Strategic partnerships foster growth in LatAm

Despite the severe global economic downturn, there are rays of hope for certain Latin American countries where economic policies have been particularly prudent. These factors, coupled with support from official agencies, provide the basis for a more rapid recovery than other regions argues Valentino Gallo, Managing Director and Americas Head, Citi, Export and Agency Finance.

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The credit crunch and the dramatic fall in commodity prices driven by the recession in the Western world and the sharp slowdown in China, are taking a toll on Latin American economies. Capital flows to the region waned in the last quarter of 2008, this time not so much as a result of a deterioration of Latin American risk, but more for the liquidity issues of the international lenders and a 'flight to quality' due to the aversion for risk deriving from the overall darkening perceptions of the global economy.

However, Latin America is much better prepared than in the past to weather the storm that is currently affecting the international capital markets due to a number of factors. Firstly, several countries have accumulated significant foreign exchange reserves, amassed during the years of record-high commodity prices. In addition, governments and the private sector shifted a significant portion of their debt funding from the international markets to the burgeoning local markets, reducing the dependence on foreign capital. Finally, the disciplined fiscal policies and austerity measures consistently implemented for several years by fiscally conservative administrations are giving countries like Brazil, Chile and Peru the possibility to employ counter-cyclical policies to help economic recovery.

The macro-economic scenario in the region is less benign for the countries that are more dependent on commodity prices or other external factors. In Argentina, the business environment continues to deteriorate as government intervention increases, as exemplified by the nationalization of its pension funds, and the stress is compounded by falling international prices for agricultural commodities and a severe drought that this year may affect export volumes. Ecuador and Venezuela have to cope with sliding oil-export revenues, while Mexico's greater economic integration with North America has made it seemingly more susceptible to the effects of the US recession. Finally, the smaller economies of Central America are suffering from the drop of remittance flows, and with more shallow local capital markets, have remained more dependent on offshore liquidity.

On a micro-level, debt refinancing will be one of the most critical corporate finance challenges in the region in 2009. With significant dislocations in the international capital markets still persisting, the most urgent issue faced by several large Brazilian and Mexican companies is the refinancing of the debt they raised in the past few years to support their capex plans and domestic and foreign acquisitions.

There is about US$50 billion of international debt due by Latin American borrowers in 2009, and its refinancing is made difficult by the general deterioration of their risk rating and the liquidity constraints of their international lenders. Investors are showing preference for safety over yield, and it is assumed that this will eventually lead to many companies cutting back significantly on cash spending on capex to build cash reserves in order to avoid financial distress.

The lower prices of commodities are, of course, hurting the commodity companies as well, which are also the largest capex investors in the region, with a multiplier effect on local and foreign suppliers. In the SME segment, many enterprises all across the region – from Mexico to Brazil and Central America – are facing severe financial troubles as supply chain financing undergoes further stress and larger businesses in the region or in the US are cutting back on orders.

With banks still overextended and in need to slim balance sheets as well as further consolidation in the industry, it is clear that the official agencies are going to play a major role as 'Lender of Last Resort' by filling the gap left by the bank and capital markets by providing financing for Latin American corporates and sovereigns in 2009. Multilateral Lending Agencies (MLAs) and Export Credit Agencies (ECAs) have announced multiple initiatives to ease the stress in the international trade financing markets, including Latin America.

As an example, in response to the global financial crisis and the growing financial imbalances in the region, Inter-American Development Bank (IADB) announced at the end of last year the establishment of a fast-track liquidity facility of US$6 billion for the sovereigns of Latin America and the Caribbean. In a similar

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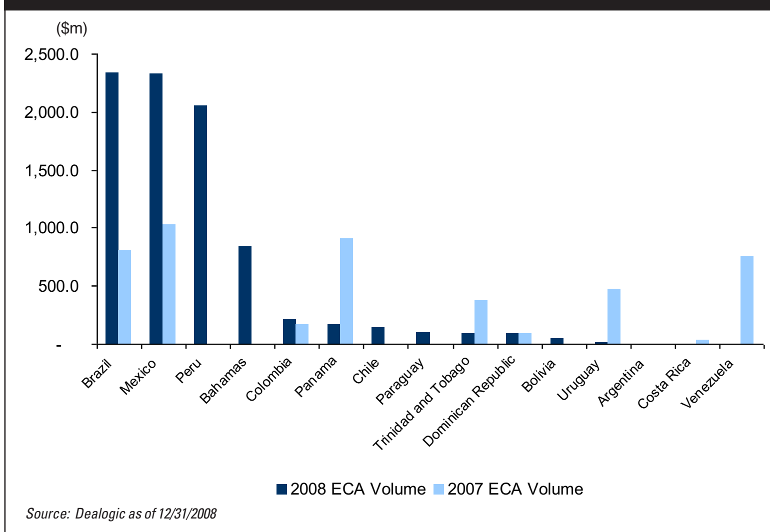


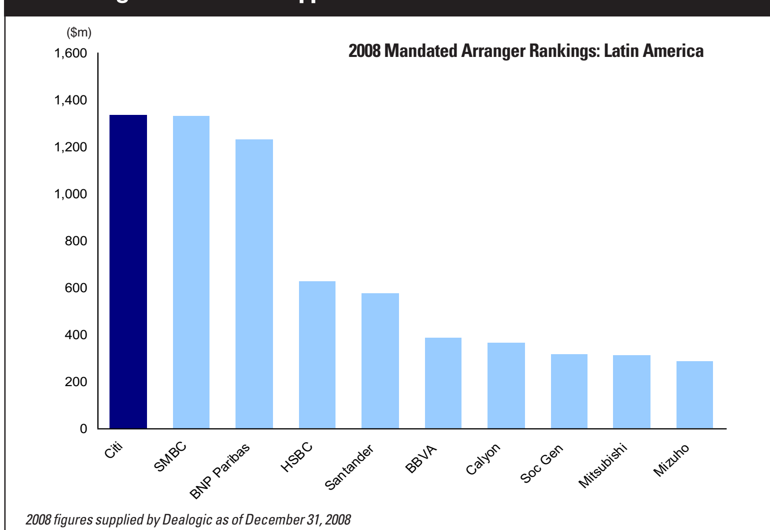
Source: Dealogic as of 12/31/2008

move, Corporación Andina de Fomento (CAF) has also made available a credit line of US$1.5 billion for its shareholder countries.

On the trade financing front, both the International Finance Corporation (IFC) and IADB have announced the increase of their short-term trade facilitation programs for the region. Among the ECAs, the strongest response is coming from the agencies of the export-led economies – particularly from Asia and Europe, where the governments are taking exceptional measures to help national exporters save employment at home and retain market share in strategically important foreign markets.

ECAs are positioned to be a critical source of funding for the major corporates of the region with large imports of equipment and technologies from the US, Europe and Asia. Now more than ever, ECAs will play an important role in the financing of infrastructure projects, where they will share the burden with MLAs and other untied official lenders.

ECAs are also expected to provide support for short-term trade financing. The Latin American banks have generally strengthened their balance sheets and liquidity positions over the years, but the credit crunch has led to a contraction of dollar liquidity, as flows deriving from remittances, exports, foreign debt and correspondent banking lines have all significantly contracted at the same time, limiting the availability of dollar funding for local enterprises, in particular in the smaller countries and in the SME segment. Banks and bank-industry representatives are currently debating with official agencies about the introduction of new instruments through which the official agencies could facilitate the flow of new liquidity in the trade finance markets worldwide, including Latin America. These prospective initiatives include funded and unfunded risk-participation arrangements in the primary and secondary markets, as well as enhanced delegation of authority on export credit insurance to accelerate approval processes and access to funds.



2008 figures supplied by Dealogic as of December 31, 2008

Another important driver for the business will be the financing of infrastructure and energy projects – especially in the smaller economies. We anticipate that projects in strategic segments such as energy, infrastructure, oil and gas, and mining will compete to access scarce funds. Project sponsors and governments will have to rely heavily on the funding coming from MLAs, development agencies and ECAs, and local markets. An example of this is given by the US$2.3 billion financial backing of the project for the expansion of the Panama Canal, which was finalized in December 2008. The project had strong economic rationale and unique visibility appeal, but the need for very long-term financing and the volatile market conditions made a bank-loan solution unattainable, which opened the way for full-agency financing, with funds provided by CAF, EIB[1], IADB, IFC and JBIC[2]. The commercial banks will support projects selectively, but the market is indicating preference for shorter tenor structures. Leverage and margins have also been impacted and should remain at more conservative levels. Certainly there will be a continued need for close collaboration among banks and agencies to successfully execute project-finance deals.

The regional league tables for ECA-financing show a steep increase from 2007 to 2008. The increases have been particularly pronounced in Mexico and Brazil and, from an industry perspective, in the oil and gas and telecom sectors. We are expecting this trajectory to continue in 2009. Even though capital expenditures in the region and the associated financing needs are expected to contract, it is anticipated that ECA-financing will make up a much larger portion of the funding accessed by issuers in the region. While bank lending will continue to be constrained and international and local capital markets will continue to stay relatively illiquid, ECA-financing will, in part, substitute the traditional bond and bank loan markets as the source of financing for capital expenditures by top and mid-tier corporate names in the region, in particular in Brazil and Mexico. ■

NOTES:
1 European Investment Bank
2 Japan Bank for International Cooperation

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