



Latin America in the driver's seat

Stefan Hofer gives a rundown on why Latin America continues to be an attractive destination for global investors.

Central bankers, finance ministers, multilaterals, investors and analysts convened at the recent annual meetings of the Inter-American Development Bank (IDB) in Mexico. Against the backdrop of the IDB's intended capital increase, so as to expand its role in the region, policymakers shared their views on emerging markets and broader global issues.

A prominent theme among participants was that Latin America can be largely grouped into two categories of countries. The first has managed the recent global recession well, with GDP growth likely to be relatively strong over the next two years. Fiscal balances have not suffered in a material way, while debt levels remain reasonably low. These countries include Chile, Peru, Colombia, Brazil and Mexico.

The second group continues to face a difficult outlook, weighed down in part by institutional challenges. This group includes Argentina, Venezuela and Ecuador. While high energy and commodity prices overall have certainly been beneficial for these economies, heterodox economic policies have led investors, on average, to be more sceptical regarding their longer-term outlooks.

The prospects for Brazil given the

October presidential elections were a focus at the meetings this year. Given discussions with political experts, the following conclusions can be drawn. First, given the electorate's strong preference for continuity, President Lula's preferred choice, Dilma Rousseff, is seen as the strongest candidate. (That said, Rousseff is not yet well known among voters.) Second, the fight for the Brazilian presidency promises to create a significant amount of political noise over the summer – something which, arguably, is not yet being factored in by market participants. Being confident that Brazil will keep its current constructive policy orientation after October does not preclude a noisy election, which in turn means there is downside risk to Brazilian assets.

From what we can gather at this still-early stage of the election, a Rousseff victory could mean a larger role for the state in Brazil's economy. Specifically, the state development bank BNDES and Banco do Brazil would either maintain or grow its market share in domestic lending. BNDES played a hugely important role in averting a credit crunch in Brazil, post-Lehman Brothers, in compensating for the lack of private sector credit. However, as

global credit conditions have normalised, BNDES has shown little interest in scaling back its operations.

One of the key take-aways from the IDB meetings is Mexico's relative attractiveness in the region. The central bank and finance ministry in particular are exceptionally well managed, while the representatives from the ratings agencies implicitly stated that Mexico's investment grade rating remains solid. Importantly, the 2010 political calendar in Mexico is relatively quiet. Ten governorships races will take place, but these should be seen in the context of the presidential elections due in 2012.

With 80 per cent of exports headed to the US, Mexico remains geared to the recovery of its northerly neighbour. In terms of the composition of exports, there is evidence that Mexico has been able to move up the value chain, as illustrated below by the increased share of the US car market. Lastly, there is also evidence that the decline in output from Mexico's main oil field, Cantarell, has ceased. This has important positive implications for Mexico's fiscal finances over the shorter term.

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