.3	46.9	42.4
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	-7.8	-7.3	-11.8	-10.6	-16.0	-11.9
Public Sector Domestic Debt (% GDP)	21.8	22.2	29.6	29.0	59.0	46.4
Public Sector External Debt (% GDP)	27.0	26.7	29.8	31.3	42.2	43.5
Total Public Sector Debt (US\$ billion)	92.5	98.0	108.7	121.0	154.7	136.4
Total Public Sector Debt (% of GDP)	48.8	49.0	59.4	60.3	101.2	89.8

\* Privatization proceeds included in revenues.  
Source: Finance Ministry and JPMorgan

China	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	164.3	161.4	158.7	152.5	149.2	146.2
Public Sector External Debt (US\$ billion)	140.3	134.1	127.4	124.4	121.9	119.2
Private Sector External Debt (US\$ billion)	24.1	28.2	30.5	28.2	27.4	27.0
External Debt (% GDP)	18.3	16.8	15.9	14.1	12.8	11.4
External Debt (% of exports)	79.2	77.5	71.9	55.0	50.9	44.9
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	14.8	18.1	21.5	21.1	22.5	22.9
Amortization (US\$ billion)	11.5	12.4	14.0	14.1	16.1	16.6
Interest (US\$ billion)	3.3	5.7	7.5	7.1	6.4	6.3
Public Sector Debt Service (US\$ billion)	12.9	15.3	15.6	16.8	15.4	15.2
Amortization (US\$ billion)	10.0	10.5	10.1	11.2	11.0	11.0
Interest (US\$ billion)	2.9	4.8	5.4	5.6	4.4	4.2
Private Sector Debt Service (US\$ billion)	1.9	2.7	5.9	4.3	7.1	7.7
Amortization (US\$ billion)	1.5	1.9	3.9	2.9	5.1	5.6
Interest (US\$ billion)	0.4	0.9	2.1	1.4	2.0	2.1
External Debt Service (% of GDP)	1.7	1.9	2.2	2.0	1.9	1.8
External Debt Service (% of exports)	7.1	8.7	9.8	7.6	7.7	7.0
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-0.8	-1.2	-2.1	-2.8	-2.8	-2.7
Public Sector Domestic Debt (% GDP)	7.2	8.6	11.2	13.1	14.4	15.2
Public Sector External Debt (% GDP)	15.6	13.9	12.7	11.5	10.5	9.3
Total Public Sector Debt (US\$ billion)	205.3	217.2	239.9	265.3	289.5	315.0
Total Public Sector Debt (% of GDP)	22.9	22.6	24.0	24.6	24.8	24.5

Source: IIF and JPMorgan

India	1997-98	1998-99	1999-00	2000-01P	2001-02P	2002-03P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	102.1	108.7	112.5	116.5	119.0	121.6
Public Sector External Debt (US\$ billion)	75.5	77.4	79.6	79.1	81.2	83.3
Private Sector External Debt (US\$ billion)	26.6	31.3	32.8	37.4	37.8	38.2
External Debt (% GDP)	26.6	27.8	26.6	25.7	24.9	24.1
External Debt (% of exports)	226.4	228.7	207.7	182.2	168.1	153.9
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	12.6	12.3	13.1	12.8	14.0	15.1
Amortization (US\$ billion)	6.8	6.1	6.4	5.9	6.3	6.6
Interest (US\$ billion)	5.9	6.2	6.7	6.9	7.7	8.5
Public Sector Debt Service (US\$ billion)	3.1	8.5	8.8	8.4	9.0	9.7
Amortization (US\$ billion)		5.4	5.4	4.9	5.5	6.0
Interest (US\$ billion)	3.1	3.1	3.4	3.5	3.5	3.6
Private Sector Debt Service (US\$ billion)	2.8	3.8	4.3	4.5	4.9	5.4
Amortization (US\$ billion)		0.7	1.0	1.0	0.8	0.6
Interest (US\$ billion)	2.8	3.1	3.3	3.5	4.2	4.8
External Debt Service (% of GDP)	3.3	3.1	3.1	2.8	2.9	3.0
External Debt Service (% of exports)	28.0	25.9	24.2	20.1	19.7	19.3
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-5.2	-5.4	-5.4	-5.8	-6.5	-4.9
Public Sector Domestic Debt (% GDP)	27.3	27.9	38.9	39.0	39.3	38.8
Public Sector External Debt (% GDP)	19.7	19.8	18.8	17.5	17.0	16.3
Total Public Sector Debt (US\$ billion)	180.2	186.7	244.5	255.6	269.2	281.3
Total Public Sector Debt (% of GDP)	46.9	47.7	57.8	56.4	56.3	55.1

Source: IIF and JPMorgan

Indonesia	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	143.6	150.9	148.2	135.5	134.0	132.4
Public Sector External Debt (US\$ billion)	60.5	71.5	79.6	79.5	84.2	86.3
Private Sector External Debt (US\$ billion)	83.1	79.4	68.6	56.0	49.9	46.1
External Debt (% GDP)	66.0	164.1	104.8	88.3	93.5	90.6
External Debt (% of exports)	220.6	265.9	256.8	185.5	181.2	163.3
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	24.0	19.9	23.3	22.8	22.3	20.1
Amortization (US\$ billion)	16.3	11.1	14.4	14.0	14.5	12.5
Interest (US\$ billion)	7.7	8.9	8.8	8.8	7.8	7.6
Public Sector Debt Service (US\$ billion)	8.6	9.3	8.8	9.4	15.2	15.0
Amortization (US\$ billion)	5.4	4.3	2.8	3.4	9.2	9.0
Interest (US\$ billion)	3.2	5.0	6.0	6.0	6.0	6.0
Private Sector Debt Service (US\$ billion)	15.5	10.6	14.5	13.4	7.1	5.1
Amortization (US\$ billion)	10.9	6.8	11.6	10.6	5.3	3.5
Interest (US\$ billion)	4.5	3.9	2.8	2.8	1.8	1.6
External Debt Service (% of GDP)	11.0	21.7	16.5	14.9	15.6	13.7
External Debt Service (% of exports)	36.9	35.1	40.3	31.2	30.2	24.7
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-0.9	-2.6	-4.0	-4.6	-4.5	-3.5
Public Sector Domestic Debt (% GDP)	-	-	38.3	48.4	46.2	45.3
Public Sector External Debt (% GDP)	27.8	77.7	56.3	51.8	58.7	59.1
Total Public Sector Debt (US\$ billion)	60.5	71.5	133.7	153.9	150.3	152.5
Total Public Sector Debt (% of GDP)	27.8	77.7	94.6	100.2	104.9	104.4

Source: IIF and JPMorgan

Malaysia	1997	1998	1999	2000P	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	49.5	43.4	42.6	41.1	40.5	41.1
Public Sector External Debt (US\$ billion)	16.8	17.7	20.3	22.0	23.0	23.5
Private Sector External Debt (US\$ billion)	32.7	25.7	22.4	19.1	17.5	17.6
External Debt (% GDP)	49.4	59.8	53.9	45.9	45.2	42.8
External Debt (% of exports)	51.8	51.1	43.5	36.0	36.8	35.0
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	6.5	8.3	8.2	8.2	7.5	6.8
Amortization (US\$ billion)	3.6	5.3	5.5	5.4	5.2	4.8
Interest (US\$ billion)	2.9	2.9	2.7	2.8	2.3	2.0
Public Sector Debt Service (US\$ billion)	1.6	1.3	1.4	1.5	1.6	1.7
Amortization (US\$ billion)	0.9	0.9	0.9	1.0	1.1	1.2
Interest (US\$ billion)	0.7	0.5	0.5	0.5	0.5	0.5
Private Sector Debt Service (US\$ billion)	4.9	6.9	6.8	6.8	5.9	5.1
Amortization (US\$ billion)	2.7	4.5	4.5	4.5	4.1	3.6
Interest (US\$ billion)	2.2	2.5	2.2	2.3	1.8	1.5
External Debt Service (% of GDP)	6.5	11.4	10.3	9.2	8.4	7.1
External Debt Service (% of exports)	6.8	9.7	8.3	7.2	6.8	5.8
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)*	6.1	-1.3	-0.1	-2.8	-4.2	-2.4
Public Sector Domestic Debt (% GDP)	28.0	32.9	34.3	34.4	38.2	38.4
Public Sector External Debt (% GDP)	16.8	24.4	25.6	24.5	25.7	24.5
Total Public Sector Debt (US\$ billion)	44.9	41.4	47.4	52.8	57.2	60.3
Total Public Sector Debt (% of GDP)	44.8	57.2	60.0	58.9	63.8	62.9

\* Consolidated public sector balances.

Source: Bank Negara Malaysia, Institute of International Finance, and JPMorgan

Philippines	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	54.4	56.2	60.2	58.5	55.4	55.9
Public Sector External Debt (US\$ billion)	24.8	27.9	32.1	31.4	31.5	31.0
Private Sector External Debt (US\$ billion)	29.6	28.2	28.1	27.1	23.9	24.9
External Debt (% GDP)	66.0	85.8	78.5	78.0	77.6	70.6
External Debt (% of exports)	113.1	129.4	127.7	119.7	122.4	115.2
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	6.3	6.2	5.9	7.3	7.9	8.7
Amortization (US\$ billion)	3.7	3.9	3.4	3.8	5.1	6.0
Interest (US\$ billion)	2.6	2.3	2.5	3.5	2.8	2.7
Public Sector Debt Service (US\$ billion)	4.1	4.5	5.7	5.0	5.6	6.1
Amortization (US\$ billion)	2.9	3.1	3.8	3.1	3.5	3.9
Interest (US\$ billion)	1.2	1.4	1.8	1.9	2.1	2.2
Private Sector Debt Service (US\$ billion)	2.2	1.7	0.2	2.3	2.3	2.6
Amortization (US\$ billion)	0.8	0.8	(0.5)	0.7	1.6	2.2
Interest (US\$ billion)	1.4	0.9	0.7	1.6	0.7	0.5
External Debt Service (% of GDP)	7.6	9.4	7.6	9.7	11.1	10.9
External Debt Service (% of exports)	13.0	14.2	12.4	14.9	17.5	17.8
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-0.3	-1.9	-3.3	-4.5	-4.3	-3.8
Public Sector Domestic Debt (% GDP)	52.0	52.1	54.0	51.8	54.5	52.6
Public Sector External Debt (% GDP)	30.1	42.7	41.8	41.8	44.1	39.1
Total Public Sector Debt (US\$ billion)	67.3	62.1	73.5	70.3	70.4	72.7
Total Public Sector Debt (% of GDP)	82.1	94.8	95.9	93.6	98.6	91.8

Source: Department of Finance, Institute of International Finance, and JPMorgan

South Korea	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	159.2	148.4	133.4	128.2	118.2	112.7
Public Sector External Debt (US\$ billion)	22.3	36.5	29.5	27.9	25.0	24.0
Private Sector External Debt (US\$ billion)	137.0	111.8	103.9	100.3	93.2	88.7
External Debt (% GDP)	33.4	46.8	32.8	28.0	25.0	21.4
External Debt (% of exports)	94.3	92.5	76.2	60.4	56.0	48.6
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	12.0	41.8	43.1	24.8	25.5	15.5
Amortization (US\$ billion)	5.7	33.6	34.7	15.8	19.6	10.4
Interest (US\$ billion)	6.3	8.3	8.4	9.0	5.9	5.2
Public Sector Debt Service (US\$ billion)	2.8	5.3	15.5	0.3	9.6	2.9
Amortization (US\$ billion)	1.3	4.2	12.5	0.2	7.4	1.9
Interest (US\$ billion)	1.5	1.0	3.0	0.1	2.2	0.9
Private Sector Debt Service (US\$ billion)	9.2	36.6	27.5	24.5	15.9	12.7
Amortization (US\$ billion)	4.4	29.3	22.2	15.6	12.3	8.5
Interest (US\$ billion)	4.8	7.2	5.3	8.9	3.6	4.2
External Debt Service (% of GDP)	2.5	13.2	10.6	5.4	5.4	2.9
External Debt Service (% of exports)	7.1	26.1	24.6	11.7	12.1	6.7
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	0.0	-4.2	-4.2	1.1	-1.0	-2.0
Public Sector Domestic Debt (% GDP)*	14.0	30.6	34.3	37.4	35.9	34.3
Public Sector External Debt (% GDP)	4.7	11.5	7.3	6.1	5.3	4.5
Total Public Sector Debt (US\$ billion)	88.8	133.5	168.8	198.9	195.2	205.1
Total Public Sector Debt (% of GDP)	18.6	42.1	41.6	43.5	41.2	38.8

\* Includes central and local government debt + government guaranteed debt (KAMCO and KDIC).  
Source: IIF, MOFE, and JPMorgan

Thailand	1997	1998	1999	2000	2001P	2002P
<b>External Debt Balance</b>						
Total External Debt (US\$ billion)	109.3	105.1	95.4	79.5	69.9	62.4
Public Sector External Debt (US\$ billion)	24.1	31.1	36.0	33.8	29.0	24.0
Private Sector External Debt (US\$ billion)	85.2	74.0	59.4	45.6	40.9	38.4
External Debt (% GDP)	72.3	93.9	78.2	65.0	61.4	51.8
External Debt (% of exports)	143.5	151.8	128.1	93.4	80.9	66.4
<b>External Debt Service</b>						
External Debt Service (US\$ billion)	18.0	17.2	13.5	10.5	13.3	14.5
Amortization (US\$ billion)	11.3	10.7	7.6	5.0	8.8	10.5
Interest (US\$ billion)	6.7	6.5	5.9	5.5	4.5	4.0
Public Sector Debt Service (US\$ billion)	3.5	4.1	4.4	3.5	7.0	8.2
Amortization (US\$ billion)	2.5	2.8	2.9	2.0	5.5	6.5
Interest (US\$ billion)	1.0	1.3	1.5	1.5	1.5	1.7
Private Sector Debt Service (US\$ billion)	14.5	13.1	9.1	7.0	6.3	6.3
Amortization (US\$ billion)	8.8	7.9	4.7	3.0	3.9	4.7
Interest (US\$ billion)	5.7	5.2	4.4	4.0	3.0	2.3
External Debt Service (% of GDP)	11.9	15.4	11.1	8.6	11.6	12.0
External Debt Service (% of exports)	23.7	24.9	18.1	12.4	15.3	15.4
<b>Public Sector Finances</b>						
Nominal Fiscal Balance (% of GDP)	-0.9	-2.5	-3.6	-3.0	-3.6	-3.5
Public Sector Domestic Debt (% GDP)	6.9	15.7	23.3	24.6	25.7	26.1
Public Sector External Debt (% GDP)	15.9	27.8	29.5	27.7	25.5	19.9
Total Public Sector Debt (US\$ billion)	34.5	48.7	64.5	63.9	58.2	55.4
Total Public Sector Debt (% of GDP)	22.8	43.5	52.8	52.3	51.2	46.0

Source: Bank of Thailand, IIF, and JPMorgan

### The Global Economic Outlook in Summary

	Real GDP Growth (% YOY) <sup>1</sup>			Consumer Prices (% YOY avg)			Current Account Balance (% GDP)		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
<b>The Americas</b>									
United States	4.1	1.0	0.1	3.4	2.1	1.9	-4.5	-4.1	-3.8
Canada	4.4	1.3	0.8	3.1	2.0	1.9	2.5	3.3	2.4
Latin America	4.0	0.7	1.0	6.8	5.5	4.9	-2.3	-2.2	-2.3
Argentina	-0.5	-2.1	-1.0	-0.7	-0.5	0.0	-3.1	-1.7	-0.6
Brazil	4.5	1.6	1.0	6.0	7.0	6.0	-4.1	-4.8	-3.8
Chile	5.4	3.2	3.2	4.5	3.6	3.0	-1.4	-1.9	-1.2
Colombia	2.8	1.5	2.7	8.7	8.0	7.0	0.1	-0.8	-1.3
Ecuador	2.3	6.0	2.4	91.0	24.5	9.0	10.3	3.1	2.0
Mexico	6.9	-0.2	1.0	9.0	5.3	5.0	-3.2	-2.7	-3.4
Peru	3.6	0.0	3.0	3.7	1.8	4.4	-3.0	-3.3	-5.2
Venezuela	3.2	2.9	1.6	13.4	10.0	10.0	9.7	7.2	4.2
<b>Asia/Pacific</b>									
Japan	1.5	-0.5	-1.6	-0.8	-0.5	-0.3	2.5	1.9	1.5
Australia	3.3	2.0	2.5	5.8	2.8	2.3	-4.0	-2.1	-2.3
New Zealand	3.8	2.5	2.2	4.0	1.7	1.7	-5.6	-2.5	-2.6
Emerging Asia	7.2	3.3	4.1	2.6	2.0	2.9	3.5	2.7	2.0
China	8.0	7.3	7.2	1.5	-0.3	1.7	1.9	0.8	0.1
Hong Kong	10.5	0.4	1.7	-2.1	-2.0	0.6	5.4	6.3	9.3
India	5.2	4.8	6.0	3.5	4.7	5.4	-0.6	-1.0	-0.6
Indonesia	4.8	3.0	1.9	9.3	11.0	8.0	5.5	3.7	3.1
Korea	8.8	2.5	3.5	3.2	3.5	2.4	2.4	1.8	0.7
Malaysia	8.3	-0.2	1.5	1.3	1.3	1.2	9.4	9.2	7.4
Philippines	4.0	2.6	2.4	6.6	5.4	5.5	12.0	5.7	4.7
Singapore	9.9	-2.8	0.1	2.1	0.0	0.9	23.6	26.9	25.5
Taiwan	5.9	-2.6	0.8	1.7	-1.3	2.4	2.9	4.5	2.7
Thailand	4.4	1.5	1.3	1.3	1.3	2.3	7.7	4.1	3.6
<b>Africa</b>									
South Africa	3.4	1.7	2.6	7.0	4.8	5.2	-0.3	-0.7	-1.5
<b>Europe</b>									
Euro area	3.4	1.5	0.6	2.6	2.2	1.6	-0.8	-0.2	0.7
Germany	3.2	0.7	0.2	2.3	1.9	0.8	-0.5	0.1	0.6
France	3.5	2.0	0.9	1.9	1.5	0.8	1.3	1.1	0.8
Italy	2.9	1.8	0.6	2.7	2.4	1.0	-0.5	0.2	1.2
Netherlands	3.5	0.8	0.4	3.0	4.1	1.4	3.7	3.8	4.1
Spain	4.1	2.5	1.4	4.0	3.2	1.1	-3.1	-2.8	-2.7
Denmark	3.2	1.3	1.3	2.6	2.2	1.6	1.1	1.4	1.5
Norway	2.2	1.1	1.3	3.1	2.5	2.4	14.4	13.2	10.7
Sweden	3.5	1.6	0.9	1.5	3.1	2.3	2.4	1.6	2.0
Switzerland	3.0	1.6	0.1	1.6	0.3	0.2	13.1	11.6	12.2
United Kingdom	2.9	2.2	1.8	3.1	1.5	2.4	-2.0	-1.3	-1.8
Emerging Europe	6.6	1.0	3.2	20.3	26.0	18.9	2.9	3.5	0.3
Bulgaria	5.8	4.5	3.5	11.3	5.8	4.0	-5.8	-8.5	-7.6
Czech Republic	2.9	3.4	3.0	4.0	4.2	2.7	-4.5	-4.8	-4.4
Hungary	5.2	3.6	3.2	10.1	7.5	5.6	-3.3	-2.6	-4.3
Poland	4.1	0.9	1.2	8.5	3.9	3.8	-6.3	-3.9	-3.6
Slovak Republic	2.2	2.5	3.0	8.4	7.0	4.0	-4.9	2.0	0.9
Russia	8.3	5.0	4.5	20.1	18.7	18.0	18.5	12.5	4.6
Turkey	7.2	-8.2	2.0	39.0	71.9	43.0	-5.8	-8.5	-7.6
Global <sup>2</sup>	3.8	1.2	0.6	3.2	2.5	2.2	—	—	—
Developed Market Economies	3.3	0.9	0.1	2.3	1.6	1.4	-1.4	-1.2	-1.1
Emerging Market Economies	5.9	2.2	2.9	6.4	6.5	5.7	1.6	1.2	0.5

1. % Dec/Dec for emerging economies; % Q4/Q4 for developed economies.

2. JPMorgan sample.

Source: JPMorgan

## Asia

	Moody's		S & P		Recent Moody's Action		Recent S&P Action		Comments
	Rating	View	Rating	View	Action	Date	Action	Date	
China	A3		BBB	-	Affirmed, stable	14 Aug 01	Affirmed, stable	9 Oct 01	No change expected
Hong Kong	A3	o	A+	-	O/L changed to (+)	15 Feb 01	Upgrade, stable	9 Feb 01	Potential Moody's upgrade
India	Ba2	o	BB	oo	O/L changed to (+)	8 Aug 01	Affirmed, O/L (-)	20 Nov 01	
Indonesia	B3	-	CCC	oo	O/L changed to stable	6 Mar 00	Downgrade, O/L (-)	2 Nov 01	
Kazakhstan	Ba2	o	BB	-	Upgrade, O/L (+)	18 Jun 01	Upgrade, stable	18 May 01	
Korea	Baa2	-	BBB+	-	Affirmed, stable	19 Mar 01	Upgrade, stable	13 Nov 01	
Malaysia	Baa2	-	BBB	-	Upgrade, stable	17 Oct 00	O/L changed to stable	5 Apr 01	No change expected
Pakistan	Caa1	-	B-	-	O/L changed to stable	29 Oct 01	Affirmed, stable	23 Apr 01	
Philippines	Ba1	oo	BB+	oo	O/L changed to (-)	3 May 01	Affirmed, O/L (-)	19 Jun 01	No change expected
Singapore	Aa1	-	AAA	-	Affirmed, stable	27 Jun 01	Affirmed, stable	15 May 01	
Taiwan	Aa3	-	AA	oo	Affirmed, stable	6 Oct 00	Downgrade, O/L (-)	26 Jul 01	
Thailand	Baa3	-	BBB-	-	Upgrade, stable	22 Jun 00	Affirmed, stable	31 May 01	No change expected
Turkmenistan	B2	-	nr	-	Affirmed, stable	13 Aug 01			
Vietnam	B1	-	nr	-	O/L changed to stable	23 Apr 01			

RATING SCALE			STANDARD TERMINOLOGY AND PROCEDURES				
	MOODY'S	S&P		MOODY'S	S&P		
Upper Investment Grade	Aaa	AAA	Not currently subject to change	STABLE	STABLE		
	Aa1	AA+		Possible long-term change Likely to be put on review	OUTLOOK (+or-)	OUTLOOK (+or-)	
	Aa2	AA			Likely change in short term	REVIEW (+or-)	CREDITWATCH (+or-)
	Aa3	AA-				UPGRADE / DOWNGRADE AFFIRMED / STABLE	UPGRADE / DOWNGRADE AFFIRMED / STABLE
	A1	A+					
A2	A						
A3	A-						
Lower Investment Grade	Baa1	BBB+					
	Baa2	BBB					
	Baa3	BBB-					
Non-Investment Grade	Ba1	BB+					
	Ba2	BB					
	Ba3	BB-					
Lower Non-Investment Grade	B1	B+					
	B2	B					
	B3	B-					
	Caa1	CCC+					
	Caa2	CCC					
	Caa3	CCC-					
	Ca	CC					
	C	C					
Default		SD					
		D					

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 movement. An outlook suggests that a review/watch or a long/intermediate-term movement is likely.

- stable outlook  
o positive outlook  
oo negative outlook

X positive review/watch  
XX negative review/watch

WR Rating Withdrawn

### Latin America

	Moody's		S & P		Recent Moody's Action		Recent S&P Action		Comments
	Rating	View	Rating	View	Action	Date	Action	Date	
Argentina	Caa3	-	SD	-	Downgrade, O/L (-)	12 Oct 01	Downgrade	6 Nov 01	Downgrade risks persist
Barbados	Baa2	-	A-	-	Upgrade, stable	8 Feb 00	Assigned, stable	8 Jan 01	
Bolivia	B1	-	B+	-	Affirmed, stable	3 Feb 00	Downgrade, stable	18 Oct 00	
Brazil	B1	-	BB-	oo	Upgrade	16 Oct 00	O/L changed to (-)	10 Aug 01	S&P downgrade possible in December
Chile	Baa1	-	A-	-	Affirmed, stable	1 Mar 00	Affirmed, stable	10 Oct 01	
Colombia	Ba2	-	BB	oo	Affirmed, stable	1 Mar 00	Affirmed, O/L (-)	31 Aug 01	Possible S&P outlook change to stable
Costa Rica	Ba1	o	BB	o	O/L changed to (+)	22 Mar 00	O/L changed to (+)	27 Jul 00	
Cuba	Caa1	-	nr	-					
Dominican Republic	Ba2	-	BB-	-	Upgrade, stable	29 Aug 01	Upgrade, stable	5 Sep 01	
Ecuador	Caa2	-	CCC+	-	Affirmed, stable	10 Aug 00	O/L changed to stable	4 Dec 01	
El Salvador	Baa3	-	BB+	-	Affirmed, stable	1 Mar 00			
Guatemala	Ba2	-	BB	-	Affirmed, stable	1 Mar 00	Assigned	18 Oct 01	
Honduras	B2	-	nr	-	Affirmed, stable	3 Feb 00			
Jamaica	Ba3	-	B+	-	Affirmed, stable	18 May 00	Upgrade, stable	2 May 01	
Mexico	Baa3	o	BB+	o	O/L changed to (+)	4 Sep 01	Affirmed, O/L (+)	7 Jun 01	Possible S&P upgrade
Nicaragua	B2	-	nr	-	Affirmed, stable	30 Mar 00			
Panama	Ba1	-	BB	-			Downgrade, stable	20 Nov 01	
Paraguay	B2	-	B	oo					
Peru	Ba3	oo	BB-	-	O/L changed to (-)	12 Dec 00	Affirmed, stable	25 Sep 01	Potential Moody's outlook change to stable
Trinidad & Tobago	Baa3	-	BBB-	-	Affirmed, stable	30 Aug 00			
Uruguay	Baa3	-	BBB-	-			Affirmed, stable	8 May 01	
Venezuela	B2	-	B	-	Affirmed, stable	29 Jan 01			

RATING SCALE			STANDARD TERMINOLOGY AND PROCEDURES				
	MOODY'S	S&P		MOODY'S	S&P		
Upper Investment Grade	Aaa	AAA	Not currently subject to change	STABLE	STABLE		
	Aa1	AA+		Possible long-term change Likely to be put on review	OUTLOOK (+or-)	OUTLOOK (+or-)	
	Aa2	AA			Likely change in short term	REVIEW (+or-)	CREDITWATCH (+or-)
	Aa3	AA-				UPGRADE / DOWNGRADE AFFIRMED / STABLE	UPGRADE / DOWNGRADE AFFIRMED / STABLE
	A1	A+					
	A2	A					
A3	A-						
Lower Investment Grade	Baa1	BBB+					
	Baa2	BBB					
	Baa3	BBB-					
Non-Investment Grade	Ba1	BB+					
	Ba2	BB					
	Ba3	BB-					
Lower Non-Investment Grade	B1	B+					
	B2	B					
	B3	B-					
	Caa1	CCC+					
	Caa2	CCC					
	Caa3	CCC-					
	Ca	CC					
	C	C					
Default		SD					
		D					

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- stable outlook  
o positive outlook  
oo negative outlook

X positive review/watch  
XX negative review/watch

WR Rating Withdrawn

### Europe, Africa, and Mid-East

	Moody's		S & P		Recent Moody's Action		Recent S&P Action		Comments
	Rating	View	Rating	View	Action	Date	Action	Date	
Algeria	nr	-	nr	-					Rating expected within a year
Botswana	A2	-	A	-	Assigned	12 Mar 01	Assigned	2 Apr 01	
Bulgaria	B2	-	BB-	-	O/L change to stable	25 Jul 00	Upgrade, stable	7 Nov 01	
Croatia	Baa3	oo	BBB-	-			O/L changed to stable	9 Feb 01	
Cyprus	A2	-	A	-	O/L changed to stable	12 Mar 01	Affirmed, stable	16 Nov 01	
Czech Republic	Baa1	-	A-	-			Affirmed, stable	18 Dec 00	
Egypt	Ba1	-	BBB-	oo			Affirmed, O/L (-)	2 Jul 01	
Estonia	Baa1	-	A-	-	Affirmed, stable	26 Jan 00	Upgrade, stable	20 Nov 01	
Greece	A2	-	A	o			Upgrade, O/L (+)	13 Mar 01	
Hungary	A3	-	A-	-	Upgrade, stable	14 Nov 00	Upgrade, stable	19 Dec 00	No change expected
Israel	A2	-	A-	-	Affirmed, stable	23 Feb 01	Affirmed, stable	5 Jul 01	
Ivory Coast	nr	-	nr	-					No rating expected
Jordan	Ba3	-	BB-	o			O/L changed to (+)	9 Apr 01	Med-term upgrade potential
Kuwait	Baa1	o	A	-	Affirmed, O/L (+)	9 Jan 01	Affirmed, stable	2 May 00	
Latvia	Baa2	-	BBB	o			Affirmed, stable	11 Jul 01	
Lebanon	B2	oo	B	oo	Downgrade, O/L (-)	30 Jul 01	Downgrade	28 Sep 01	
Lithuania	Ba1	-	BBB-	-	Affirmed, stable	17 Mar 00	Affirmed, stable	11 Jul 01	
Morocco	Ba1	-	BB	oo	Affirmed, stable	16 Mar 00	O/L changed to (-)	2 Nov 01	Downgrades expected in 2002
Nigeria	nr	-	nr	-					
Oman	Baa2	-	BBB	-	Affirmed, stable	27 Mar 00	Upgrade, stable	27 Feb 01	
Poland	Baa1	-	BBB+	-	Affirmed, stable	19 Sep 00	O/L changed to (s)	22 Aug 01	
Qatar	Baa2	-	BBB+	o	Affirmed, stable	22 Feb 01	Upgrade, positive	9 Mar 01	
Romania	B3	-	B	o			Upgrade, positive	7 Jun 01	Upgrade expected in near future
Russia	Ba3	-	B	o	Upgrade, stable	29 Nov 01	Affirmed, O/L (+)	4 Oct 01	
Saudi Arabia	Baa3	o	nr	-	O/L changed to (+)	10 Aug 00			
Senegal	nr	-	B+	-			Assigned, stable	18 Dec 00	
Slovak Republic	Baa3	-	BBB-	o	O/L changed to (+)	13 Nov 01	Upgrade, O/L (+)	30 Oct 01	
Slovenia	A2	-	A	-	Upgrade	14 Nov 00	Affirmed, stable	6 Jul 00	
South Africa	Baa2	-	BBB-	-	Upgrade, stable	29 Nov 01	Affirmed, stable	12 Feb 01	
Tunisia	Baa3	o	BBB	-	O/L changed to (+)	3 Feb 00	Affirmed, stable	11 Jul 00	
Turkey	B1	oo	B-	-	O/L changed to (-)	11 Jul 01	O/L changed to stable	30 Nov 01	
Ukraine	Caa1	o	nr	-	O/L changed to (+)	20 Nov 01			

RATING SCALE			STANDARD TERMINOLOGY AND PROCEDURES			
	MOODY'S	S&P		MOODY'S	S&P	
Upper Investment Grade	Aaa	AAA	Not currently subject to change	STABLE	STABLE	
	Aa1	AA+		Possible long-term change Likely to be put on review	↓	↓
	Aa2	AA			OUTLOOK (+or-)	OUTLOOK (+or-)
	Aa3	AA-			↓	↓
	A1	A+			REVIEW (+or-)	CREDITWATCH (+or-)
	A2	A			↓	↓
	A3	A-			UPGRADE / DOWNGRADE AFFIRMED / STABLE	UPGRADE / DOWNGRADE AFFIRMED / STABLE
Lower Investment Grade	Baa1	BBB+	Likely change in short term			
	Baa2	BBB				
	Baa3	BBB-				
Non-Investment Grade	Ba1	BB+				
	Ba2	BB				
	Ba3	BB-				
Lower Non-Investment Grade	B1	B+				
	B2	B				
	B3	B-				
	Caa1	CCC+				
	Caa2	CCC				
	Caa3	CCC-				
	Ca	CC				
	C	C				
Default		SD				
		D				

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- stable outlook  
o positive outlook  
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X positive review/watch  
XX negative review/watch

WR Rating Withdrawn

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# JPMorgan Emerging Markets Research Contact Information

Joyce Chang, Global Head of Emerging Markets Research    joyce.chang@jpmorgan.com    (1-212) 834-4203

## SOVEREIGN STRATEGY

<b>Latin America</b> <b>Graham Stock, VP</b> graham.stock@jpmorgan.com    (1-212) 834-4439 <b>Luis Fernando Lopes, VP<sup>1</sup></b> luis.fernando.lopes@jpmorgan.com    (55-11) 3048-3503 <b>Luis Oganés, VP</b> oganes_luis@jpmorgan.com    (1-212) 834-4326 <b>Eva Sanchez Ampudia, VP</b> eva.a.sanchez@jpmorgan.com    (1-212) 834-4066			<b>Relative Value and Trade Strategy</b> <b>Jonathan Bayliss, MD, Global Head of Quantitative Strategy</b> jonathan.bayliss@jpmorgan.com    (44-20) 7777-3020 <b>Eric Beinstein, VP</b> beinstein_eric@jpmorgan.com    (1-212) 834-4211 <b>Stuart Sclater-Booth, VP</b> stuart.sclater-booth@jpmorgan.com    (1-212) 834-4022 <b>Anna Titarchuk, VP</b> anna.titarchuk@jpmorgan.com    (1-212) 834-4711		
<b>Asia</b> <b>Greg Batey MD, (CMAL)</b> <b>Non-Japan Asia Credit</b> greg.batey@jpmorgan.com    (852) 2841-4773 <b>David Fernandez, VP, (MGT)</b> fernandez_d@jpmorgan.com    (65) 882-2461 <b>Robert Quist, VP<sup>1</sup>, (CMAL)</b> robert.quist@jpmorgan.com    (852) 2841-4783 <b>Sushanta Mallick, Associate (CMAL)</b> sushanta.mallick@jpmorgan.com    (852) 2841-4410			<b>Analytics</b> <b>Glenn Souther, VP</b> souther_glenn@jpmorgan.com    (1-212) 834-7039 <b>Victor Dituro, VP</b> dituro_victor@jpmorgan.com    (1-212) 834-7072 <b>Jesse Yan, VP</b> yan_jesse@jpmorgan.com    (1-212) 834-7043		
<b>Central and Eastern Europe, Middle East and Africa</b> <b>Robin Hubbard, MD, (CMIL)</b> robin.hubbard@jpmorgan.com    (44-20) 7777-4945 <b>Michael Marrese, VP, (CMIL)</b> michael.marrese@jpmorgan.com    (44-20) 7777-4627 <b>Francis Beddington, VP, (CMIL)</b> francis.beddington@jpmorgan.com    (44-20) 7777-3770 <b>David Richter, Associate, (CMIL)</b> david.richter@jpmorgan.com    (44-20) 7777-0840			<b>Portfolio Research and Bond Index</b> <b>Peter Rappoport, MD</b> rappoport_peter@jpmorgan.com    (1-212) 834-7046 <b>Gloria Kim, VP</b> kim_gloria@jpmorgan.com    (1-212) 834-4153 <b>Drausio Giacomelli, VP</b> giacomelli_drausio@jpmorgan.com    (1-212) 834-4685 <b>Amy Li, VP, (CMAL)</b> amy.li@jpmorgan.com    (852) 2841-4527 <b>Jade Lam, Analyst</b> jade.lam@jpmorgan.com    (1-212) 834-4029 <b>Frank Zheng, Associate</b> frank.zheng@jpmorgan.com    (1-212) 834-9226 <b>Jarrad Linzie, Professional</b> linzie_jarrad@jpmorgan.com    (1-212) 834-7041		

## LOCAL MARKETS STRATEGY

<b>Latin America</b> <b>Martin Anidjar, VP, (JPMSI)</b> anidjar_martin@jpmorgan.com    (1-212) 648-1849 <b>Gabriel Sod-Hoffs, VP, (CMB)</b> gabriel.sod-hoffs@jpmorgan.com    (1-212) 834-4455 <b>Eric Torres, Research Analyst<sup>1</sup></b> eric.torres@jpmorgan.com    (1-212) 834-4426			<b>Asia</b> <b>Bernie Eschweiler, MD, Non-Japan Asia Rates, (MGT)</b> eschweiler_bern@jpmorgan.com    (65) 882-2212 <b>Bert Gochet, VP, (MGT)</b> gochet_bert@jpmorgan.com    (65) 882-2221 <b>Aashish Pitale, VP, (JPMSIPL)</b> pitale_aashish@jpmorgan.com    (91-22) 268-1456 <b>Rebecca Patterson, VP, (MGT)</b> patterson_rebecca@jpmorgan.com    (65) 882-2218 <b>Hsin-Li Chia, Associate, (MGT)</b> chia_hsin-li@jpmorgan.com    (65) 882-2220 <b>Jinsoo Lee, Associate, (MGT),</b> lee_jinsoo@jpmorgan.com    (822) 3705-6640		
<b>Central and Eastern Europe, Middle East and Africa</b> <b>Robin Hubbard, MD, (CMIL)</b> robin.hubbard@jpmorgan.com    (44-20) 7777-4945 <b>Laurent Fontaine, VP, (CMIL)</b> laurent.fontaine@jpmorgan.com    (44-20) 7777-3983 <b>Dan Beghegeanu, VP, (JPMSL)</b> beghegeanu_dan@jpmorgan.com    (44-20) 7777-0185 <b>James Pitt, Associate, (JPMSL)</b> pitt_james@jpmorgan.com    (44-20) 7325-0769 <b>Juliette Declercq, Research Analyst (JPMSL)</b> declercq_juliette@jpmorgan.com    (44-20) 7325-1608			<b>South African Market Strategy</b> <b>Deanne Gordon, VP<sup>2</sup>, (CMB),</b> deanne.gordon@martin.co.za    (27-21) 689-2444		

## CORPORATE STRATEGY

<b>Latin America and Europe</b> <b>Ignacio Ponce de Leon, MD, Credit Research</b> ignacio.a.ponce.de.leon@jpmorgan.com    (1-212) 834-4214 <b>Jeanne DesJardins, VP</b> desjardins_jeanne@jpmorgan.com    (1-212) 834-7042 <b>Aaron Holsberg, CFA, VP</b> aaron.holsberg@jpmorgan.com    (1-212) 834-4208 <b>Douglas Krehbiel, CFA, VP</b> douglas.krehbiel@jpmorgan.com    (1-212) 834-4210 <b>Victoria Miles, VP, (CMIL)</b> victoria.miles@jpmorgan.com    (44-20) 7777-3582			<b>Asia</b> <b>Sanjai Vohra, VP, (CMAL)</b> sanjai.vohra@jpmorgan.com    (852) 2841-4770 <b>Edwin Chan, CFA, VP, (CMAL)</b> edwin.chan@jpmorgan.com    (852) 2841-4782 <b>Prasoon Dayal, Associate, (JPMSA)</b> dayal_prasoon@jpmorgan.com    (852) 2901-4005 <b>Joshua Drucker, Associate</b> joshua.drucker@jpmorgan.com    (852) 2901-4002 <b>Jennifer Y. P. Kwan, Associate (CMAL)</b> jennifer.y.p.kwan@jpmorgan.com    (852) 2843-1205		
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<sup>1</sup> Works with both Local Markets and Sovereign Strategy

CMAL = Chase Manhattan Asia Limited  
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**JPMORGAN SECURITIES  
INCORPORATED**  
270 Park Avenue  
New York, N.Y. 10017  
Tel. (1-212) 270-0740

**JPMORGAN SECURITIES  
INCORPORATED**  
60 Wall Street  
New York, N.Y. 10260-0060  
Tel. (1-212) 648-4379

**CHASE MANHATTAN  
INTERNATIONAL LIMITED**  
125 London Wall  
London EC2Y 5AJ  
Tel. (44 20) 7777-1821

**JPMORGAN SECURITIES  
LIMITED**  
60 Victoria Embankment  
London EC4Y 0JP  
Tel. (44 20) 7600-2300

**JPMORGAN SECURITIES  
(ASIA PACIFIC) LIMITED**  
One Exchange Square, 39/F  
Central, Hong Kong  
Tel. (852) 2841-4321

**JPMORGAN SECURITIES ASIA  
PRIVATE LIMITED**  
Akasaka Park Building  
2-20 Akasaka 5-chome  
Minato1`-ku, Tokyo 107-6151, Japan  
Tel. (813) 5573-1185

## JPMorgan's Emerging Markets Trade Strategies

**Argentina:** We continue to favor low dollar price '18s and '31s versus '08s.

**Russia:** MinFin4 and MinFin6 are 300-380 bps cheap to Eurobond curve. The '30s have tightened versus '18s and we unwound this trade.

**Turkey:** We continue to recommend '30s versus '10s and also favor the recently issued '06, which has widened by 40-50 bps relative to the curve since issuance.

**Venezuela:** We continue to recommend DV01 curve flattening positions through credit default swaps: sell 0.6 7-year protection, buy 1.0 3-year protection.

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