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FEATURED Q&A

What Is Driving Appetite for Latin American Bonds?

Bond sales in Latin America reached a two-decade high last year. Among the reasons were President Michel Temer's reforms, which helped fuel demand for bonds in Brazil. However, the pace of bond sales in the region may be fading. // File Photo: Brazilian Government.

Q Companies and governments in Latin America and the Caribbean announced sales of $37 billion in bonds in January after tapping markets for a two-decade high of $240 billion last year, Bloomberg News reported. Some analysts expect the fast pace of sales to ebb later this year, however, as volatility returns to global markets. What is the outlook for Latin American bond sales in the coming months, and is a fundamental shift likely? Has the high level of recent issuance been healthy for the region on balance? How has Latin America compared to other parts of the world in the bond market?

A Joy Gallup, partner in the Latin America and Corporate practices of Paul Hastings: "Many Latin American bond issuers, both corporate and sovereign, planned ahead in 2017 and early 2018 to meet their long-term financing needs in advance of predicted market uncertainty in 2018. Presidential elections will be held in 2018 in Colombia (May 27), Mexico (July 1), and Brazil (Oct. 7). In each of these countries, the political developments related to the presidential candidates are very different, but the impact of these elections is expected to be significant. Changes in regime, or prolonged uncertainty if no clear winner emerges, could result in exacerbated volatility in these major Latin American markets. In addition, uncertainty surrounding United States trade policy, including the renegotiation of the North American Free Trade Agreement, creates instability in a variety of industries and affects the ability of companies to make long-term plans. For these reasons, market observers expect a slowdown in the pace of

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TODAY'S NEWS

POLITICAL

At Least 21 Killed in Brazil Prison Break Attempt

Gunmen attacked the prison in Pará State in an attempt to free prisoners, setting off a gun battle with authorities. Nearly all of the dead were either prisoners or assailants.

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ECONOMIC

Moreira Takes Post as Brazil's Energy & Mining Minister

Wellington Moreira Franco was sworn in to the post on Tuesday. He previously served as secretary of the presidency under President Michel Temer.

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POLITICAL

Maduro to Skip Summit of the Americas

Venezuelan President Nicolás Maduro announced that he would skip the two-day Summit of the Americas, which is to begin Friday in Lima. Peru's government had earlier disinvited him.

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Maduro // File Photo: Venezuelan Government.

POLITICAL NEWS

At Least 21 Killed in Attempted Prison Breakout in Brazil

At least 21 people were killed Tuesday when gunmen attacked a prison in northern Brazil in an effort to aid inmates in an attempted mass escape, Folha de S.Paulo reported. Fifteen of those killed in the ensuing gun battle with police at the Santa Izabel Penitentiary were prisoners, and five of those killed were assailants, the newspaper reported. A guard at the prison, which is located in Pará State, was also killed. The incident began when explosives were placed next to a prison wall, according to the state's public security secretariat. Police and guards then engaged in a gunfight with armed men who were trying to help inmates to escape. Authorities seized two assault weapons, three pistols and two other guns from the assailants who tried to enter the prison in order to free inmates, police investigator Rodrigo Leão told The New York Times. Late Tuesday, prison guards were conducting a headcount inside the prison to determine if any inmates had escaped.

Authorities seized two assault weapons, three pistols and two other guns.

ECONOMIC NEWS

Moreira Takes Post as Brazil's Energy & Mining Minister

Wellington Moreira Franco was sworn in on Tuesday as Brazil's new minister of mining and energy, the government announced. Moreira Franco previously served as secretary of the presidency under President Michel Temer and as governor of the Rio de Janeiro State, as well as stints in the Brazilian Chamber of Deputies. Moreira Franco's appointment came as energy officials prepare state-owned electric utility Eletrobras for privatization later this year. Temer announced Moreira Franco's appointment on Sunday, along with the sudden departure of Deputy Mining and Energy Minister Paulo Pedrosa. Moreira Franco will replace Fernando

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Latin American bond issuance, at least until the latter part of 2018. The variety of currencies, tenors and structures of the Latin American bonds that were issued recently indicates a beneficial diversification of risk and is a sign of the increasing sophistication of the Latin American bond market. Latin America has stood out, along with other emerging markets, as an attractive area for bond investors seeking higher yields in a low interest rate environment; however, that may change going forward. Interest rates are beginning to rise worldwide due to Federal Reserve and European Central Bank monetary policy, which typically inhibits bond market performance."

A **Barbara Kotschwar, adjunct professor at the Center for Latin American Studies at Georgetown University and senior private sector specialist at the World Bank:** "Historically low interest rates, more market-friendly government policies and an adjustment over the past year to the new U.S. political volatility have meant a boom for Latin American borrowing in the past few months. However, recent tightening by the Fed plus upcoming presidential elections in Brazil, Colombia and Mexico may cause political uncertainty that will again push up the premium on Latin American bonds. Whether uncertainty persists depends on the

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NEWS BRIEFS

Venezuela's Maduro Says He'll Skip Summit of the Americas

Venezuelan President Nicolás Maduro on Tuesday said he will not attend the Summit of the Americas in Lima this week, El Comercio reported. The announcement came just hours after the White House announced that U.S. President Donald Trump was skipping the summit in order to monitor the U.S. response to the alleged use of chemical weapons in Syria. The White House said Vice President Mike Pence would travel to Peru in Trump's place. Peru had earlier disinvited Maduro over human rights violations and his handling of the humanitarian crisis in the country. Maduro called the meeting "a waste of time" aimed at "the economic colonization of the region."

Embraer, Boeing Nearing a Deal: Brazilian Defense Minister

Brazilian Defense Minister Joaquim Silva e Luna said on Tuesday that aircraft manufacturer Embraer is "approaching an agreement" with U.S. manufacturer Boeing, O Globo reported. The two companies are nearing a deal to establish a "joint venture" for the Brazilian firm's commercial jets, though Luna said the process would "likely end in marriage" between the companies. The Brazilian government has a right to review and nullify any deal.

Argentina's Soybean Imports Hit Highest Level Since 1997

Argentina's imports of U.S. soybeans are at their highest level since 1997 due to a severe drought in the South American country, Reuters reported on Tuesday. This year's harvest in Argentina is projected at 40 million metric tons, the smallest since 2009, which saw a harvest of 32 million, according to the United States Department of Agriculture.

Coelho Filho, who stepped down to run for a seat in Brazil's Congress, Reuters reported. On Monday, Eletrobras CEO Wilson Ferreira Jr. told Reuters that Moreira Franco's appointment would improve the chances that the Brazilian Congress would approve the privatization of his company. According to Ferreira, Moreira

Moreira Franco // Photo: Brazilian Government

Franco's political weight improves the chances of privatization despite the unclear political environment ahead of the country's October election. Temer's government hopes to complete the reforms before the vote.

BUSINESS NEWS

Guyana's Offshore Oil Contract Favors Exxon: IMF

The International Monetary Fund told Guyanese officials in a report that the terms of its offshore oil contract are "relatively favorable" to ExxonMobil and recommended that the country rewrite its royalties laws, Bloomberg News reported Monday. According to the report, the production sharing agreements between Guyana and ExxonMobil "appear to enjoy royalty rates well below of what is observed internationally." In a statement, Exxon said that the deal is normal for a new oil play. "Government take is generally lower in frontier plays than in established areas as governments need to incentivize companies to undertake high-risk exploration," the firm said in the statement. Government receipts from the Stabroek oil play, which was discovered in 2015, are expected to reach $700 million by 2020, doubling Guyana's tax intake. The Stabroek project will bring to surface just 15 percent of the oil that has been discovered so far. Mineral Resources Minister Raphael Trotman told the news service that, although Guyana would not change the terms of the existing deal, the terms for future deals would be different. Other international firms such as Repsol, Total and Tullow Oil are reportedly exploring in Guyanese offshore areas. The IMF report included other recommendations, including that Guyana improve its regulatory bodies and introduce a progressive royalty scheme to take in additional revenue from more successful projects. Officials in Guyana have been working to modernize legal and regulatory mechanisms as oil and gas production ramps up, but analysts have expressed concern that, after decades of "brain drain," government ministries lack capacity to put in place effective policies. [Editor's note: See related Q&A in the Jan. 24 edition of the Advisor.]

THE DIALOGUE CONTINUES

Will Automation Create or Kill Jobs in Latin America?

Q Within Latin America and the Caribbean, Mexico and Brazil are leading the way in the use of automation, the IDB said in research released last year, with two robots per thousand workers on average. However, the two countries lag far behind more developed nations. Switzerland, Germany, Japan and South Korea, the countries with the highest numbers of robots per industrial worker, boast more than 20 per thousand workers, and China is automating quickly. Is automation a good thing for Latin America and the Caribbean, at this stage of the region's economic development? What policies would bring productivity gains and economic vitality while creating secure jobs? How are elections in key countries this year likely to alter the outlook for the ways countries invest in technology and automation?

A Jaana Remes, economist and partner at the McKinsey Global Institute: "Since 2010, the Latin America's productivity growth rates have been among the lowest in the world, and the advent of a new automation age could help restore growth and dynamism, creating new work as well as lifting societal prosperity. Our research suggests that, globally, automation and AI technologies could raise productivity by between 0.8 percent and 1.4 percent. For Latin American countries such as Argentina, Brazil and Mexico, which face economic headwinds as a result of slowing growth of their working-age populations, this productivity injection would be enough to maintain current GDP per capita growth. In countries with younger populations, such as many in Central America, automation will give a helpful bounce to the economy, but additional productivity-raising measures will be even more necessary to sustain economic development. Technological advances will drive automation adoption, but other factors will also influence the pace and extent of timing, including wage rates, labor supply and demand, and social acceptance. While much of the public debate around automation focuses on jobs that will be lost, our research highlights the considerable new labor demand—and hence new work—that it will create. The big challenge for Latin America will be to ensure education and training is improved, and that transition support is put in place to help the millions of workers who will need to shift their occupational category and upgrade their skills as these new technologies are increasingly adopted in the workplace."

EDITOR'S NOTE: The comment above is a continuation of the Q&A published in the April 5 issue of the Advisor.

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degree of expected policy change in these major markets. Mexico, for example, faces a potential change in policy mix, though recent announcements of appointments by leading front-runner, the left-of-center candidate Andrés Manuel López Obrador, signal more economic policy continuity than would have been expected in previous campaigns. Against the backdrop of the renegotiation of its core trade agreement, Mexico is vulnerable to additional volatility. A main determining factor will be changing financial conditions in developing country markets. The past few years have seen few instances of emerging market contagion—episodes of debt restructuring or political turmoil in one country have not sent shock waves to other markets. An optimistic view attributes this to stronger macroeconomic fundamentals, less foreign currency debt and the greater ability by investors to distinguish among emerging markets. A more cautious interpretation would attribute this to the gentler economic conditions. As the United States continues its quantitative tightening, we may see which storyline holds."

A **Matias Silvani, partner and portfolio manager at GoldenTree Asset Management:** "Market issuance going forward will depend on global volatility, but also on individual sovereign and corporate fundamentals. Generally speaking, the fundamental outlook for Latin America remains solid, although important event-driven risks can disrupt that outlook. The obvious headwinds could be escalating fears of trade wars, central banks over-accelerating the pace of monetary tightening and political noise around specific events, namely presidential elections in Colombia, Mexico and later in Brazil. Several countries and corporates have anticipated higher rates and more volatile times ahead, hence frontloading issuance needs. Latin America has issued more than $58 billion, only outpaced by Asia this year. Yet within the region, Argentina and Ecuador make up most of sovereign issuance, while Mexican and Brazilian entities dominate corporate issuance, generally to refinance maturing debt. We should keep in mind that large issuance also reflects a large demand from market participants. This demand for bonds is unlikely to drastically change, although it will likely become more selective. In that sense, the relatively high level of issuance is not necessarily a fundamental concern, so long as growth prospects remain. Moreover, quality is important. For example, debt-financed infrastructure projects, or industries with strong growth potentials are a 'healthy source' of leverage, while debt to finance persistent deficits is more problematic. Given all this, it is likely that issuance will somewhat slow down in the quarters ahead. In the end, the amount of issuance will depend on investor appetite and investment opportunities. Markets and appetite for new bonds are likely to become more bifurcated and select, with strong viable projects enjoying high demand for their bonds while riskier projects demand a higher yield for their issuance."

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— Matias Silvani

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Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

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freetrial@thedialogue.org