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MARKET REPORT

The Real Estate and Hotel Industries in South America and the US Dollar at Risk of Losing its Position as Reference Currency

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How could this affect countries like Argentina and Uruguay, where the American dollar has historically been the only reference currency? Is it time to think of other options like those used in Brazil or Chile?

New York City Mayor Michael Bloomberg has recently warned that if the US government fails to raise the debt ceiling the world will no longer trust the country and the dollar could lose its status as the world's reserve currency. Bloomberg hit the Democrats and Republicans alike for pushing the US government to the brink of defaulting, jeopardizing the full faith in the country, and the dollar's credibility as a world's reserve currency.

However, regardless of whether the United States defaults on its debt or not, the fact is that in some South American markets, like Argentina and Uruguay, the continuous devaluation of the US dollar along with a rise in prices (albeit in different degrees in each of them) is increasingly affecting both the real estate and hotel industry players.

The construction cost and therefore the reinstatement cost of construction materials are growing in dollar terms on a monthly basis, while market prices, traditionally set in US dollars, start to have less and less reinstatement value.

As stated by the sector's major players, Argentina's demand has reached a plateau that would not have affected price levels, which tend to remain the same as last year.

But the dollars cashed are becoming increasingly insufficient to replace the same square meters of similar quality and location.

In such a scenario, a real estate market of new units with a fixed-rate financing in dollars until construction is complete would seem hard to be sustained for a long period of time.

It would not sound reasonable for developers to bear the brunt not only of risking their margins but also of not collecting enough to meet their costs.

The same holds true for someone selling an already existing property either to replace it or make some other investment. How can he/she be sure that what seemed to be a fair and also good valuation, in US dollars as usual, would be enough to keep his/her property valuation in dollars?

In a context where the dollar does not seem to find a floor, it would be sensible to expect some changes in the market.

Would it be then time to start making transactions in local currency, as occurs in other countries in the region like Brazil or Chile, for instance, or implement some kind of updating system like the Chilean unidades de fomento - UF (inflation indexed units of account) in use for several years now?

During the Mundo Inmobiliario (Real Estate) Congress held in Montevideo a couple of weeks ago, a number of renowned Uruguayan real estate agents said they were working in this direction to find the best solution that will need to have the government's approval and should not damage the increasingly growing demand.

However, using local currency as the only different parameter poses a similar risk in the event of very high inflation, since no one can guarantee that our property valuation in dollars will be kept with a currency that can buy less and less property with the same amount of money.

With regard to the hotel business, the situation is fairly similar to that of the traditional real estate business.

The rise in costs has hit very hard and requires careful handling and a great deal of ingenuity to avoid a negative bottom line. As stated by some industry players, unfortunately this would seem to be happening in some properties with a particularly complex administration and, in Argentina's case, in those properties affected by Puyehue Volcano's ash.

In the hotel business, rates are hard to change overnight, and the industry usually operates based on annual agreements, like corporate agreements or those with travel agents. Rates, as usual, are set in US dollars.

However, while it is difficult to change rates as already said, the rise in costs has become a variable that severely affects the business, in some cases with increases that can hardly be absorbed by a relative change in revenue.

This scenario of decreasing rates in constant currency and rising costs both in Argentine pesos and US dollars shows no sign of changing in the short run.

Therefore, considering that businessmen are unable to modify the dollar parity or to control the above rise in prices, should hotel rates not start to be set in local currencies, as has long been the case of Brazil, for instance?

The debate has just begun, but it seemingly needs to be solved faster than expected. It is unreasonable to think that developers, investors, or businessmen, both in the traditional real estate and hotel sectors, should accept working without getting anything in return for their effort.

There is a promising future ahead for both industries almost throughout the region; however, adequate solutions need to be found to problems that are currently complicating such operations.
Solutions do not seem simple in a world that is not yet ready to understand that the dollar might no longer be the reference currency. But the flexibility and ability to adapt to change, which the major South American countries have developed as a result of their history, will no doubt provide a way out of the special situation encountered by the regional markets.