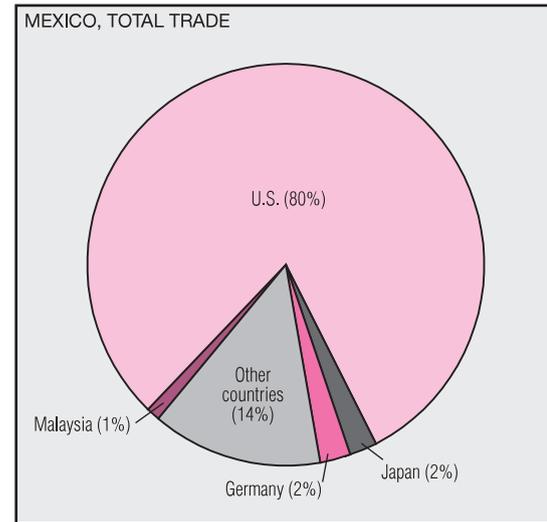
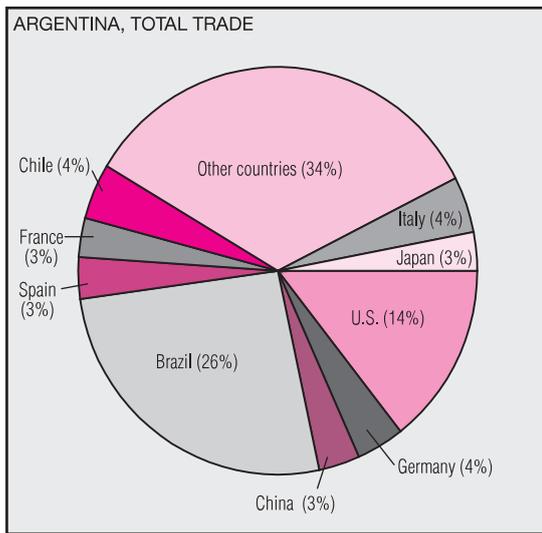
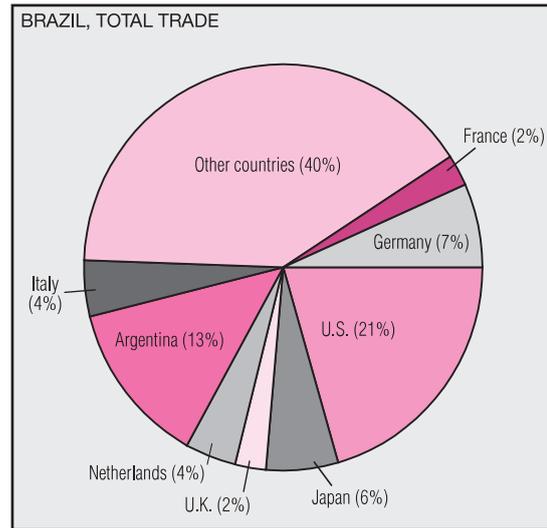
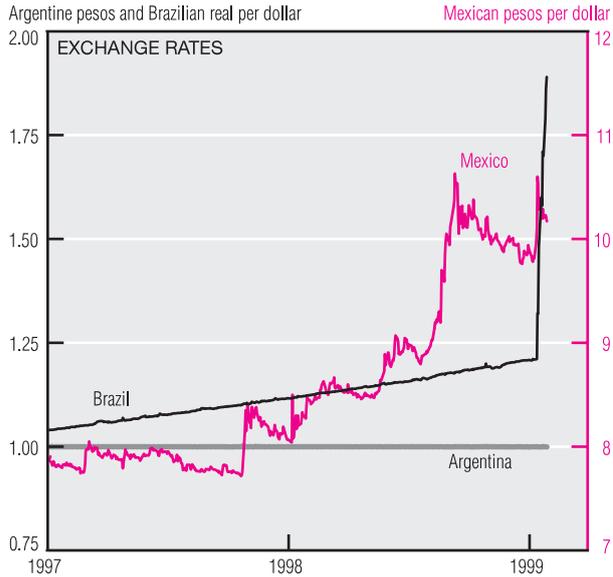


Brazil



SOURCES: Federal Reserve Bank of New York; International Monetary Fund, *Direction of Trade Statistics*; and Morgan Stanley Capital International.

On January 13, Brazil devalued its currency, the *real*, creating further turmoil in world financial markets. By January 22, the real had fallen 29% despite large expenditures of dollar reserves by Brazil's central bank. It was unclear whether planned fiscal reforms would be sufficient to slow the currency's fall, and reliance on further interest rate increases might not be credible given their probable negative effects on the Brazilian economy.

The decline in the value of the real and the weakening of Brazil's economy are concerns for its trading partners. In particular, Argentina main-

tains the value of its currency against the U.S. dollar. The real's decline against the dollar increases the cost to Brazil of Argentinian exports. Although the U.S. accounts for the largest share of Brazil's trade (21%), Brazil is Argentina's largest partner (26%). Argentina already has begun to consider cutting some import taxes to lessen the impact on industries that depend on Brazilian trade.

Other Latin American economies could be influenced as well. Commerce between Brazil and Argentina accounts for most of the trade within Mercosur, the South American trading bloc that also includes Paraguay

and Uruguay. The continued fragility of the Mexican banking system and the peso's weakness in 1998 suggest that the decline of the real could affect Mexico significantly. Mexico has little trade with either Brazil or Argentina, but Brazil's problems could hamper the economic growth of other countries which in turn would reduce their trade with Mexico. Or a pure contagion effect could occur whereby investors pull back from an entire group of countries. To date, however, there is little evidence of significant consequences for Mexico.