As Colombia devalues currency

Financial crisis spreads through Latin America

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The sudden devaluation of the peso by Colombia late Tuesday night is the clearest sign of the impact that the world financial crisis is having in Latin America. The crisis which has staggered the economies and financial systems of Asia and Russia is now sweeping through another region of the world.

The government of President Andres Pastrana, who took office in the spring, announced that it would lower the trading band for the Colombian peso by 9 percentage points, allowing an immediate devaluation of the currency by that amount and an eventual decline of 26.6 percent for the balance of the year.

The action came as a surprise to the currency markets, where Colombia had been actively defending the value of the peso as late as last Friday. The government has spent $1.5 billion this year trying to prop up the currency, but it was unable to stop a 7 percent decline in the market value of the peso during August. Colombia's hard currency reserves were being depleted by the effort, falling to only $8.7 billion.

The government had raised interest rates to 30 percent in an effort to retain foreign capital, which has been fleeing the country as part of a general loss of confidence in the so-called emerging markets of Latin America, Asia, Russia and Eastern Europe.

The devaluation came less than two days before the opening of a meeting between Latin American finance ministers and the International Monetary Fund, which began on the morning of September 3. Representatives of the 'Group of Nine'--Mexico, Brazil, Argentina, Chile, Venezuela, Colombia, Peru, Ecuador and Uruguay--were to meet for two days with IMF, World Bank and US Treasury officials, including Treasury Secretary Robert Rubin and his chief deputy Lawrence Summers.

All of these countries have been hard hit by the panic selling of their stocks and bonds and the dumping of their currencies by foreign investors in the wake of the debt default and freeze on currency trading in Russia.

The most immediate impact will be on neighboring Venezuela, for which Colombia is the second biggest trading partner, after the United States. Venezuela is already in economic free fall as a result of the decline in the world price of oil, its principal export and foreign exchange earner. A barrel of oil, which sold for $22 a year ago, now brings only $13.

Interest rates have been pushed up to 70 percent in an effort to stop the decline of the Venezuelan currency, the bolivar. Shares on the Caracas stock exchange have fallen 70 percent this year--a crash surpassed only by the Moscow market. The country's foreign exchange reserves have fallen to only $13 billion.

There is a widespread conviction that the country will soon default on some or all of its overseas debts. The interest rate on some Venezuelan government bonds has reached 40 percent. On August 31, Standard & Poor downgraded the country's financial prospects, citing resistance to 'essential market-oriented reforms' from both political leaders and the populace as a whole.

The agency cited the support for a moratorium on debt payments by the candidate who holds a commanding lead in the polls in advance of December's presidential elections. Hugo Chavez, a former army colonel who led an unsuccessful military rebellion in 1992, has attracted support through populist attacks on the economic measures of the government and the IMF.

Mexico has suffered an abrupt economic reversal in the space of six weeks. Since mid-July, stock prices on

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the Mexico City exchange have fallen 40 percent and the value of the Mexican peso has dropped 13 percent against the dollar. The Russian default has triggered a virtual collapse of lending in Mexico, with interest rates in some markets jumping from 18 percent to 40 percent overnight. This week auto dealerships in Mexico City stopped making car loans because credit was simply unavailable.

The region's largest economy, Brazil, faces the combination of financial convulsions and a presidential election. The Sao Paulo exchange lost 40 percent of its value in August and $12 billion in currency reserves were drained from the country, but the government of President Fernando Henrique Cardoso has sought to avoid a sharp increase in interest rates before the presidential vote, scheduled for October 4. Instead Brazil's finance minister, Pedro Malan, appealed for the US Federal Reserve to lower its interest rates.

The accumulation of these economic shocks will inevitably produce its effects within the United States, as Wall Street analysts have already begun to warn. 'As we see it, there is no way that Brazil, Mexico and Venezuela can now avoid facing a substantial and painful slowdown,' said John Lipsky, chief global economist at the Chase Manhattan Bank. 'And that can't but help to have an impact on the United States.'

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