Investing in PERU

FINANCIAL TIMES **SPECIAL REPORT** | Wednesday September 21 2011

Beware Brazilians bearing gifts
Peruvians have mixed feelings about their neighbour's influence
Page 2

www.ft.com/peru-2011 | twitter.com/ftreports

Mood of cautious optimism takes hold

Business slowly accepts president as early fears of an authoritarian approach seem to fade away, says **John Paul Rathbone**

Ollanta Humala admits he sometimes looks in the mirror and cannot believe he is president. Members of the exclusive Club Nacional, styled on the English gentleman's model and situated a few hundred metres from the presidential palace in central Lima, feel the same way.

It has been less than four months since Mr Humala, a former army officer with no government experience, unexpectedly won the June 5 run-off. His narrow victory over centre-right candidate Keiko Fujimori, the daughter of a former president, sparked a record sell-off on the Lima stock exchange.

Since then, Mr Humala has dispelled many of the concerns held by investors – including the buttoned-down businessmen lunching in the Club Nacional's chandeliered dining rooms. "There is a mood of cautious optimism," admits one.

Smart mover: President Humala has so far shown a moderate approach on policy, although sceptics are worried he may launch into greater state intervention if the economy falters Getty

Even by Latin American standards, it has been a remarkably volatile year in Peru. It is the world's second-biggest producer of copper, silver and zinc, and one of the globe's fastest-growing economies, having trebled in size since 2000.

Electoral tensions really began to heat up in April, after centrist candidates split the electorate and Mr Humala scooped up their votes in the first round. Local debt markets subsequently clammed up. Some feared Mr Humala's rise in the polls might jeopardise the $42bn of investment that international mining companies – such as BHP Billiton, Xstrata and Freeport-McMoRan – were set to pour into Peru's $168bn economy.

Since then, markets have rebounded, the country's debt rating has been upgraded and pledges of even more foreign investment have come in, after the little-known Mr Humala has proved not to be the bogeyman many feared he was.

The 49-year-old has assembled a rainbow cabinet consisting of leftwing radicals and former military men, admixed with orthodox economists. Luis Miguel Castilla, the finance minister, served in the previous government. Julio Velarde, the widely respected head of the central bank, has been reappointed.

"We are all very non-ideological," says Salomón Lerner, a millionaire businessman who is Mr Humala's prime minister. "What's important is not the colour of the cat, but that it catches mice."

If at times Peruvians' worries have seemed hysterical, it is with good reason. In 2000, Mr Humala, then a colonel, led a failed revolt against Alberto Fujimori, the president at the time. After he was pardoned, he ran in the 2006 elections, espousing the kind of socialist rhetoric bellowed by Venezuela's radical president Hugo Chávez – and only narrowly lost.

This year, advised by Brazilian political image-makers, he adopted a more moderate approach. Following former Brazilian president Luiz Inácio Lula da Silva's lead, he dropped talk of nationalising companies and spoke instead about economic centrism and social-inclusion policies for the poor.

The rhetorical switch helped Mr Humala win the election. But it also left doubts about where his true instincts lay and whether his political makeover masked a latent authoritarianism.

Such concerns are particularly pertinent in a country that is still traumatised by recent hyperinflation, insurgency and authoritarianism. After all, it was only in the mid-1990s that former president Fujimori, now serving a 25-year prison sentence for human rights abuses, suppressed the Shining Path guerrillas and brought order to the macroeconomy.

Inside this issue

Everyone is wondering if there are any more shocks on the way, says Hernando de Soto, the internationally acclaimed Peruvian economist. "Yet, so far, the change in Mr Humala's approach shows he realises he has to be the president of all Peruvians. That shows he is a smart politician."

Certainly, the president is going to need all the good ideas he can assemble if he is to deliver on his central promise of social inclusion, while keeping Peru's commodity-heavy economy thrumming.

Nobody disagrees with his government's patently reasonable desire to fight corruption, beat crime and reduce poverty by expanding social services to the poorest regions, especially the Andes and Amazon. There, more than 200 social conflicts have flared up this year as indigenous groups have protested the impact of new mining projects.

It will still be a delicate balancing act, however, to keep public finances trim, while meeting the high expectations Mr Humala has nurtured among his core constituency – the third of Peruvians who live on less than $4 a day.

So far, the ramp-up in social spending he promised during his campaign has been well calibrated and carefully targeted. The government budget, which is running a surplus, can easily meet the extra $370m cost.

A tax on windfall mining profits has also proved digestible – and followed a very un-Chávez-like consultation between the government and mining companies. Instead of seeking to raise $2bn-3bn as companies had feared, the extra tax bill is about $1.1bn.

As a political outsider, Mr Humala has so far turned to a close circle for advice, in particular his wife, Nadine Heredia, and the prime minister. The 35-year-old Ms Heredia is telegenic, grew up in the same area as Mr Humala and accompanies her husband to all high-profile state functions. She has his ear.

The president's appointment of former military colleagues to key advisory positions has been more controversial. "This stirs understandable fears," says one western diplomat. "But it's also understandable that Mr Humala has gone first to those he knows best – and it may be that they will also prove good at their jobs."

It is all part of the ambiguity that surrounds Peru's new president. He wants to strengthen the role of the state, but at the same time the state is renowned for its corruption and inefficiency. Improving it is the work of generations, not a single presidency.

Indeed, as consecutive terms are not allowed under the constitution, many wonder if his wife might run in 2016, allowing Mr Humala to return again in 2021 – just as the Kirchner husband-and-wife team sought to do in Argentina. When asked, he replies that it is too early to say.

For now, high commodity prices give his new government the financial elbow room to be all things to all people. Growth remains high – a 6-7 per cent expansion is forecast for this year and 5-6 per cent for 2012.

A "strategic alliance" with Brazil will see the continent's largest country build roads linking its agricultural markets to the Pacific, benefiting from Peru's many free-trade agreements with the US and Asia. This could even turn Peru into "one of the most dynamic regions on earth", says Walter Molano, head of research at BCP Securities, the emerging-markets focused investment bank.

Nonetheless, sceptics worry about what would happen if Mr Humala's popularity sagged, or commodity prices collapsed. Then he could launch into greater state intervention and become the populist authoritarian many fear he is at heart.

"While commodity prices are high, he can be a Lula," says Moisés Naím, a senior associate in the Carnegie Endowment think-tank's economics programme in Washington, DC. "Should they fall, he could become a Chávez."

So far, Mr Humala has followed the Brazilian script. He has been fiscally prudent and politically pragmatic. There is little evidence – yet – that he will not continue that way.

Well-balanced choice of advisers favours growth

Politics

President selects cabinet from left and right, reports **Naomi Mapstone**

Markets have applauded Ollanta Humala's decision to swap his signature red T-shirt and revolutionary rhetoric for a sombre suit and pledges to protect the rights of investors.

However, the Peruvian president's abrupt shift in message has left observers, and some of his own supporters, waiting to see what he does next.

"Humala is a work in progress," says Michael Shifter, president of Inter-American Dialogue, the Washington policy forum.

"The initial signs are basically positive on economic and social policy. The concerns are more in terms of his statements on human rights and some of the advisers he has on security and democracy issues."

The new president has promised "more action and fewer words" than Alan García, his predecessor.

Mr Humala's first acts included the brokering of a $1.1bn windfall mining levy, the creation of a new ministry of social inclusion and the signing of a law granting communities the right to be consulted over investments.

His choice of cabinet and advisers casts more light on his thinking on policy, and how he plans to balance the radical leftist elements of his support base with the moderates who helped him win the election.

Luis Favre, an Argentine communist-turned-socialist adviser sent to Peru last year by Brazil's Workers' party, has been instrumental in Mr Humala's political makeover.

Mr Favre's experience – he worked closely with the campaign that carried former Brazilian president Luiz Inácio Lula da Silva to victory – helped him turn a radical ally of Venezuela's President Hugo Chávez into someone the business community could warm to.

For the role of prime minister, Mr Humala chose his closest adviser, Salomón Lerner, a 65-year-old millionaire businessman. Mr Lerner has had a long history on the fringes of Peruvian politics, and has headed a state-owned fishmeal company, a radio station and a bank, in between running a helicopter business. He says the government regards the private sector as an important motor of development.

The appointment of Harvard- and Johns Hopkins-educated Luis Miguel Castilla as finance minister has been greeted as a strong sign of continuity in

Prime Minister Lerner

macro-economic policy. Mr Castilla, who served as deputy finance minister in the previous administration, is prioritising private investment in major infrastructure works.

"We need to sustain growth of 6-7 per cent for poverty reduction along with our social programmes," he says. "Without growth it's very difficult to reduce poverty. And that's a fundamental objective of ours."

As head of the new ministry of development and social inclusion, Kurt Burneo, a former director of the central bank, will be charged with fulfilling

Continued on Page 2

Property rights are key to fair inclusion

Taking the long view

Hernando de Soto, the economist, talks to **John Paul Rathbone**

Two graceful alpacas are grazing in front of Hernando de Soto's home, but there is no sign of his pet dogs, Marx and Engels, so named because "they are German, hairy and have no respect for property".

The Peruvian economist first came to fame with his 1987 bestseller *The Other Path*. Now, he is everywhere. So far, some 30 governments – from Afghanistan to Mexico and Russia – have sought his advice on how to harness his brand of popular capitalism.

When the FT met Mr de Soto on a typically grey Lima afternoon, he was suffering from jet lag. Yet despite his globe-trotting, the wellspring of much of his thinking remains Peru.

The lights are low in the study. History books and economics tracts are piled high on a glass table and on the shelves. The subject of the day is the new president, Ollanta Humala, a former army officer.

Yet Mr de Soto prefers to take the long view on local politics and the closely fought second-round vote against Keiko Fujimori, daughter of the former president. He advised Mr Fujimori until they fell out when the leader made a grab for power.

"A notable point about this year's election is that – however controversial it was – the losers respected the result. That's a good sign," Mr de Soto comments. "And if people do worry about Mr Humala's military background, that's also positive: being sensitised is a way of protecting themselves."

Another of Mr Humala's more unusual features is his unconventional family. The president's father believes in Quechuan racial superiority, and one brother is serving a prison sentence, having led a 2005 coup. Mr Humala himself led a revolt in 2000.

"Jimmy Carter and Bill Clinton had brothers, Margaret Thatcher a son," observes Mr de Soto drily. As for Mr Humala's economic policies, early signs are positive, although it is too early to tell for sure.

"Both Keiko and Humala campaigned on a reform platform, and were a vote for change. Humala's difference is that he believes the state has an economic role to play. The question is, how much will he tinker?"

Mr de Soto's most heartfelt current subject, though, is the Peruvian Amazon. In a country that is the world's second-largest producer of copper and silver, the Amazon is the scene of some 200, often bloody, social conflicts.

> 'A notable point about this year's election is that the losers respected the result. That's a good sign'

Some of these are crude battles for local power, fomented by smugglers. But most relate to protests by local indigenous groups against foreign investment in mining and hydrocarbons. How to anticipate and prevent them is the theme of Mr de Soto's next book, *The Amazon is not Avatar*.

Its provocative title shows his undiminished promotional flair. But, contrary to popular myth and James Cameron's blockbuster movie, Mr de Soto believes indigenous life and globalisation are compatible.

After months of fieldwork, Mr de Soto found that indigenous people do feel their poverty and isolation, do want better education and health services, and do want property and businesses.

When conflict arises, it is usually because of a feeling of powerlessness.

Mr de Soto's solution is better property rights, a view that draws on his original insight in *The Other Path*. Most poor people, given the chance to participate fairly in a capitalist system, would do so rather than stay outside. Yet any sense of inclusion also requires a legal system that people feel is on their side. One way of ensuring this is to give full legal protection to poor peoples', usually de facto, property rights.

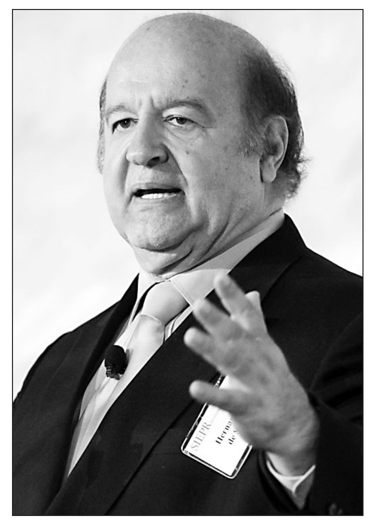
A common example is untitled slum dwellers. For the Amazon, Mr de Soto gives this example: "A foreign investor comes to Peru. He secures title to a project under Peruvian law. Moreover, because of tax treaties, this legal title carries multilateral weight. With that in hand, the investor can raise funds easily, anywhere.

"Contrast that with what indigenous people have: property titles unrecognised outside their communities. We know of a case of a mahogany tree sold for 3kg of sugar, about $3. By the time it reached California, that same tree was worth as much as $50,000."

Critics might say shaky property rights have not stopped China's booming economy. Mr de Soto admits the Amazon presents special problems. Many indigenous titling systems do not provide precise locations, contain naming errors and are inaccessible. Communal-ownership rules often differ, even between neighbouring groups, which in themselves are diffuse.

Nonetheless, Mr de Soto says that attempts to confer legitimate title must be made if there is to be a real attempt to avoid the kinds of protests that left more than 30 people dead in the Amazonian town of Bagua two years ago.

Mr Humala's government is equally sensitive to the subject.



De Soto: land title is everything

One of its first pieces of legislation was a consultation law, which gives local communities the right to be consulted about proposed investments.

"That's all every well, but who do you consult with?" asks Mr de Soto.

The implication is that this can never be clear while property rights remain insecure. It is only with secure title that indigenous groups can choose between turning their backs on the world economy, or engaging with it.

"Once title has been established, at least you have a choice," he says. "Without it you have nothing."

Choice of advisers favours growth

Continued from Page 1

Mr Humala's key electoral pledges. Mr Burneo, who began the 2011 campaign as the head of former president Alejandro Toledo's economic team, will oversee implementation of a pension scheme targeting poor over-65s, and the broadening of Juntos, the conditional cash-transfer scheme.

In the key portfolio of mining and energy, Mr Humala chose Carlos Herrera Descalzi, an engineer who briefly held the post in 2000 after the collapse of the Fujimori government. Mr Herrera has moved swiftly to broker the new mining levy and demand that Camisea, the country's flagship natural gas project, operated by a consortium led by Pluspetrol of Argentina, must prioritise domestic markets. He will also review Peru's multibillion-dollar agreement with Brazil to build up to six hydroelectric dams in the Amazon. "We respect commitments, but the previous government approached this in a very bad way. I want to see how far it has advanced," he said in an interview.

To alleviate lingering concerns that he was about to make a radical turn in economic policy, Mr Humala also persuaded well-respected banker Julio Velarde to remain as central bank governor.

Humberto Speziani, president of Confiep, Peru's employers' association, says Mr Humala managed to "dispel the doubts" with his cabinet picks.

"We're very satisfied. The president has been pragmatic, acting in the interests of the country. He's shown that Peru will have continuity in economic policy," he says.

Business approval came at the expense of discord among the more radical elements of Mr Humala's base, who mutter that the president is allowing "the enemy to steer the ship".

Aída García Naranjo, a prominent feminist activist and educator, and the new minister for women, is flying the flag for the left in the cabinet, backed up by vice-ministers such as the trade unionist Pablo Checa in the labour ministry.

Susana Baca, a renowned singer and the first female Afro-Peruvian minister, was a popular choice for the culture ministry.

Mr Humala's selections for the ministries of the interior and defence have been more controversial, prompting criticism that he fudged electoral promises to appoint civilians.

The president tapped two retired military officers, Daniel Mora and Oscar Valdez Dancuart, to head defence and the interior respectively. Home affairs is particularly sensitive in Peru, given the recent dramatic rise in coca production in remote zones controlled by remnants of the Shining Path insurgency of the 1980s and 1990s.

Mr Humala also raised eyebrows with the appointment of Adrian Villafuerte, once a close associate of Vladimiro Montesinos, the disgraced former spymaster, as a military adviser.

More than a little shy, Mr Humala favours scripted public appearances and the occasional tweet over interviews. When pressed, he tends fall back on a watch-this-space-style message. "More than words, judge me for what I do," he said this month. The world is watching.

Brazilian influence grows ever stronger

Foreign relations

'Strategic alliance' helps provide route to booming Pacific markets, writes **John Paul Rathbone**

From a distance, the huge statue of Jesus that gazes out at the Pacific on Lima's seafront appears identical to the more famous Christ the Redeemer in Rio de Janeiro that overlooks the Atlantic. It is almost the same size, and Christ's arms are outstretched in almost the same way.

The resemblance is no accident. The 36m-high Cristo del Pacífico statue was sculpted in Brazil, and its $1m cost was almost entirely met by Odebrecht, the Brazilian construction company.

More importantly, the statue, which was inaugurated on June 29 this year, is a symbol of Brazil's growing presence in South America's fastest growing big economy. It is also a reminder of why Brazil's presence in Peru is increasing so quickly: China.

"In the 20th century, the world economy was all about the Atlantic," says Miguel Veja Alvear, head of the Brazil-Peru chamber of commerce in Lima. "In the 21st century, it's all about the Pacific: more than half of all global trade is there."

The statue is one of a number of projects under way as part of Brazil's "strategic alliance" with Peru. This is designed to bring their economies close together and provide a commercial bridge for Brazil into the Pacific on the back of Peru's free-trade agreements with China, South Korea and the US.

The initiative dates back to 2005 under former Peruvian president Alejandro Toledo, when Luiz Inácio Lula da Silva was his Brazilian counterpart. It continued under Peru's next president, Alan García. But it is under their successors – Ollanta Humala in Peru and Dilma Rousseff in Brazil – that the alliance is likely to take off.

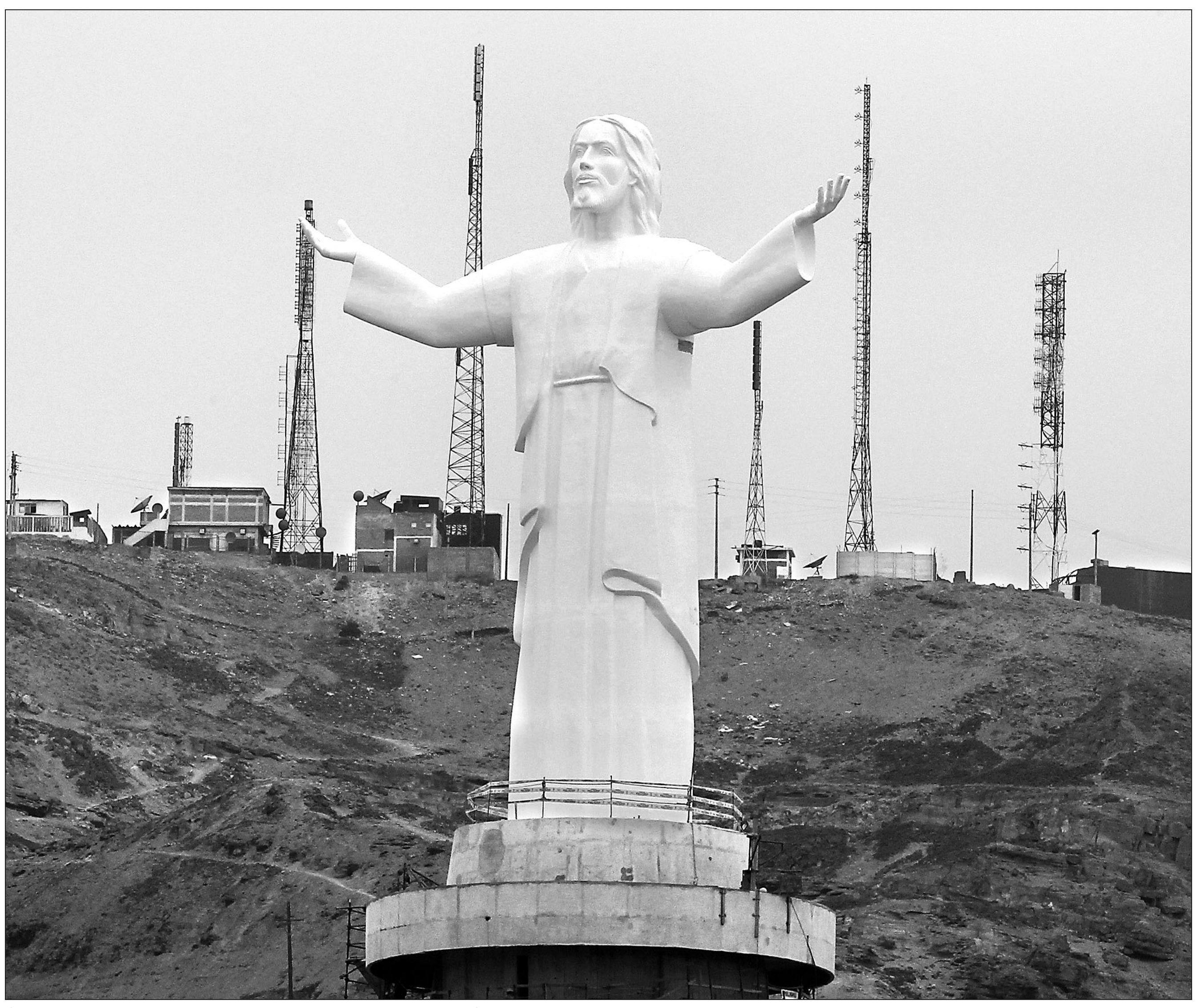
"Over the past 10 years, there have been more presidential meetings between Peru and Brazil than over the previous 180," says Mr Veja approvingly.

Three vast infrastructure projects, largely financed with subsidised funding from BNDES, Brazil's state-owned development bank, are planned that will link – by canal, road and train – Brazilian markets to Peru's Pacific ports and thence Asia. The southernmost one, the Interoceanic highway, built by Odebrecht, is almost complete.

Meanwhile, Brazil's Votorantim Metais, the mining company, has purchased zinc mines as well as Cajamarquilla, Peru's biggest refinery. Vale, another mining company, operates a phosphates concession in northern Peru. Petrobras, the state-controlled oil company, has investment plans. And Gerdau bought Peru's biggest steel plant in 2006 and says it plans to invest $120m over the next three years.

The idea behind the alliance is simple: Brazil provides technology and investment. Some $15bn of Brazilian investment is pouring in, compared with the $10bn that China is due to invest, although that is still less than total US or Spanish investment.

In return, Peru can offer labour and market access. The early results have been startling: bilateral trade has increased sevenfold in just six years to $3.4bn.



Seeing double: the gift of a Pacific almost-twin to Christ the Redeemer has raised questions about Brazil's role in Peru Reuters

Nonetheless, Brazil's growing presence worries many Peruvians. Brazil may enjoy a cuddly image in Lima, thanks to its football and carnival, and its social-democratic economic model, now apparently being copied by Mr Humala, is seductive in a country where more than a third of the population lives in poverty.

Yet many Peruvians are asking whether they really want their country to be "Brazilianised" – and not without reason: in the past 10 years, Peru's economic growth has been higher and poverty has fallen faster than in Brazil.

As one letter-writer to Peru's La República newspaper has pointed out, when it comes to the World Bank's annual Doing Business report, Peru ranked second among Latin American countries, in the number 36 spot globally, while Brazil was 127th out of 183.

Another problem is the environment. Brazilian utility companies have been exploring the possibility of building hydroelectric plants along the border. Understandably, local inhabitants wonder why their communities should be flooded to send electricity elsewhere.

"Brazil is very important to Peru," says Rafael Roncagliolo, Peru's new foreign minister, who describes his approach as "absolutely pragmatic" and as focused on "strengthening regional ties".

He adds: "Nonetheless, while there are many opportunities, there are also problems and threats. One problem is the need to remove commercial barriers and tariffs. One threat is drugs: we don't want to have the same supply relationship with Brazil as Mexico does with the US."

Peru is currently the world's largest producer of cocaine and Brazil – a rising consumer in its own right – is increasingly an important onward shipment point to Europe's fast-growing market for illegal drugs.

Whatever the concerns, it appears that the links are only going to get stronger, especially if Brazil's early courtship of Mr Humala is anything to go by.

Political image-makers from Brazil's Partido dos Trabalhadores (Workers' party) advised Mr Humala on campaigning strategy and tactics. After he won the election, the first visit Mr Humala made as president was to Brasília.

What is most extraordinary is that perhaps no country other than Brazil would have been able to get away with the same strategy. It would have been unthinkable for Venezuela or the US, for example, to have played a similar role in Peru without a huge outcry.

It speaks to the might of Brazilian "soft power" – and the country's huge gravitational pull on a continent where it accounts for half the landmass and its neighbours cannot help but spin into its orbit.

New president moderates his inner warrior

Guest Column

FELIPE ORTIZ DE ZEVALLOS

Who is Ollanta Humala? A good question – and one to which Standard & Poor's seems to have an answer.

Peru's controversial new president had only been in office for a few weeks when the credit rating agency upgraded his country's debt.

But then the upgrade came after Mr Humala had made a moderate inauguration speech, after he had appointed a "rainbow cabinet" and after his prime minister, Salomón Lerner, gave a well-received presentation of the new government's programme to Congress.

S&P's vote of approval was reflected in other ways too: Mr Humala currently enjoys a 55 per cent approval rating – high by Peruvian standards, even if that approval is not across the board. While Mr Humala scores a rating in the mid-60s from the country's poor, wealthier classes are less convinced and give him just 40 per cent or so.

Their misgivings are understandable. Mr Humala led an army revolt in 2000. He was a radical pro-Hugo Chávez presidential candidate in the 2006 election, which he narrowly lost. He then entered the 2011 presidential campaign in much the same form.

However, after his rather radical platform only looked set to win him 15 per cent of the vote, Mr Humala gradually changed his political message from à la Chávez to à la Lula – coached by Brazilian advisers.

Mr Lerner, then acting as Mr Humala's campaign manager, played a crucial role in persuading him to drop his original radical "plan" and adopt a more moderate "road map". All this helped Mr Humala to eventual victory. After he won, Mr Humala was also wise enough to insist on Mr Lerner accepting the premiership.

Where is Mr Humala from? His family is from Ayacucho, a proud but poor Andean region, where the Shining Path guerrilla movement had its roots. His father was a member of the Communist Party in the 1950s and he instilled a sense of political destiny in his sons. Indeed, Ollanta means "far-seeing warrior" in Quechua and is a name of which Mr Humala feels proud.

He is happily married to Nadine Heredia, a distant relative who, some believe, has presidential ambitions.

What does Mr Humala think? That is unclear. At first, he called for a new constitution that would increase the state's role in the economy, compared with the current 1993 version. Although Mr Humala swore himself in as president on "the democratic spirit of the 1979 constitution", he has since dropped plans to change the 1993 constitution. This, however, may be simple pragmatism, given that he lacks sufficient votes in Congress to do so.

Elsewhere, he has shown a similarly pragmatic streak. A windfall tax on mining profits followed negotiations with the industry. The result only partially lowered the competitiveness of the mining sector while raising more than $1bn to be spent on social inclusion projects in some of the poorest regions.

To reassure financial markets, Mr Humala also asked Julio Velarde, the orthodox Central Bank governor, to stay for another term. And he appointed Luis Miguel Castilla as finance minister. Mr Castilla is respected, having worked

Felipe Ortiz de Zevallos says that, so far, Humala has been a unifying, rather than a divisive, force

previously at the Andean Development Corporation, a multilateral lender, and as vice-minister of finance in the previous administration.

True, some other appointments – in the military and the foreign service – have been controversial. There have also been some hiccups and reversals in government policy towards coca growers and fighting drug traffic. But these are perhaps the teething problems of any new government. There have been no major mistakes, as yet.

Mr Humala has a varied political base – much of it comprises centre-left moderates, although leftwing radicals form an important but smaller proportion. The latter are likely to want to see big changes to Peru's economic model; the former may be content with minor adjustments.

The model has been successful, by and large. Over the past decade, the economy has grown at 6 per cent a year and some 3.4m Peruvians have been lifted out of poverty. Still, the state remains remarkably inefficient. Partly as a consequence, this has generated a widespread sense that corruption has flourished. Social inequality remains high.

For many analysts, Peru is a country with great potential. One reason is its extraordinary diversity. Such diversity, however, also makes it difficult to govern. Political representation is scarce. Indeed, Peru's main political party, the APRA, now only accounts for four seats of the 130 in Congress.

Three months after the election, Mr Humala's presidency presents more questions than answers.

Can a former military officer, imbued with a messianic calling but with limited administrative experience, walk Peru's political tightrope?

What will his instincts be when he confronts his first crisis? Hold to the centre – or hew to his original and more radical constituency?

More importantly, will he learn from what he has been achieving by continuing to broaden his political vision?

This is the main unknown: whether Ollanta Humala will rise to the Quechua meaning of his name.

For the moment, after a volatile first half of the year, Peru is enjoying a mood of cautious optimism.

Felipe Ortiz de Zevallos is chairman of the Apoyo consultancy and Peru's former ambassador to the US.

Contributors

John Paul Rathbone
Latin America Editor

Naomi Mapstone
Andean Correspondent

Jack Farchy
Commodities Correspondent

Martin Brice
Commissioning Editor

Philip Parrish
Liz Durno
Jearelle Wolhuter
Sub-Editors

Steven Bird
Designer

Andy Mears
Picture Editor

Manhattan tastes the best of Lima

Profile
Food and drink

Gastón Acurio faces his toughest test, writes **Naomi Mapstone**

Chef Gastón Acurio wants to bring Peruvian gastronomy to the world Reuters

When Gastón Acurio opened the doors of La Mar, his Madison Square Park restaurant, in New York this week, the Peruvian chef moved a step closer to achieving a global goal.

Mr Acurio now has 33 restaurants spread across Latin America, Europe and the US, making him a veritable mini "multilatina".

While the cordon bleu-trained chef's interests represent a fraction of Latin American multinationals such as Alicorp of Peru, América Móvil of Mexico and Embraer of Brazil, his expansion has been no less aggressive.

"Our mission is to bring fine Peruvian cuisine to the world, and New York is our biggest battle," Mr Acurio says. "There's a valuable market for Japanese cuisine, French, Chinese – we want that for Peru."

Mr Acurio has used his home city of Lima as a testing ground for new concepts, launching everything from Peruvian fast-food outlets serving yellow potato chips to Chinese-Peruvian fusion.

The food revolution he has sparked at home has turned Lima into Latin America's leading gastronomic destination and has created a thriving industry of cooking schools.

Manhattan's La Mar has some big shoes to fill, moving into the space formerly occupied by Danny Meyer's Tabla.

"He has the best location in New York," says Mr Acurio. "All of our colleagues there said, 'How did you get this place? There were a hundred people interested, why did they choose you?' I said, 'The world is changing – the landlords were looking for something new'."

Peruvians will recognise Manhattan's upscale *cevicheria* as a blend of Mr Acurio's popular Lima eatery of the same name and his five-star Astrid y Gastón, which has been known to serve confit of guinea pig.

Mr Acurio's right-hand man, Victoriano Lopez, is the executive chef, and will focus on trademark *ceviches* (seafood dishes) and reinterpretations of classic Limeño dishes, such as sliced potatoes with yellow chilli sauce.

Retail Chileans cash in on consumer boom

Chilean retailers used to say Peru reminded them of Chile in the 1990s. Lately, Peru and its population of 29m has been looking more like Chile in the subsequent decade.

Surging domestic demand, the rapid expansion of regional markets and new social policies to alleviate poverty are expected to propel Peru's retail sales to $48.8bn by 2014, up 22.1 per cent from this year, according to Business Monitor International.

"Private consumption will be the main driver of Peruvian growth in 2011 and 2012, supported by increased access to consumer credit and a rise in social security payments," BMI says in an August report.

Chilean department stores, supermarket chains and mall operators already have footholds in Lima, where a third of Peru's population lives.

Ripley and Saga Falabella dominate the department store sphere, which includes a thriving credit card financing market. They face increased competition from fellow Chilean group Cencosud, which announced last month it would invest $70m in 10 department stores by 2014. The company already operates Wong, the upmarket Peruvian supermarket chain, after a 2007 takeover.

Meanwhile, Saga Falabella is investing $100m in its department stores, its Tottus supermarkets and Sodimac home improvement centres. Ripley is pouring $56m into eight new department stores in the next two years.

Chile's SMU Group joined the rush in January, snapping up supermarket operator Alvia, which has 11 stores in Peru.

Both retailers and mall operators, including Parque Arauco and Mall Plaza, are looking beyond Lima to booming regional centres such as Ica, Piura, Arequipa and Trujillo.

Forum, a Chilean car loan company, has sized up the buying power of Peru's growing middle class and announced a $48m investment in the market.

New-car sales tripled between 2006 and 2010, and Peru's automotive association is forecasting 170,000 sales this year after the signing of free-trade agreements with Japan, China and the US significantly lowered the tax on imports.

The growing number of Peruvians with the means to travel has also cemented the commitment of LAN, the Chilean flagship carrier, to its Latin American hub. Over the next five years, LAN will invest $700m in Peru, including the construction of a corporate headquarters.

Naomi Mapstone

Cross-border stocks start trading slowly

Profile
Exchanges

Mila launches amid turmoil, writes **Naomi Mapstone**

It has been a slow start for the Mercado Integrado Latino Americano (Mila), the cross-trading platform that links the exchanges of Peru, Chile and Colombia.

The tie-up created Latin America's second biggest market after Brazil, with a market capitalisation of $614bn and forecast daily trading volumes of $300m.

But Mila has racked up only $2m in cross-border trades since its May launch. Francis Stenning, director general of Lima's exchange, says launching amid global market turmoil and one of Peru's most divisive presidential elections did not help.

"Mila is the beginning of a very interesting process of integrating the region," Mr Stenning says.

"We are still in the first stages, perfecting tune-ups [of regulation and tax]. We will look at going into other markets, such as fixed income or derivatives. We will [also] be looking at adding new members."

The most likely new partners are Brazil and Mexico, especially given the latter's participation in the proposed "Arc of the Pacific" economic bloc with Colombia, Chile and Peru.

All four have trade deals signed or in train with the US and Canada, and all are looking to Asia for growth. Of the four, only Colombia is yet to join the Asia-Pacific Economic Co-operation forum.

Mr Stenning says Mila will also build products around Standard & Poor's new Mila 40 index of the biggest, most liquid stocks on the three exchanges.

Several mining and energy initial public offerings are in the works, aside from the government's touted offering of shares in state-owned oil company Petroperu, he adds.

"We've had an IPO every other year or so in the past decade," he says. "A very long election process caused delays, so we expect to see some come to market in the next couple of months."

Daniel Gamba, the Peruvian-born head of Latin America and Iberia for BlackRock, says a reluctance to go public is common among the region's oligopolistic markets, but he finds it "hard to see Peru in a bear market for too long."

Ethanol Production takes off

Peru's fledgling sugar-based ethanol industry is set to take off this year, with the entry of new players Maple Energy and Gloria, writes **Naomi Mapstone**.

"Peru is arguably the best place in the world to produce sugar cane in terms of yields. The yields are phenomenal," says Rex Canon, chief executive of Aim- and Lima-listed Maple Energy.

Constant sun and negligible rainfall give cane growers on the north coast a year-round season, leading to yields of about 150 tonnes of cane per hectare, compared with about 80 tonnes in Brazil.

Until the 1960s, when a leftist military regime nationalised the sector, Peru's arid northern coast was home to one of the world's most efficient sugar industries.

Now a new law mandating a 7.8 per cent blend of ethanol in gasoline and the signing of a number of free-trade deals have given sugar growers a boost, creating domestic and export markets for ethanol producers.

"When Brazil goes to the US, there's a substantial import tariff; when we go into the US, there will be no import duties. The same is true of Europe – we can go into Rotterdam duty-free," says Mr Canon.

Given that Peru's entire domestic market will ultimately require about 25m gallons a year and Maple's plant will have a capacity of 35m gallons a year, the company is principally focused on exports, starting with Europe.

Maple's $254m project near the deepwater Pacific port of Paita is on track to go into production in the fourth quarter. The company is planting 7,800ha in its first phase, and aims to increase production to 10,000ha.

"Our goal is to be the lowest-cost producer of ethanol," says Mr Canon.

The ethanol facility has $148.5m in project-finance debt from lenders such as the Andean Development Corporation, the Inter-American Development Bank, Interbank of Peru and FMO, the Dutch development bank.

Sugar cane grows very well in Peru's climate

Miners exploit rich seams in spite of tax and local protests

Commodities

Lobbying efforts set to put sector's expansion back on track, writes **Jack Farchy**

José Marún's workplace is remote by almost any standards. The manager of Xstrata's South American copper operations spends his time shuttling between an office in Lima and the high Andes mountains, where, spurred on by record prices, the London-listed company is rushing to build new mines.

Two of those mines, Tintaya and Antapaccay, are reached by a bumpy plane ride to the ramshackle town of Yauri. Other than mining, the area's main industry is cheesemaking.

A third Xstrata project, Las Bambas, "is the most remote ore body in the country", says Mr Marún. "When we came [here], there was no electricity. Until 2005 there was no telephone communication." Workers commute by helicopter.

In recent months, Mr Marún and other mining executives have had another frontier to navigate: the corridors of power at the presidential palace in Lima.

Since the election in June of Ollanta Humala, who had campaigned on a promise of a 40 per cent windfall tax on the mining sector, the most important project for the industry has been damage limitation. The possibility of sharply higher taxes in Peru threatened to derail $42bn of planned mining investments in the country, which is among the world's largest suppliers of metals (see box).

Peru is central to the growth plans of companies such as Xstrata. Together, Antapaccay and Las Bambas will add approximately 500,000 tonnes to its annual copper production by the end of 2014, at a projected cost of $5.7bn, giving the company the largest growth pipeline in this metal in the industry.

In the fortnight after Mr Humala became president, Xstrata saw its share price fall 8 per cent. The shares of companies with higher Peruvian exposure fell even further and the Lima stock exchange was forced to close after some local miners fell 15 per cent in a day.

But the country is of broader significance to the global economy than merely as a destination for foreign investment: with its large, untapped reserves, Peru could determine the balance of the market for metals such as copper, which are crucial to the growth of emerging economies. According to Macquarie, the Australian bank, Peru will be the source of a third of the planned new copper supply over the next five years.

Since the election, however, the miners' lobbying efforts appear to have paid off. At the end of August, Salomón Lerner, the prime minister, announced that a decision had been reached on a new tax structure that would raise an additional 3bn soles ($1.1bn) from the mining sector each year. Miners expressed relief that the plan, whose details were still being finalised as it passed through Congress, would calculate a royalty based on their profits rather than revenues, and so shield them in periods of low profitability.

The uncertainty over taxes has nonetheless delayed much-needed projects in the country's mining sector. By July, Southern Copper had invested just $160m of the $800m capital expenditure it had planned for the year in Peru, according to Oscar Gonzalez Rocha, the chief executive. Peru's copper production was 3.1 per cent lower in the first half of 2011 than a year earlier.

Mr Marún of Xstrata says: "The moment you have uncertainties, you start to have rocks on the road and projects get delayed."

Despite the often remote locations of mines, Peru is one of the world's largest producers of metals Bloomberg

But tax is not the only challenge for the industry in Peru. Protests from communities, whose villages often need to be relocated due to mining sites, have grown more vocal. In April, the outgoing government of Alan García cancelled Southern Copper's Tia Maria project and in June it revoked the licence of Bear Creek's Santa Ana project.

At the site of Xstrata's Antapaccay mine, trucks and cranes move among homes dotted along the valley floor. The company is building new homes for 370 families whose church, school and community hall will be dismantled to make way for the mine.

Tintaya's previous owner, BHP Billiton, sold it to Xstrata in 2006 after it was invaded by an armed mob. Now Luis Rivera, general manager of the two mines, says he spends 70 per cent of his time dealing with the communities, rather than day-to-day mining operations.

"I have had to learn how many litres of milk it takes to produce a kilo of cheese, and how long it takes to mature a gourmet cheese," he chuckles.

Others are less cheerful about their engagement with communities. Mr Gonzalez Rocha of Southern Copper says the company is exploring in Argentina, Ecuador and Chile: "We are trying to do more diversification with other countries, in order not to have everything in one country that has problems like Peru."

Most, however, are cautiously optimistic on the prospects for the mining industry under Mr Humala – investors included. Since the election, the mining-heavy Lima general index has rallied 7 per cent, bucking a crash in mining shares in almost every other world market.

In the same week as Mr Lerner announced the new mining tax, the government passed a long-awaited law on community engagement. Crucially for the miners, however, it did not give communities a veto over new projects.

Voicing a sentiment common in mining circles all over Peru, Eduardo Hochschild, executive chairman of the London-listed precious metals miner that shares his name, says: "We're not cheering that it has passed – but it's not nearly as bad as it could have been."

Money in metals
Peru rides the boom

● **Copper** The red metal, used in the wiring of almost every building or household appliance, is Peru's most important commodity. The country is the world's second-largest producer, although it looks set to lose that title to China, as output was down 3.1 per cent in the first half. Investors and mining executives are bullish about the longer-term prospects for copper. Booming demand led by emerging economies helped push the metal to a record above $10,000 a tonne earlier this year.

● **Gold and silver** Peru is the world's sixth-largest gold producer and second-largest silver producer. Both metals have been on a tear in the past year as investors have lost faith in paper currencies. Gold hit a record above $1,900 a troy ounce in September. Analysts believe gold and silver prices will stay high as long as the eurozone sovereign-debt issues remain and monetary policy in the US remains loose.

● **Zinc** Peru produces 12 per cent of the world's zinc, behind only China. There are few large zinc projects planned in the coming years, leading some to believe the metal could be poised to rally sharply.

● **Lead** Peru is the world's fourth-largest lead producer, with 6 per cent of the market. Lead prices are below their 2008 record, currently trading at around $2,400 a tonne. The outlook for the metal is clouded by an environmental clampdown on lead-acid battery makers in China, which accounts for 45 per cent of lead demand.

Exploration catches eye of investors

Juniors and small caps

Searches are being funded increasingly from Lima, with earnings so far looking healthy, writes **Jack Farchy**

When Alex Black was trying to raise money to develop a goldmine in central Peru, no investor in the traditional markets of Toronto or London was interested.

It was 2009 and most were still chastened by the experience of the financial crisis, so Mr Black did something that, at the time, was rather unusual for a non-Peruvian: he raised all the capital for his exploration company, Rio Alto, in Lima.

"The reason we're listed here in Lima is because nobody in Canada believed our story," he says.

For juniors (miners focused on exploration) and small-cap mining companies in Peru, that is an increasingly common story.

Companies such as Minera IRL (also listed on London's Alternative Investment Market), Alturas, Rio Cristal, Candente Copper and Panoro are listed in Lima, and in many cases, Peruvian shareholders represent a growing proportion of their investor base.

Exploration is booming. The country's rich geology has been exploited for centuries, but, because of the volatile political situation of recent decades, it has not been thoroughly surveyed until now. According to Metals Economics Group, a consultancy, Peru was the third-largest destination for exploration investment in 2009.

The growth in investment has gone hand-in-hand with a rise in the number of companies raising money in the domestic market. Alberto Arispe, chief executive of Kallpa Securities, a Lima-based brokerage, estimates there are some 90 Canadian juniors with Peruvian assets, of which 15 are listed in Lima. Indeed, some argue there are more funds available to mining companies in Lima than in more traditional hubs.

Mark Cruise, chief executive of Trevali, a Canadian miner that has just raised $10m from South American investors, says it is "absolutely" easier to raise money in Peru than in Europe or North America – most of the world's mining markets are in the throes of a punishing bear market.

It is not only junior companies that are seeing the benefits. Larger Lima-listed companies such as Buenaventura, Volcan and Milpo enjoy forward price/earnings multiples of 9-12 times – well above the 6-8 times of the large London-listed diversified groups.

That is largely thanks to the booming economy that has created much wealth. Citizens in formal work must invest in pension funds, whose assets have been growing at an annual rate of 19 per cent, according to Standard Chartered, the investment bank. The funds must invest half their assets in the domestic market, so valuations have been lifted.

"The market here is small," says Mr Arispe of Kallpa. "Demand is much higher than supply; there are not so many companies to invest in."

Pension funds cannot invest in junior companies, but Kallpa is considering launching a fund to allow them an indirect investment into the sector.

The capital available has caught the interest of foreign miners. "If one wanted to go to the effort, it would be very easy to go and raise $100m," says an executive at an international mining company with assets in Peru. "It's a market that throws money at you."

Pensions Hope for reforms without politics

Beatriz Merino likes a challenge. Having completed five turbulent years as the nation's human rights defender, the new head of the private-pension fund managers' association, who was also the country's first female prime minister, is turning her sights to pension reform.

"It is unacceptable that seven out of 10 Peruvians have no kind of pension," she says. "Now is the time for reform. I ask two things: that the debate be technical, not political, and that they name a commission of independent experts who can propose a reform to the state."

The country has Latin America's highest rate of informal employment and 35 per cent of the population live below the poverty line, so keeping politics out of the equation is likely to be a challenge.

Peru's four private pension funds (AFPs) have already mobilised once this year to fend off a radical proposal by Ollanta Humala, when he was still a presidential candidate. Even before his election on June 5, he retreated from the plan, which would have created a mandatory national public pension scheme and decimated the private system. Instead, he is rolling out a scheme that targets poor Peruvians over 65.

But reform of the pension system remains a key test of the president'smission to bring social inclusion to one of the world's fastest-growing economies. "One of the main objectives of whatever reform we put together is to deepen coverage," says Luis Miguel Castilla, the finance minister. "We've had the system for close to two decades, and some overhauling is needed."

Ms Merino would like to see Peru follow the "magnificent" example of Chile, which revamped its pensions system in 2008.

Chile encouraged gradual entry to its private system, restructured fees and incentivised women to join up by paying them a $600-a-child bonus.

Peru's funds – AFP Horizonte, AFP Integra, AFP Profuturo and Prima AFP – have been criticised for levying high fees, creating another barrier to entry for the country's growing middle class.

"You have to be careful that this reform will not foster tax evasion; that in order not to pay the pension fund, you might end up making informal who is formal today," says Ms Merino, who has been on fact-finding missions to Chile and Colombia.

Despite failing to attract more than 30 per cent of formal workers, the funds' financial success and voracious appetite for high-quality investments has exposed the lack of domestic investment opportunities.

Together the funds manage $30bn in assets – 23 per cent of gross domestic product. This is expected to increase to $50bn in five years, putting pressure on the government to play its part in expanding the country's investment opportunities.

Beatriz Merino: seven out of 10 Peruvians have no kind of pension

The funds already account for almost a third of shares traded on Lima's mining-heavy stock exchange.

"We still have very shallow capital markets and there's a long way to go to deepen markets and competition. There's also a lack of instruments," Mr Castilla says.

In the dying days of the previous administration, Ismael Benavides, former finance minister (and Mr Castilla's former boss) pushed legislation through to increase the limit on the funds' overseas investments from 30 per cent to 50 per cent.

Ms Merino says the central bank will approve the percentage of funds to flow abroad, but in the meantime, "we need the government to provide a greater offer of investments and the necessary guarantees to invest".

Mr Castilla and the president have already announced they will seek significant private investment in big-ticket infrastructure investments in roads, airports, water and energy.

Jose Antonio Blanco, country officer of Citibank for Peru, welcomes the new administration's emphasis on public-private partnerships in the infrastructure sector. "For the past 30 years, Peru has been financing its short-term needs by postponing investments in infrastructure. The country is ready to invest," he says.

Ms Merino says she is confident Mr Humala will not be tempted to go back on his word and nationalise the private-pension sector, as Argentina did in 2008.

Naomi Mapstone