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Will Mexico be the good news story of 2014?

After a very good December – marked by the congressional approval of President Enrique Peña Nieto's landmark energy reform legislation – Mexico is now the country all investors are talking about. Many argue that it is set for a stellar year in 2014, with an economic recovery gathering pace and an investment surge shaping up. We believe the secret to understanding this important economy may involve disentangling two separate – but connected – 'Mexico stories'. One is a long-term story about the successes – and failures – of attempts to make the economy more competitive. The other is a shorter term, more cyclical story of the management of the country's business cycle. How do they relate?

The long-term Mexican story has recently been at the centre of attention for two reasons. First, after a year of political uncertainties and opposition demonstrations, when the reform plans of the new government often appeared to be blocked on all sides and to hang in the political balance, the administration achieved a December breakthrough. After earlier measures reforming education, banking, telecommunications, the fiscal and tax system, and the regulation of election campaigns, the government in December achieved what for many was unthinkable – congressional approval of a new regulatory framework allowing state oil company Petróleos Mexicanos (Pemex) to strike a range of deals designed to attract investment by the international oil majors. Supporters of this approach say an inflow of new money and expertise into the oil and gas sector will allow the country to reverse the 10-year decline in Pemex oil production.

When the fiscal reform is fully implemented, the government too will be less dependent on the oil sector for its revenue. Factoring in the shale oil and gas boom going on in the US, and Mexico's own very large shale reserves, the net result, they say, is that the country may be on the threshold of an era of cheap energy, which is likely to make it much more competitive.

There is a second reason for this long-term optimism. In January, the North American Free Trade Agreement (Nafta) turned 20 years old. The record on Nafta over the past two decades is mixed. It has clearly boosted Mexican trade with the US and Canada, and helped open up the economy, but it has done notably less to reduce domestic income inequalities in Mexico.

Unlike Brazil and a number of other countries in the region, Mexico cannot claim to have lifted a large section of the population out of poverty and into the middle class. According to the UN's Economic Commission for Latin America and the Caribbean (ECLAC), 52.4% of the Mexican population was classed as living under the poverty line in 1994, and although this proportion was pushed down to 42.7% in 2006, it has since climbed back up again to 51.3% in 2012, almost where it had started just under 20 years previously.

There are also issues with drug cartels, crime, corruption, poor quality transport infrastructure and excessive border controls – the latter a reflection of intensified post 9/11 US security concerns. Nafta supporters tend to acknowledge its shortcomings to date, but say they have new and important reasons to be enthusiastic about what may lay ahead.

Certainly, some prestigious analysts are highlighting what they say could be critical and positive turning points. The Boston Consulting Group (BCG), a US-headquartered global management consulting firm, calculates that because of a combination of rising wages in China and growing manufacturing productivity in Mexico, by 2012 the cost of labour in China was no longer cheaper than in Mexico.

Concamin upbeat

In its latest (January 2014) 'Pulso Industrial' report, Mexico's industry chamber group, Confederación de Cámaras Industriales (Concamin), forecast real GDP of 3.7% in 2014, with year-end inflation of 3.9% and formal employment growth of 570,000. Supportive of the Peña Nieto government's structural reforms, Concamin said that 2014 should see the consolidation of the reforms efforts, stronger infrastructure investment and the articulation of a new industrial policy.

Indeed, BCG says that on current trends Mexican manufacturing workers could by 2015 achieve a 30% cost advantage over their Chinese counterparts. This, it is suggested, coupled with geographical proximity, will lead to a 'nearshoring' investment boom by companies active on the US market that will be sourcing key components from Mexico rather than from China.

Jim O'Neill, the former Goldman Sachs analyst who back in 2001 first touted the potential of the BRICS group of emerging economies (Brazil, Russia, India and China, with South Africa latterly tagged on), has recently turned his focus to a new group, the MINTs (Mexico, Indonesia, Nigeria and Turkey). The MINTs, he argues, benefit from having young populations and being strategically placed geographically; three of the four (including Mexico) are commodity producers. O'Neill suggests that in 30 years time the MINTS are likely to be among the world's ten largest economies. A think-tank, the UK-based Centre for Economic and Business Research (CEBR), recently said Mexico would move up the ranks much faster than that. It said it would rise from its current position as the world's 14th largest economy to 9th place by 2028, a promotion "likely to reflect the continuing success of the US economy and the position of Mexico in providing cost effective production for the US market".

While there are clearly some strong arguments to be made about these long-term trends favouring Mexico, there are also a number of important questions and reservations. One to ask is when the 'long term' future will actually become a present-day reality. This brings to mind an old (and some would say outdated) joke from elsewhere in the region, when people would describe Brazil as "the country of the future" but then add sadly that "unfortunately the future never comes". Some caution may therefore be wise on this front. The global investment bank JP Morgan has estimated that Mexico's energy reform could add 1.1 percentage points to annual GDP growth, but not until around 2018; taking into account the long lead-times required to reach exploration agreements with oil majors, drill wells, find economically viable properties and exploit them.

This can also be said about all the Peña Nieto reforms: the unexpected can happen, secondary enabling legislation and political compromises may dilute the original intentions, and changes sometimes have unintended and undesired consequences negating the sought-for benefits.

Another approach, therefore, is to ignore the promise of the future for the moment, and narrow the focus down to the cyclical short term. It is widely acknowledged that the Mexican economy slowed significantly in 2013, and is now, analysts say, finally set to recover this year, helped by growing demand from its main partner, the US. On ECLAC estimates, real annual GDP growth was just 1.3% in calendar 2013, with the second quarter in particular the low point of the Mexican business cycle. It attributed the 2013 slowdown to "a significant fall in export growth, especially in the first half of the year, but also to less dynamic domestic demand and gross capital formation". The UN commission forecasts a rebound to 3.5% in 2014. However, its forecast for

Bullish forecasts from international banks

Mario Correa, Mexico economist at Scotiabank, is among the international bulls on Mexico. He forecasts real annual GDP growth of 3.3% in 2014 and formal employment growth of 713,0000, on the back of the US economic recovery and a rebound in domestic Mexican consumption, as well as higher public spending on infrastructure.

2014 is optimistic, as it puts Mexico above the regional average (3.2%) and ahead of Brazil (2.6%).

There is, of course, a potentially positive link between the long-term and the short term narratives about the Mexican economy. To the extent that investors and markets believe the narrative about an unfolding long-term transformation of the country's economic prospects, they will be more likely to want to participate in the short term cyclical upturn – in crude terms, to seek a piece of the action right now. This 'perception effect' could come into play in 2014, giving a little extra dynamism to the expected upturn, and in the more optimistic scenarios taking the country's growth up towards 4%.

SPECIAL FOCUS

REGION

Arrival of the metal-smuggling cartels?

For decades the dominant image of organised crime in Latin America has been that of the drug-running cartel, a powerful and dangerous organisation, sometimes linked to paramilitaries of the far Left and sometimes to those the far Right, which has survived despite a multitude of crop eradication and law enforcement efforts. It is a cliché, but like many clichés, it is also a reflection of reality. What perhaps gets less attention is that organised crime is active in other areas, and one of the biggest is in metals mining.

The Fuerzas Armadas Revolucionarias de Colombia (Farc) insurgents have been fighting against successive Colombian governments for more than half a century. At the moment they are involved in peace negotiations, but armed actions continue in parallel with the talks being held in Cuba. It is well known that the Farc partly finances itself through coca and cocaine production, and it has links to various drug cartels, a phenomenon sometimes described as 'narcoterrorism'. But a special report in August 2013 by Michael Smith, a *Bloomberg* journalist, revealed another side to Farc's business operations.

In the province of Guainia in south-eastern Colombia, in a vast rainforest area close to the border with Venezuela and Brazil, there is a clandestine mine of muddy red earth pits covering around six hectares, called Cerro Tigre. The mine is controlled by the Farc, and local people, largely from the Puinawai indigenous group, work there sifting the earth and extracting up to 15 tons of wolframite rocks a week. According to a *Bloomberg* investigation last year, the wolframite, a form of tungsten ore, is sold to traders who ship it by boat to San José del Guaviare on the edge of the Amazon, from where it is taken by truck to the Caribbean port of Santa Marta and exported. While the Cerro Tigre mine has been described as 'three-times illegal' (inside a forest preserve, inside an Indian reservation, and operated by an outlawed organisation), along its journey the wolframite is 'laundered' and made to appear a legitimate export.

Smith's investigation found it was being exported to companies in the US and Austria and from there the refined tungsten was finding its way into a wide range of well-known products, including cars made by BMW and Volkswagen, BIC pens, Apple iPods, Samsung and Hewlett-Packard computers and Siemens electronics. Hard and heat resistant, tungsten is used in engines, LCDs (liquid crystal displays), mobile phones and the hard tips of ballpoint pens. China controls 85% of world tungsten supply and limits exports, so demand and prices for this key hi-tech metal are high. As a result of the investigation, most of the multinational companies said they were reviewing their supply chains to avoid indirectly financing a guerrilla war. But Cerro Tigre is still operating. Perhaps its time is limited: in December, Colonel José Gerardo Acevedo of the Colombian national police was quoted saying that the security forces were "closing in on that region, to be able to get to the mine".

Later in the same month, meanwhile, customs officers in Peru were surprised by what they found in a storage container in the country's main port of Callao. It contained 508kgs of gold ingots, valued at around US$18m. They promptly confiscated the find. Local newspaper *El Comercio* said the unusually large cargo was greater than the total of illegal gold export seizures made over the preceding two years. Six local companies were implicated in the operation to export the gold to refiners in the US and Italy and will face money laundering and other charges.

The gold comes from the country's informal mining sector, which has become a growing problem for the authorities: most of the bullion is smuggled out through Jorge Chávez airport in Lima, through Madre de Dios airport in the southeast Amazon region, along the Interoceanic Highway into Brazil, and along the highway from Puno in the Peruvian *altiplano* to Bolivia. It eventually finds its way to northern hemisphere traders, refiners, and jewellers, with much of it going to Switzerland. Peru is the world's fifth or sixth largest gold producer (there are conflicting estimates). Output is roughly 160-170 tons per annum, some 20% of which is thought to be from the informal sector.

"Although Peru is believed by the United Nations to have pushed past Colombia in 2012 to become the world's largest cocaine exporter, analysts say that gold smuggling is actually the more profitable of the two activities. Taken as a whole, illegal mining is believed to generate around US$3bn per annum, about 15% more than drug trafficking earnings."

Half of the country's gold exports are shipped to Switzerland. In response to the growth in smuggling, the Swiss and Peruvian authorities in November (2013) proposed launching jointly a 'Better Gold Initiative', which would include certificates of origin and guarantees that certain minimum social, environmental and labour standards were being met in the mining process. The 'Better Gold Initiative' is a private-public partnership between the Swiss Better Gold Association and the Swiss State Secretary for Economic Affairs (SECO). It is a non-profit organisation to support the development in mining communities by enabling linkages to finance and markets. It states as its aim "to create a sustainable Gold Value Chain from mine to market".

In some parts of Peru, those standards are certainly not being observed. Last December three charities, grouped together in the Observatorio de Conflictos Mineros, published a report which said that Peruvian informal mining was growing at an explosive and unsustainable rate, and was likely to lead to a surge in social conflict in 2014. A government deadline for informal miners to register with the tax authorities this year may be resisted and may itself lead to protests. The Observatorio says 26m hectares, or 21% of Peru's surface area, is currently subject to mining concessions. Of that total, 16% (or 4m hectares) is in the 'informal' sector, where an estimated 100,000 miners work in completely unregulated fashion. Much of this is small-scale gold mining, using environmentally-harmful techniques that create mercury and cyanide pollution.

Criminal gangs have swooped on this opportunity, creating their own distribution network between the miners and northern hemisphere buyers. In November 2013, local media reported on the arrest of one gold smuggler, Yashira Cereceda, who was caught carrying 5.3kgs of gold at Madre de Dios airport. Cereceda is allegedly linked to the largest smuggling syndicate, said to be run by a Russian named Oleg Lipin, who operates through a network of local 'front' companies. Although Peru is believed by the United Nations to have pushed past Colombia in 2012 to become the world's largest cocaine exporter, analysts say that gold smuggling is actually the more profitable of the two activities. Taken as a whole, illegal mining is believed to generate around US$3.0bn per annum, about 15% more than drug trafficking earnings.

Meanwhile, the Mexican Navy is still in control of Lázaro Cárdenas, one of the country's main container ports on the Pacific coast, which it seized in a military operation on 4 November 2013. Prior to that date, the port had apparently been operating normally under the control of state police and customs officials, so its seizure in a full military operation might seem surprising. In reality, however, it was widely known that the main

Lázaro Cárdenas clean up

On 4 November Mexico's federal government launched its most complex operation so far to impose order on the key Pacific port of Lázaro Cárdenas. Four federal agencies are involved; the ministries of the navy (Semar) and defence (Sedena), the federal chief procurator's office (PGR) and the federal police. Semar has been charged with running the operations and installations of the port, providing senior officers for the posts of port administrator and port captain and deploying marines to take care of security. Sedena has taken over the municipal police, disarming all 113 officers and transporting them to a training centre elsewhere in Michoacán, where they will undergo 'confidence' screening and retraining. Soldiers will meanwhile be out patrolling the streets. The federal police has been entrusted with the task of securing the perimeter of the port and its access routes.

Michoacán-based drug syndicate, Los Caballeros Templarios (The Knights Templar) was running the whole show. In practice, the port was theirs, and the government had to resort to the Navy to get it back. Tellingly, one of the first things the Navy did when it took control was to disarm the state police and send them off for "re-training".

The problem is that apart from suffering rampant criminality and poverty, Michoacán is also Mexico's largest iron ore producer, with only the Pacific Ocean between it and mainland China, which for years has displayed a voracious appetite for iron ore and steel. After the port was recovered, Governor Fausto Vallejo said, "the mines were mercilessly exploited, and the ore was leaving. But not in rafts or launches – it was going via the port, through customs, on ships".

The Caballeros' operation was sophisticated. The organisation in effect ran an extortion racket against legitimate mining companies, 'taxing' them in kind, and demanding a share of iron ore output. Speaking out against this was dangerous. In April 2013, an official at the local ArcelorMittal steel mill who had reported illegal mining was shot dead.

The gang also helped prospectors to stake mining claims, in return for 'protection', charged as a proportion of future output. From the small town of Arteaga, birthplace of Caballeros leader Servando Gómez, the gang operated a fleet of hundreds of trucks that travelled around the mines loading up ore. It also controlled freight transport unions through another protection scheme, and of course bribed Lázaro Cárdenas-based police and customs officials to ensure the ore could flow freely through the port. One government official told the *Reuters* news agency that "most of the groups mining are Knights Templar or belong to them. They have the whole chain". Governor Vallejo has estimated that criminal activity around Lázaro Cárdenas, including illegal iron exports to China, and illegal imports of the chemicals needed to make methamphetamines, also from China and other Asian sources, may be worth US$2bn a year, half the state's total budget.

CHINA AND LATIN AMERICA

More opportunity than threat in 2014

China should exert a positive influence over the economies of Latin America in 2014. Growth in Chinese imports from the region have been accelerating. Inwards Foreign Direct Investment (FDI) appears to have been growing and is substantial in absolute terms. The main caveat is that they year ahead does not produce a financial crisis in China that is of sufficient magnitude that it brings the recovery of the global economy to a halt.

Developments in China matter a lot more to the economies of Latin America than they used to. In September 2011*, researchers at the Inter-American Development Bank (IDB) found that 'the long-term impact of a China GDP shock on a typical Latin American economy has tripled since the mid-1990s, while the long-term impact of impact of a US GDP shock has halved and the transmission of shocks to Latin America and emerging Asia (excluding China and India) has not changed.' [*IDB Working Paper Series No. IDB-WP-266, *China's Emergence in the World Economy and Business Cycles in Latin America*, September 2011].

In the recent past, the impact of China on regional economies has been benign. In its Latin American Trade Trend Estimates 2013, published in December, the IDB noted that there was a sharp improvement in exports from the region to China in the middle of last year. In March 2013, exports to China (as measured by the quarterly moving average of year-on-year percentage growth rates) were 15% lower than they had been in the same month of 2011. In September, exports to China were, by this same metric, about 15% higher. By way of comparison, exports to the US were broadly unchanged through the first nine months of the year, while exports to the European Union (EU) were consistently 10% lower than they had been in the same month of 2011.

The IDB's detailed estimates of exports from the various economies of Latin America provided a nuanced, but still essentially positive picture. The IDB believes that total exports from the region to the rest of the world amounted to US$1.07trn in 2013. This included exports of US$433bn and US$379bn from Brazil and Mexico respectively. Total exports from the region were unchanged relative to those of 2012. However, 2% growth in exports from Mexico, and 4% growth in exports from Argentina, were basically offset by falls of 1%, 3% and 11% from Brazil, Colombia and Peru, respectively. Peruvian exporters had to deal with lower prices for gold and copper as well as a collapse in demand in Europe. **[See chart 1]**

"Exports to Asia were a bright spot, rising by 8% to US$231bn. This was in large part due to a 40% surge in exports from Colombia to Asia."

Regional Exports in 2013

	Export Growth (%)					Total Exports (US$bn)	
	To Latin America	To USA	To Asia	To Europe	Total	Variation	Total
Brazil	5	-8	9	-2	-1	-2	433
Argentina	2	2	9	-14	4	3	84
Colombia	-7	-12	40	1	-3	-2	59
Chile	1	16	-2	-3	1	1	78
Peru	-3	19	-6	-18	-11	-4	40
Mexico	-6	4	14	-4	2	9	379
Latin America	0	0	8	-5	0	0	1,068
Variation (US$bn)	0	0	20	-6	0		
Total	180	426	231	122	1,068		

Source: IDB, Latin American Trade Trend Estimates, 2013, p9.

NB. Chilean exports to China rose by 7%. Supply problems and/or lower prices for particular oil types hit Venezuela. However, petrol exports to India rose by 12%. Peru's exports to Asia and Europe were adversely affected by lower prices for copper and gold. Regional exports to China were contracting by 15% (quarterly moving average of yoy % growth rates) in March last year, but up 15% in September.

These results reflected uneven economic conditions in Latin America's major trading partners. In Europe, continued sluggishness was reflected in a 5% drop in demand for the region's exports. In contrast, China's imports from Latin America increased nearly 10% region-wide, in spite of slower growth in the Asian nation, while Japan and Korea reduced their purchases from the region.

IDB Press release of 10 Dec 2013

Exports to Asia were a bright spot, rising by 8% to US$231bn. This was in large part due to a 40% surge in exports from Colombia to Asia. Exports to Asia from Argentina and Brazil increased by 9% relative to 2012; from Mexico, by 14%. Exports from Peru and Chile dropped by 6% and 2% respectively. However, Chilean exports to China rose by 7%. Elsewhere, Venezuelan exports slipped as a result of supply/logistics problems and lower prices for particular types of oil. Nevertheless, Venezuela's exports of petroleum products to Asia (and to India especially) rose by 12%.

One of the challenges facing the global economy is that the pace of economic growth in China has been slowing from rates that were unsustainably high. In its Latin American Trade Trend Estimates 2013, the IDB notes that there has been a fairly high correlation between annual GDP growth rates in China and those of a proxy of six large economies in Latin America (the LA6 – comprising Argentina, Brazil, Chile, Colombia, Mexico and Peru) since Q1

2011. As year-on-year growth in China has slowed from nearly 10% to around 7.8%, growth in the LA6 has slipped from about 5.5% to below 3%.

The most recent indicators of the health of China's economy have been positive. On 6 January 2014, for instance, HSBC noted that its Composite Purchasing Manager's Index (PMI - reflective of developments in both the manufacturing and services sectors) had slipped from 52.3 in November to 51.2 in December. Given that any figure above 50.0 signifies an increase in activity, this points to a deceleration of growth. Interpreting the result, Hongbin Qu, HSBC's Chief Economist for China, noted that the slippage was due mainly to slower growth in new business. However, labour market conditions in China improved for the fourth consecutive month in December. Qu notes that HSBC expects 'the steady expansion of manufacturing sectors to lend support to service sector growth. Moreover, the implementation of reforms, such as lowering the entry barriers for private businesses in service sectors and the expanded VAT reforms, should help to revitalise service sectors in the year ahead.'

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In early 2014, Gordon Orr, a director at global consultancy McKinsey & Co. identified ten trends that he expects will dominate China's economy over the course of this year. Most of the trends that he identified have few obvious implications for economies (or companies) in Latin America. Orr's first and third trends, productivity growth (thanks in part to disruptive new technology) and a new focus by the central Beijing government on employment growth, must be considered to be broadly positive. This is because they are consistent with greater output in China's economy, even if the government is less concerned than it used to be about the headline figure for GDP expansion.

Orr's fifth and sixth themes are consistent with strong(er) demand for raw materials, some of which will be sourced from Latin America. 'Much of the residential and office construction in China over the past 30 years used low-quality methods, as well as materials that are ageing badly. Some cities are reaching a tipping point: clusters of buildings barely 20 years old are visibly decaying. Many will need to be renovated thoroughly, others to be knocked down and rebuilt.' Meanwhile, the government plans to double the length of high-speed rail track from the current 9,000km or so to 18,000km by the end of 2015.

Of course, China's engagement with Latin America goes a long way beyond being a market for the region's exporters. China is also a significant source of actual and potential inwards FDI. As the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC) notes*, this is in the context of overall inwards FDI flows that are substantial in absolute terms and which expanded during 2012 in face of a contraction in global FDI flows. [*ECLAC, *Foreign Direct Investment in Latin America and the Caribbean 2012*]. **[See Chart 2]**

CHART 2: Total inwards foreign direct investment (FDI) flows (US$mn)

	2000-2006	2007	2008	2009	2010	2011	2012
Brazil	19,144	34,585	45,058	25,949	48,506	66,660	65,272
Chile	5,387	12,572	15,518	12,887	15,373	22,931	30,323
Colombia	4,108	9,049	10,596	7,137	6,758	13,438	15,823
Mexico	22,916	31,380	27,853	16,561	21,372	21,504	13,431
Argentina	4,473	6,473	9,726	4,017	7,848	9,882	12,551
Peru	1,870	5,491	6,924	6,431	8,455	8,233	12,240
All Others	10,285	16,832	23,023	9,966	16,056	23,167	24,906
Total Region	68,183	116,382	138,698	82,948	124,368	165,815	174,546

Source: ECLAC, Foreign Direct Investment in Latin America and the Caribbean, 2012, pp24-25, based on preliminary figures and estimates of late April 2013

> “In its discussion of inwards FDI in 2012, ECLAC noted that Sinopec's purchase of a 30% stake in Petrogal for US$4.8bn accounted for much of FDI into Brazil's natural resources sector(s) that year.”

ECLAC highlights a number of aspects of inwards FDI in the region. First, the importance of different sectors and industries as recipients of FDI varies widely in different parts of the region. Natural resources, the sector(s) that are generally seen as being of greatest interest to Chinese companies, account for a (very small) majority of inwards FDI in South America outside Brazil, but for 10-13% elsewhere. Second, it is extremely difficult to quantify how much of the FDI actually comes from China. This is partly because the governments of a number of Latin American countries do not provide timely and complete data in relation to where the money is coming from. It is also because many multi-national companies channel investment into the region through third countries/territories such as the British Virgin Islands (BVI), the Cayman Islands, Luxembourg or the Netherlands. **[See Chart 3]**

CHART 3: Sectoral allocation of inwards FDI flows, 2012

	Natural Resources	Manufactures	Services
Brazil	13%	38%	48%
Mexico, Central America and Caribbean	10%	48%	42%
South America (ex Brazil)	51%	12%	37%

Source: ECLAC, Foreign Direct Investment in Latin America and the Caribbean, 2012, p39.

Transnational companies often channel investment through third countries such as BVI, Cayman Islands or Lux. Several countries in the region do not provide complete and timely data of the source of inwards FDI. 'For these two reasons, it is especially difficult to esitmate the share of the region's inward FDI that is sourced in China'.

Nevertheless, FDI from Chinese parties appears to have been substantial. In its discussion of inwards FDI in 2012, ECLAC noted that Sinopec's purchase of a 30% stake in Petrogal for US$4.8bn accounted for much of FDI into Brazil's natural resources sector(s) that year. ECLAC specifically alluded to two transactions in Argentina. One was the purchase of 80% of the local subsidiary of South Africa's Standard Bank by Chinese giant Industrial & Commercial Bank of China (ICBC). The other was the purchase of land for soybean production by Chongqing Grain Group, which looked to partner with Argentine food processing group Molino Cañuelas. ECLAC suggests that Chinese parties account for about one fifth of the stock of investment in natural resources projects in Peru. **[See Chart 4]**

CHART 4: Inwards FDI in 2012: ECLAC's comments

Brazil	US$65,272mn	Extractive industries accounted for 13% of the total: this included Sinopec's purchase of a 30% stake in Petrogal for US$4.8bn).
Chile	US$30,223mn	The copper industry accounted for nearly half of the total.
Colombia	US$15,823mn	Oil and mining accounted for US$5.4bn and US$2.3bn respectively.
Mexico	US$12,649mn	Manufacturing accounted for well over half of the total. The total figure was compressed by Santander's US$4.1bn sale by IPO of a 25% stake in its Mexican subsidiary.
Argentina	US$12,551mn	China's ICBC acquired 80% of Standard Bank Argentina, the subsidiary of the South African bank. Chongqing Grain Group bought land for soybean production and looked to partner with Molinos Cañuelas.
Peru	US$12,240mn	There is no official data on the destination of FDI flows, but China accounted for 22% of the stock of US$26.7bn invested in exploration projects.

NB There were no comments on Chinese FDI in the other countries

Source: ECLAC, Foreign Direct Investment in Latin America and the Caribbean, 2012, pp27-36

Given continuing growth in global trade, as well as expansion in the economies of Latin America and China, it is reasonable to expect that inwards FDI from China will expand further in 2014-15. Various developments highlight three themes. First, ICBC is not the only major listed (predominantly) state-owned commercial bank to be on the expansion path in Latin America. Second, access by regional sovereign borrowers to funding from China is seen by major ratings agencies as a positive factor: this is true even if the government in question does not have a long-established record as a proponent of orthodox economics and public finances. Third, and perhaps most importantly, Chinese companies appear set to play key roles as providers of money and know-how for infrastructure projects in Latin America. In December 2013, representatives of the Pacific Alliance nations of Mexico, Colombia, Peru and Chile presented details of US$140bn in infrastructure projects in Beijing to Chinese companies that may become involved. This total included US$100bn in projects in Mexico alone. **[See Chart 5]**

CHART 5: Chinese investment in Latin America - selected recent developments

04-Sep-13	China Railway Construction Corporation (CRCC) seeks local partners to compete in the railway concessions planned as a part of Brazil's logistics investment program.
18-Oct-13	In part because of availability of funding from China, Fitch upgrades Ecuador's sovereign rating from B- to B.
04-Nov-13	China Construction Bank (CCB) agrees to buy Brazilian BicBanco from the Bezerra de Menezes family for 1.6bn reais.
12-Nov-13	State government of Chihuahua, Mexico secures US$6bn from Chinese investors for a range of projects, including San Jerónimo- Sta. Teresa railway line
18-Nov-13	Industrial & Commercial Bank of China (ICBC) receives licence to operate in Peru
05-Dec-13	China Machinery Engineering Corporation (CMEC) signs US$2,470 financing deal with Argentine rail operator Belgrano Cargas
10-Dec-13	Governments of Mexico, Colombia, Peru and Chile have presented over US$140bn in infrastructure projects to Chinese investors in Beijing

Source: Business News Americas

In their assessment of how Latin American economies had become less vulnerable to GDP shocks in the US, but significantly more exposed to GDP shocks in China, the IDB's researchers noted that these changes were only partly due to the long boom in commodity prices. What mattered more were 'indirect effects, associated with stronger trade linkages between China and Latin America's largest trade partners - the USA and the euro area.'

"In their assessment of how Latin American economies had become less vulnerable to GDP shocks in the US, but significantly more exposed to GDP shocks in China, the IDB's researchers noted that these changes were only partly due to the long boom in commodity prices..."

The implication of this is crucial. A comprehensive discussion of the vulnerabilities of China's economy is beyond the scope of this paper. However, it is widely known that: growth in the money supply has been rapid; a lot of the newly created funds have been flowing through the so-called shadow finance system, over which the authorities in Beijing have limited control; a number of actors within the Chinese economy, such as the local government funding vehicles (LGFVs) of the local and regional governments (LRGs) are highly geared. In other words, there is a significant possibility that there will be some kind of financial crisis in China in 2014.

Should such a crisis be of such magnitude that it causes the economic recoveries of the US, Japan and the EU to stall (or worse), it would undoubtedly have a negative impact on the economies of Latin America. In terms of the IDB's analysis of late 2011, the 'indirect effects' would be considerable. However, this outcome is far from certain. Provided that such a crisis does not occur, it is reasonable to look for continuing growth in exports from Latin America to China and inwards FDI to the region from China. The absolute amounts of money involved will be substantial, if not necessarily easy to quantify. For the economies of Latin America, China remains much more of an opportunity than a threat in 2014.

The Damocles Sword

Of the many court cases involving Argentine foreign debt still working their way through the US legal system, two stand out. The 'big' case involves the demand by a group of 'hold-out' creditors, including many hedge funds, that demand that they be paid in full for money owed when Argentina defaulted on its foreign debt of around US$100bn in late 2001/early 2002. While about 93% of the country's creditors by value accepted a write down of around 70% in rescheduling agreements reached in 2005 and 2010, the remaining 7% of hold-out creditors have been arguing that they have a right to payment in full. The reason this issue is being dealt with in the US legal system is that most of Argentina's debt contracts were written under US law. The US courts have tended to agree with the holdouts. In October 2013, Judge Thomas Griesa of the New York-based 2nd Court of Appeals ruled that Argentina cannot service its restructured debt if it does not at the same time pay off US$1.33bn to the holdouts, something the Buenos Aires government has consistently refused to do. There is a stay on execution of this ruling to allow Argentina to appeal to the Supreme Court. While dates may change, Argentina is expected to submit its appeal by mid-February. There is no firm date for a final judgement. The outcome is critically important to the Argentine economy because if the ruling is upheld and Argentina still refuses to pay, a technical default will be triggered.

Continued on page 11

ARGENTINA

On the road to ruin – or stumbling to the finish line in 2015

The recent fall in foreign exchange reserves, and the rise in the black market 'Dólar Blue' exchange rate, has prompted many commentators to suggest that Argentina is headed imminently towards an inevitable – and major – currency and monetary crisis. In our view, this is incorrect. A full blown crisis of that scale would require an exogenous shock. In the event of such a shock, be it the result of problems with the soybean harvest or something else, there are numerous policy options still available to the government led by President Cristina Fernández to bring the situation under control.

Various recent developments have highlighted the fragility - and long-term unsustainability - of the economic model that continues to be pursued by the Fernández administration (notwithstanding the recent and important changes to her economics team). The central bank's foreign reserves hit US$29.8bn in mid-January, their lowest level since 2006, having slipped from US$30.7bn in early December 2013 and US$33.2bn in late October 2013. Thanks to the continued monetisation of the budget deficit, inflation is generally reckoned to be running at around 25%-30%.

Prompting particular commentary is the fairly sharp depreciation in the Dólar Blue rate in central Buenos Aires. As of 20 January, the rate stood at ARS11.95/US$. This compares with the official rate of ARS6.81/US$. Another widely followed unofficial exchange rate, the Dólar Bolsa, stands at ARS10.35/US$. The Dólar Bolsa is the rate at which institutional investors may gain access to foreign currency, by buying debt securities in pesos and then selling the securities for US dollars.

Overall, though, it is premature to suggest that a financial crisis is imminent. In terms of the numbers of pesos that may be bought with one US dollar, the Dólar Blue rate stands at a premium of about 75% to the official exchange rate. Although that is quite high by the standards of the second half of 2013, when the premium was typically in the 50%-65% range, it is less than the 100% premium reached when the Dólar Blue spiked to above 10 (the so-called 'Messi Rate', for the jersey worn by the Argentine football star) for the first time in May this year.

Moreover, as is indicated by the figures above, the rate at which foreign reserves have been falling appears to have slowed. Reports indicated that in early January, the Administración Nacional de la Seguridad Social (ANSES - the state pension fund agency) raised around US$2.3bn in US dollars by selling Argentine government treasury notes maturing in 2018. ANSES had purchased these securities from the government in 2011.

The unresolved disputes in US courts between the Argentine government, on one hand, and the 'vulture funds' that hold its debt on the other; mean that the government continues to be denied access to global capital markets. The government simply cannot raise money the orthodox way - through a large-scale issue of US dollar denominated bonds.

However, unorthodox sources remain available to the government. As we pointed out in *Latin American Economy & Business* (July 2013), two Chinese state-owned policy banks, China Development Bank (CDB) and China Ex-Im Bank, have been active lenders in Latin America over the last five years or so. Some funds have also been forthcoming from Industrial & Commercial Bank of China (ICBC - one of the four large state-owned commercial banks). Sometimes, the Chinese institutions lend at higher interest rates than those

The Supreme Court separately has agreed to hear the 'little case', but one which also has important repercussions. On 10 January, the court agreed to hear an appeal by Argentina against a lower court ruling allowing one of the holdouts, NML Capital (a unit of Elliott Management Corp), to subpoena records of Argentine assets from the US offices of Bank of America and Banco de La Nación. NML says it has obtained over US$1.6bn in legal judgements against Argentina, and has the right to subpoena the bank records to identify assets and locations where it may recover its debts. NML and other creditors have already taken some actions in this regard. They were behind the temporary seizure of ARA Libertad, the Argentine navy's training ship, in Ghana in late 2012. "Federal law does not give Argentina the right to conceal its assets from its lawful creditors" an NML lawyer said. Argentina made no official comment, but has in the past said such a subpoena would violate its sovereign immunity. On this point, the US authorities seem to be inclined to support Argentina. US Solicitor General Donald Verrilli said that without condoning Argentina's refusal to pay debts as ordered by US courts, the lower court ruling would impose "worrisome burdens on a foreign State".

demanded by multilateral lenders such as the World Bank; on other occasions, at lower rates. On occasions, the Chinese banks advance the money on a loan-for-oil basis: the Latin American borrowers gain US dollar cash immediately, while Chinese parties have access to a reliable supply of oil over the medium term. If the borrower is not providing oil, it may be required to make commitments for the award of contracts to Chinese companies for infrastructure construction or supply of capital goods.

Data compiled by the Inter-American Development Bank (IDB) and the World Bank indicates that, from 2005 to 2011, Chinese institutions lent US$10.0bn to Argentina. Over the same period, the World Bank and the IDB advanced US$7.2bn and US$9.6bn respectively. Over the same period, the total amount lent by these three sources to Mexico was, at US$27.4bn, very similar to the US$26.8bn advanced to Argentina. However, the Chinese institutions only lent US$1.0bn to Mexico: the remainder came from the two multilateral lenders.

In March last year, we suggested that the government would likely face problems on at least one of two fronts. One was the possibility that Argentine households and businesses shun peso deposits in order to avoid the impact of structurally (very) high inflation. In this situation, the money would likely be spent on goods and services and/or invested in real assets within Argentina, given the capital controls that have been imposed by the government. Alternatively, we saw the possibility that rampant inflation (including demands by workers for wage increases) or a disruption to the flow of tax revenues from soybean farmers to the government, would result in a budgetary crisis.

Notwithstanding that the premium of the Dólar Blue rate to the official rate has surged in recent weeks, it appears that we were overly pessimistic. The government appears to be generating the revenues that it needs to maintain its regular operations (albeit critics accuse it of 'robbing Peter to pay Paul'). There have not been the shortages of consumer goods or a bubble in real asset prices that would take place in the event that households and businesses refused to support the peso.

In short, the Argentine government has proven itself able to 'muddle through' a challenging financial and economic environment – much as it has for most of the time since the 2001-02 crisis. Since May 2013, foreign reserves have fallen dramatically, from around US$39bn. In the meantime though, the global economic environment has improved. It is not obvious that there have been any other fundamental changes. Argentina posted estimated real GDP growth of 4.5% year-on-year in 2013, on (December 2013) estimates by the UN's Economic Commission for Latin America and the Caribbean, which however projects slower growth of about 2.6% in 2014.

Mainstream media reports indicate that Argentina is headed towards a bumper soybean crop this (southern) summer. This would boost foreign exchange earnings and the government's tax revenues. We concede that any development over the next 13 weeks or so which results in a weaker-than-expected harvest (be it anti-government action by farmers and other workers, dislocation in global soybean markets, or weather-related problems), would likely have a sharply negative impact on investor sentiment and would substantially increase the challenges facing the government.

In the event of a true crisis in the coming weeks, the government would have to achieve three outcomes simultaneously. It would need to boost the foreign currency reserves at its disposal. It would need to stabilise the Dólar Blue rate. And it would need to engineer a profound change in sentiment of investors and other market protagonists.

This would be difficult, but not impossible. We suggest that the government has the following policy options to deal with a crisis, whatever the exogenous shock may be:

In another move to preserve scarce dollars, the Argentine tax collection agency (AFIP) has introduced new regulations forcing Argentines purchasing goods from international websites to make a sworn declaration and produce it at a customs office, where packages have to be collected. Items purchased from websites like Amazon and eBay are no longer delivered to home addresses. Argentines are allowed to buy up to US$25 worth of goods from abroad tax-free; above that level a 50% tax is levied. These new restrictions on online shopping come on top of a pre-existing 35% tax on credit card transactions outside the country.

- The government could tap unorthodox sources (such as Chinese loans or the foreign currency assets of entities under its control).

- The central bank could increase the Badlar rate (paid by banks on wholesale deposits in pesos) from the current level of around 20%. The Badlar rate has not provided wholesale depositors with a real return for a long time: if it were perceived to be doing so, the flow of money from dollars to pesos could be substantial.

- The government could issue new tranches of US dollar certificates of deposit (Cedins) and economic development bonds (Bodes) on attractive terms, with the aim of attracting 'blue' dollars circulating within Argentina.

- The government could intervene aggressively in the Dólar Blue market, in order to suppress the premium to the official rate (which, presumably, would continue to weaken as a result of the 'sliding peg' policy). This intervention would probably be accompanied by ferocious rhetoric from the President and her economy team: they would argue that the move was essential to counter currency speculators seeking to undermine the government and the economy. Anyone that had been foolish enough to borrow 'blue' dollars to speculate would be hurt badly.

We recognise that pursuing the third and fourth of these options (or both together) would result in a substantial dollarisation of the financial system. More crucially, it would likely produce a massive currency mismatch within Argentina's banks. In the short term, US dollar deposits would be boosted enormously. However, loans and securities would be denominated mainly in pesos. The mismatch would greatly increase the risks within the system.

Paris Club

As the government continues tightening currency controls, on 22 January Economy Minister Axel Kicillof said that Argentina was 'optimistic' about rescheduling its Paris Club foreign debt and was expecting an initial response from the creditors.

Argentina faces a potentially very serious dollar shortage in the last two years of President Fernández's term (running to end-2015). A successful renegotiation of Paris Club debts, which have been in default since late 2001, might help ease some of that pressure. At issue is whether next year's democratic transition will have to be carried out against the backdrop of a deepening financial crisis - or whether it will be a calmer affair.

The Paris Club groups creditor governments and multilateral financial institutions. Argentina stopped servicing its Paris Club debts at the end of 2001. By end-2012, outstanding debt stood at US$6.5bn, mostly owed to Germany and Japan. If overdue interest and penalties are included, the total could be US$9.5-US$10bn, on some estimates. Kicillof and Hernán Lorenzino (the former economy minister who now heads the government's debt restructuring team) were in Paris in mid-January to meet Club officials and present their proposals. Details were scant, but the Argentine press speculated that Buenos Aires might be offering a down payment (perhaps US$2bn) and might accept the Club's demand that it 'normalise' its relationship with the International Monetary Fund (IMF), which would mean allowing its economic policies to be reviewed through the mechanism known as Article IV consultations.

Speaking on his return to Buenos Aires, Kicillof said he was "optimistic" about the outcome, but warned that negotiations could take time and insisted that Argentina would not change its economic policies. "The worst agreement with a creditor is one that can't be delivered" he noted. Separately, the former finance secretary Guillermo Nielsen, said that one point in favour of an agreement was that the Paris Club was being lobbied by big companies and capital equipment suppliers, "who don't want the Argentine market to be left entirely to the Chinese, who continue lending to the country".

Drummond pulled up again

On 8 January the Colombian government ordered the US-owned Drummond mining company to halt all coal-loading operations at its port of Ciénaga, in Santa Marta Bay on the Caribbean coast. The order triggered an immediate 3.2% increase in European coal prices to US$81.5/tonne. After Russia, Colombia is the second largest coal supplier to the European Union (EU) and Drummond's clients include Electricité de France (Edf). The decision was taken because Drummond has failed to move from an open air crane-and-barge loading system, which is said to cause coal dust pollution, to a covered direct-loading conveyor belt system. President Juan Manuel Santos is running for re-election in May, and may be calculating that getting tough on environmental issues will improve his standing with voters.

"This cannot come as a shock because for years Drummond knew it needed to upgrade its facilities" said a government official cited by the UK business daily, *The Financial Times*. Indeed, Law 1,450 (passed in 2011) established 1 January 2014 as the deadline for the introduction of conveyor-belt loading. Cerrejón, Colombia's biggest coal mining company (owned by Anglo American, BHP Billiton and Glencore Xstrata), has used conveyor belt systems for more than a decade. Drummond, a privately-owned company with headquarters in Alabama, did not comment on why it had failed to meet the deadline. According to press reports, it may not be until February or March this year that it can introduce a new system. Officials had already announced that Drummond would be fined for each day of crane-and-barge loading carried out after the 1 January deadline. The company indicated that it planned to pay the fine while continuing to ship some 80,000 tonnes of coal a day through the port.

Comptroller general calls for generalised crackdown on polluters

On 21 January a delegate from Colombia's office of the comptroller general, Leonardo Arbeláez, called on "the competent authorities" to make sure that all those liable for damages for polluting the Bay of Santa María contributed their share. "This includes not only Drummond, Prodeco (the local coal arm of the Swiss giant Glencore) and Río Cordoba (the port operator) [but also], shrimpers, oil merchants, the Navy", he stated. He also said that relevant public officials should be sanctioned for not enforcing environmental regulations.

For President Santos this was unacceptable. On his *Twittte*r feed, he said he had ordered Environment Minister Luz Helena Sarmiento to travel to Santa Marta, accompanied by regulatory and port authorities, to assess the situation. Yesterday Sarmiento announced a total ban on loading once the last few barge cargoes are cleared. "We know that this is a very costly decision for the country, but what is at stake here, apart from the environmental and social issues, is the institutional credibility of the Colombian authorities. The law is for everyone and our obligation as a government is to enforce it", she said. An additional investigation by the superintendency of ports has been opened, with the threat of further fines equivalent of up to 35 days' worth of Drummond's gross revenues. Drummond was fined US$3.6m last year, after an accident in which 500 tonnes of coal were dumped into the Caribbean. It was also hit by a 53-day miners' strike in 2013.

The decision is not without financial and possibly reputational costs for the Bogotá government, which prides itself as being one of the most investor-friendly in Latin America. "We back the development of mining activity… but not at any price" said Mining Minister Amylkar Acosta, acknowledging there would be a significant loss of revenue from royalties. Colombia is the world's fourth-largest coal exporter, shipping 85m tonnes last year, worth over US$6bn.

It is not yet known how long it will take to get back to normal operations. Acosta says it will be hard for Drummond to use an alternative port because of problems with logistics. It is reportedly able to stockpile up to 45 days' worth of mining output. If the Ciénaga port is still non-compliant after 45 days (late February), it might have to halt mining. In December Drummond's Colombia president, José Miguel Linares, had said that in that case the company might need to temporarily suspend 80% of its staff – a total of 4,160 workers. But Labour Minister Rafael Pardo says this will not be allowed, and that any lay-offs will lead to more fines. Given the timing, this could become a hot subject in the election campaign (legislative elections are in March, followed by the presidential vote in May).

Mercosur faces difficult decisions

After two postponements, the Mercosur presidential summit (due to be attended by the leaders of Argentina, Brazil, Paraguay, Uruguay and Venezuela) was due to be held in Caracas at the end of January, but as we went to press was delayed again until the first fortnight in February. In the run-up to the meeting, the list of disputes and issues requiring the attention of the heads of state was looking daunting.

As with most big international summits, the Mercosur presidential summit is likely to conclude with an up-beat statement talking of progress and positive steps towards the group's aims of boosting trade, cooperation, and development. Real progress is of course absolutely possible, but it is far from certain and in the weeks before the meeting the list of disputes requiring resolution looked long and difficult. There was the question of Paraguay formally rejoining the block after its political expulsion in June 2012, following the impeachment of the-then president Fernando Lugo (2009-2012).

In Paraguay's absence, Venezuela was finally admitted as a full member, a decision Asunción had long opposed and prevented. Following the August 2013 elections, Paraguay's new president, Horacio Cartes, began steering Paraguay back into the group, accepting Venezuelan membership of the club as a fait accompli (membership was finally ratified by the conservative Paraguayan congress in December; the congress for several years had been the single remaining legislature unwilling to accept Venezuela's Mercosur entry).

But there are still tensions and matters to be resolved on this front. Paraguay had been demanding that it be given the next rotating Mercosur presidency (this no longer seems to be a demand and the presidency is due to pass from Venezuela to Uruguay); more importantly, Paraguayan officials also warn against any assumption that the country will retrospectively validate all decisions taken in its absence.

EU-Mercosur
According to the EU Commission, the objective of the talks with Mercosur is to negotiate a comprehensive trade agreement, covering not only trade in industrial and agricultural goods but also services, improvement of rules on government procurement, intellectual property, customs and trade facilitation and technical barriers to trade.

Next, there is a longstanding dispute between Argentina and Brazil, the two largest economies in the bloc, primarily focused on protectionist measures taken by the Argentine authorities against imports from Brazil. Tensions in this particular quarrel have in fact eased a bit in the last few months, following Argentina's ministerial reshuffle in November, which saw the departure of the controversial domestic trade secretary Guillermo Moreno (who despite his job title was seen as the main advocate of the import restrictions). "The issue that has been upsetting our exporters has been resolved", Brazil's trade minister Fernando Pimentel said during a visit to Buenos Aires in December, which unblocked Brazilian car and footwear exports to Argentina stuck at the border for months. Based on prior experience, it is worth noting, however, that these disputes can flare up again quite easily, particularly since Argentina's dollar shortage forces it to try and limit imports.

Other important disputes include a battle between Argentina and Uruguay. Because Argentina opposes increased production at Uruguay's UPM paper and pulp plant – which it claims pollutes the River Uruguay, it has slapped protectionist measures on Uruguayan shipping. Uruguay has responded by announcing long term plans, partly funded by a US$500m investment from Brazil, to develop a new deep sea port at Rocha. Roberto Kreimerman, Uruguay's energy and mining minister, has suggested that while relations will Argentina will improve from their current low point, bilateral trade between the two countries is unlikely to recover to its previous peaks.

Montevideo port 'strangled' by Argentina

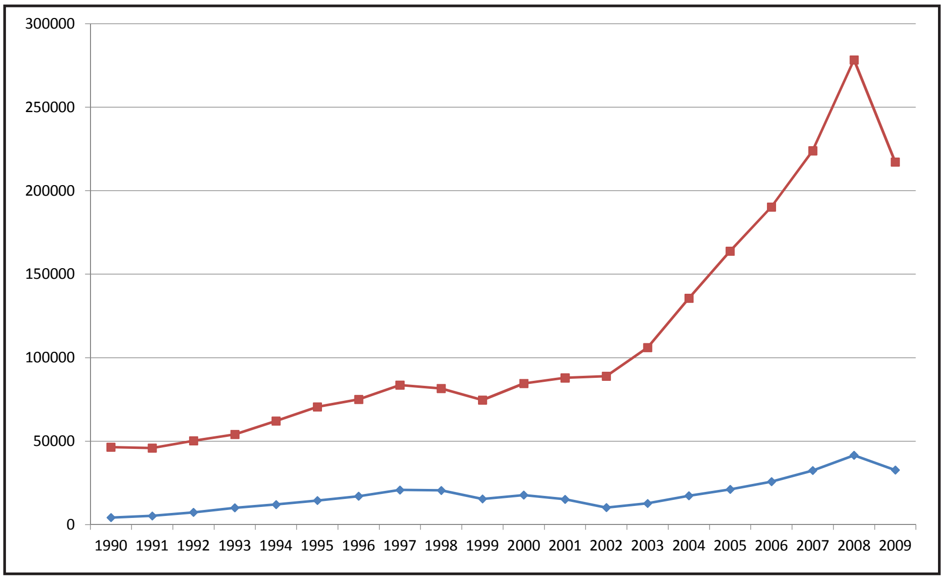
On 8 January Uruguay's civil navigation centre released a report which claimed that as result of the recent cargo transhipment restrictions imposed by Argentina, maritime cargo traffic passing through the port of Montevideo fell by 43% year on year in the last two months of 2013. Commenting on the report, Mario Baubeta, the head of the civil navigation centre, said that the figures show that Argentina's November decision to forbid shipments destined from being unloaded in Uruguayan ports was harming the Uruguayan economy. Pointing out that Uruguay's maritime transport industry is "deeply concerned" by the matter, Baubeta called on the government to "quickly" negotiate a bilateral agreement with Argentina at the next Southern Common Market (Mercosur) summit scheduled to take place in Caracas on 31 January.

One of Mercosur's underlying internal difficulties is that its members are following very different economic policies, to the point that the trade bloc's very raison d'etre is called into question. The new government in Paraguay is centre-right in outlook. Both the Brazilian and Uruguayan governments are centre-left, but their economic policies can be described as broadly pragmatic and market-friendly. Venezuela, followed by Argentina to a somewhat lesser degree, pursues what could be described as 'market-unfriendly' policies reliant on rising state intervention in the economy. Of particular importance is the fact that both those economies suffer high inflation, operate multi-tier exchange rates, and are forced into protectionist trade measures to try and conserve limited foreign currency reserves.

Trade breakdown

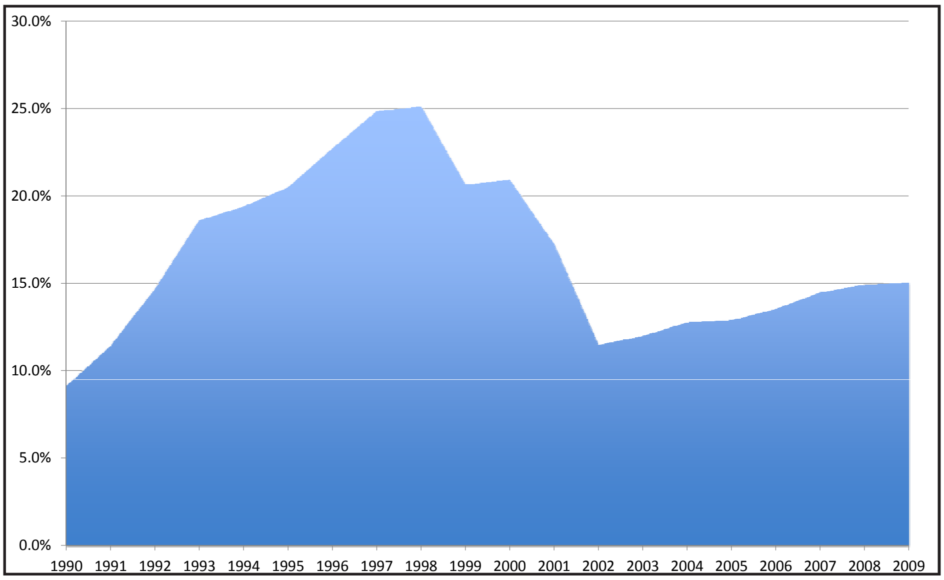
Mercosur's main exports to the EU comprise agricultural products (40% of total exports) and raw materials (28%), while the EU mostly exports manufactured products to Mercosur, notably machinery and transport equipment (45% of total exports) and chemicals (22%). The EU is also a major exporter of commercial services to Mercosur (EUR16bn in 2011, on EU figures).

CHART 1: Intra Mercosur exports against total exports (US$mn)



These centrifugal economic policies within Mercosur may explain why the 22-year old organisation is no longer achieving high levels of internal trade growth. From 2000 to 2013, world exports multiplied by a factor of 2.9, rising to US$23.5trn. Mercosur exports grew faster (up by a factor of 3.6 to US$436bn), but this was spearheaded by Brazil (growing 4.3 times to US$235bn), with Argentina and Venezuela lagging (up by factors of 3.2 and only 2.8 respectively). The key point is that Mercosur itself seems to have contributed little to this growth. In 2013, 12% of Mercosur exports went to destinations within the bloc (i.e. to other member countries), down from 17% in 2000. One sharp-tongued and pessimistic Brazilian trade official is alleged to have commented on the bloc's economic policy divergences by saying, "Brazil is becoming Argentina, Argentina is becoming Venezuela, and Venezuela is becoming Zimbabwe".

CHART 2: Intra as % of Total



Source for chart data: Natalia Cordoba, 'Snapshot of Mercosur & the EU', University of Wuppertal, based in Central Banks of Argentina, Paraguay and Uruguay; Brazilian Foreign Trade Secretariat, Mercosur Secretariat, and IMF

This is an over dramatisation, but the internal difficulties in the bloc are clearly having a negative impact on its wider negotiations, particularly with the European Union (EU). Mercosur has been trying to reach a common bloc-to-bloc free trade agreement with the EU for almost 20 years (since late 1995). Having petered out in 2003, talks were formally re-launched in May 2010 and both sides had undertaken to exchange lists of proposed import duty reductions (formally, 'market access offers') before the end of 2013. In December 2013, EU officials were reported to be seeking tariff reductions on goods representing 90% of existing trade between the two blocs. The Brazilians are said to have a list representing 87%, while Argentina was suggesting it might be able to make proposals on up to 70%-80%.

In the event, Brussels was reported to have suggested postponing the deadline for the tariff proposals, first to January and then to February, purely because of scheduling difficulties. Mercosur analysts suspect the delays are not just a scheduling issue but reflect divided counsel within the bloc, particularly between Brazil and Argentina. On 9 January, the Argentine foreign ministry angrily rejected reports by the Brazilian business daily *Valor Económico* that it had held up the process.

Prospects have become further complicated by an EU decision to open a complaint against Brazil at the World Trade Organisation (WTO) over a range of import tax increases introduced in 2011 and levied on cars, computers, smartphones and semi-conductors. Brazil increased import tariffs to 35% - the maximum allowed under WTO rules – but it also allowed exceptions for domestic producers (for example there is a lower 30% rate on auto-parts for importers who meet a 65% domestic content requirement), and the EU believes these exceptions are discriminatory and in violation of WTO rules. EU car exports to Brazil are reported to have fallen more than 11% in 2013 because of the higher taxes, according to Daniel Caspary, a German member of the European Parliament. An EU official close to the negotiations commented that "The protection of Brazil's domestic industry comes at the expense of goods imported from Europe and that is unacceptable". Both sides have 60 days to resolve the issue, and if they cannot do so it will go to a ruling by a WTO panel. While Brussels says this WTO process should not affect the wider trade agreement discussions, it clearly does not make for a good climate; Argentina too is angry over EU anti-dumping measures taken against its bio-diesel exports.

Exit from GSP puts pressure on Mercosur

All Mercosur countries, with the exception of Paraguay, as of 1 January 2014 no longer benefit from the EU's Generalised Scheme of Preferences (GSP, which allows developing country exporters to pay lower duties on their exports to the EU), due to their classification as high middle-income countries. However, they remain GSP-eligible countries, according to the EU Commission.

PERU

A media war in the making?

The media in Latin America is both a business like any other, but also the focus of conflicting political attentions and pressures because of its importance to freedom of expression and democratic values. Governments have sometimes sought to limit media market dominance: cynics say they may be more interested in trying to get favourable coverage from the market leaders. Mexico last year reformed the telecommunications industry with new regulations designed to limit market shares held by the likes of Carlos Slim's América Móvil and TV broadcasters *Televisa* and *TV Azteca*. In Argentina, after years of constitutional argument in 2013 the government finally secured approval of its new media law, which forces the break-up of the powerful Grupo Clarín. Now, it may be Peru's turn, with Grupo El Comercio, which dominates the newspaper market, under scrutiny.

The press, radio, television, and other means of expression and social communication and, in general, enterprises, goods and services related to freedom of speech and communication, cannot be objects of exclusivity, monopoly, or hoarding, directly or indirectly, by the State or private parties.

- Article 61 of Peru's 1993 Constitution.

While the governments of Enrique Peña Nieto in Mexico and Cristina Fernández de Kirchner in Argentina thought long and hard before setting out to regulate the media, Peru's President Ollanta Humala seems to have stumbled across the subject in a series of interviews and – possibly - made up policy on the hoof.

In August 2013, Grupo El Comercio, the country's dominant media group, succeeded in acquiring a 54% stake in the local publisher Empresa Nacional Periodística SA (Epensa) for US$17m, after the failure of a rival bid from Grupo La República. Grupo El Comercio, and its leading daily El Comercio, is editorially aligned with the Peruvian right, having supported Keiko Fujimori, daughter of the jailed ex-president Alberto Fujimori in the 2011 elections that were won by Humala.

La República, on the other hand, might be considered editorially as sitting more towards the centre-left, at least in comparison with *El Comercio*. It says it has a 17% market share and by bidding for control of Epensa was trying to increase that share and achieve a more politically-balanced media landscape. La República believes it may still be able to block the takeover by pursuing legal action. Critics say that if the deal remains unchallenged Grupo El Comercio will increase its share of the Peruvian newspaper market from about 54% to 78%, on top of its two television channels and other outlets.

In a television interview on 29 December, President Humala said: "It is an embarrassment that here in Peru we have a group that practically owns all of the media. That's dangerous… This group, in addition to having its tentacles in television, in newspapers, in radio, also has commercial enterprises that do business with the state".

When his interviewer pointed out that the group's dominant role was not illegal, Humala responded, "No, it's not illegal. Right now it is not illegal." At this stage it looked as if the president was doing no more than express an opinion, and indeed one of his ministers suggested there was little likelihood of legislation on the matter. But by 2 January Humala's position had hardened, with the president saying that congress should discuss legislation aimed at limiting the concentration of ownership in the media.

All parties to this dispute talk about freedom of expression at every turn (but still disagree). In an editorial, *El Comercio* described the president's comments on legislation as "a veiled threat to freedom of expression". Cesar Pardo, the group's chief executive, was quoted by the *Wall Street Journal* as saying: "Every law that has been passed to control the concentration of media ownership has been done with a pretext for the common good, but ends up censoring the media." Lourdes Flores, leader of the centrist opposition Partido Popular Cristiano (PPC), said it was an "open threat" to freedom of expression. Nadine Heredia, the First Lady, who is also now president of the ruling Partido Nacionalista Peruano (PNP), countered with "the concentration of ownership in the media reduces pluralism and affects freedom of expression". *La República* believes it can challenge the takeover based on Peru's 1993 Constitution, which states: "The companies, goods, and services related to freedom of expression and communication, cannot be the objects of exclusivity, monopolies, or hoarding".

César Hildebrandt

César Hildebrandt, a well-known Peruvian left-leaning commentator, said on 14 January that Grupo El Comercio's purchase of Epensa was within the law and that the complainants (i.e. the rival Grupo La República) were merely irritated that they had been outbid. He said the real problem is that Peru's current legislation liberally permits the concentration of media ownership in private hands, to the detriment of small (independent) players. "The problem is not who buys who. The problem is that of 13m voters, [just] 1 million reads newspapers and TV [the dominant media] is controlled by conservative sectors", he noted.

Grupo El Comercio's flagship daily newspaper is one of the oldest in the country, with a circulation of 94,000. Among its other publications are the business daily *Gestión* and *Trome*, a tabloid which the group claims is the world's largest Spanish-language newspaper, with a daily circulation of over 700,000 in the first half of 2013. The takeover of Epensa makes business sense, because it will give the group a better footprint outside the capital Lima. Epensa's *Ojo*, another tabloid, had a daily circulation of 300,000, also in the first half of last year.

BRAZIL

The limits of pre-paid

In recent years, running a Brazilian mobile telephony company has been as close as you can get to having a licence to print money. With millions of people willing to pay for instant, portable communications, mobile phone subscriptions grew for many years at breakneck speed. But this is no longer the case: the market is showing signs of saturation, forcing operators to rethink their strategies in an attempt to defend their margins.

There are a lot of mobile phones in Brazil. In fact, according to the latest available figure from the local market regulator Anatel, there were 270.5m mobile phone lines in use in November 2013, representing a comparatively modest year-on-year increase of 4.0%, well below the double-digit growth rates experienced some years back. Slower growth is not surprising perhaps, since there are now more mobile phones than there are members of the population (est. 199m in 2013).

That turning point was reached back in 2011. We calculate that there are now roughly 136 mobile phone lines per 100 members of the population. Or to say the same thing differently, the average Brazilian owns 1.36 mobile phones. This phenomenon is now common in developed and many emerging economies, with a number of people owning two phones (typically, a personal and a company phone). But in Brazil, a further factor is the proliferation of cheap, pre-paid phones, also known as pay-as-you-go phones. Some consumers simply stop using theirs, discard them, or throw them away. Inactive phone lines eventually get purged from Anatel numbers, but at any point in time the aggregate number may overstate the number of phones actually in operation.

Cheap, pre-paid phones are now feeling like a mixed blessing for the operators. In their time, they played an absolutely vital role to encourage early adoption and spread the mobile phone habit to a majority of the population. But now that the market has become saturated and commoditised, it is very difficult to make a profit with a business model centred on pre-paid. In fact, pre-paid phone lines grew by only 0.9% in the year to November, and the absolute number of pre-paid phones actually dipped in the month of September.

This could be the beginning of a long-term decline. Pre-paid currently represents just under 80% of the total market, and if not dead as a duck, it is at least as sleepy as a sloth, as far as future prospects are concerned. Instead, all the excitement is focused on the post-paid 20% of the market, currently growing at a much more attractive annual rate of 17%. It is here that consumers are more likely to be using smartphones on 3G or 4G networks – in short using more high-value services on better-quality wireless communications systems and generating higher ARPUs (the industry acronym for average revenues per unit).

So, what to do? Not surprisingly, the operators are experimenting with a range of strategies to push up ARPUS and to eventually get more customers to trade up from pre- to post-paid. One approach, pursued by TIM, the number two operator, has been to persuade customers to go for a kind of hybrid between pre- and post-paid plans, known as *control*.

Typically, Brazilian pre-paid users top up their phones with credits that can be purchased online or from a variety of retail outlets. On average they spend BRL18 a month (US$7.53). So TIM offers the option to sign up to *control* for a regular monthly automatic charge of BRL30 (if usage exceeds this amount the customer can purchase additional credits in pay-as-you-go fashion). TIM CEO Rodrigo Abreu says switchover from basic pre-paid to *control* has been growing at 15%-16% each quarter. In the third quarter of 2013, for the first time TIM offered customers the ability to pay via credit cards. Abreu says this streamlines the process, cuts transaction costs, and transfers credit risk assessment to the credit card companies, who are best placed to carry out that function, taking it out of TIM's hands. The sign-up process, which can require 40 minutes in a retail outlet, can now be completed via credit card in about five minutes.

Brazil is the world's fifth largest wireless market. Telefónica TIM, America Móvil and Oi are the four main players

Claro, owned by Mexican giant América Móvil, is trying to boost ARPUs from pre-paid users by offering them a data-plan costing BRL0.50 a day. Since August 2013, Claro pre-paid users who remain in credit are offered free connection to the social network site *Facebook* (this was widened to include *Twitter* in October). Mauricio Torres, an executive at Claro, notes: "our users that access Facebook daily grew fivefold since we launched the plan".

Most analysts agree, however, that only so much can be done to titivate the pre-paid sector, but that the ultimate game plan has to be to convert more of the customer base to post-paid. One incentive for the switchover is to lower the cost of Smartphone handsets. Another wider challenge is to push up the number and customer relevance of value added services (including things such as mobile payments). An even bigger issue for the telco companies is the bundling of services to include not only landline/cellphone/broadband use, but also pay TV subscriptions. As Brazilian legislation allows bundling, it will be possible for telco companies to crossover into pay TV services, and for TV companies to offer communications services. The footprint of the fibre-optic networks necessary to support much of this bundling is still relatively small, but will grow.

Telefónica's TIM firesale challenged in Italy

On 4 December 2013 Brazil's anti-trust regulator Cade ruled that Spain's Telefónica must reduce its participation in Brazil's mobile sector, either by reducing its holdings or convincing its partner Telecom Italia (TI) to sell its local unit, TIM Participações (TIM). Cade said Telefónica should offload its direct and indirect stake in the wireless carrier TIM, or seek a new partner for its Vivo mobile phone unit, Brazil's largest mobile phone company. Together TIM Brasil and Vivo control over half the local mobile phone market. Cade also ruled that any new partner for Vivo will not be allowed to have a stake in rival companies in Brazil. The ruling was definitive and so not subject to appeal.

The Cade ruling imposed a R$15m(US$6.3m) fine on Telefónica for failing to notify regulators before it increased its stake in Telco, which owns 22.4% of TIM, in September 2013. That was in breach of a performance agreement signed in 2010, in which Telefónica agreed not to participate in TIM Brasil's management decisions or raise its stake in TIM. TIM Brasil was also fined R$1.0m (US$0.4m) by Cade for hiring a consultancy firm owned by

Telefónica. The regulator is not expected to force Telefónica to sell the stake it acquired in Telco during the capital increase. However, the option of getting the debt-ridden Telecom Italia to sell its Brazilian subsidiary could play into the hands of Telefónica, with strong suggestions that Telefónica favours a sale or breakup of TIM Brasil, worth an estimated US$11.5bn.

In mid-January, a rebel shareholder at Telecom Italia warned against a sale of the firm's assets in Brazil, claiming in a letter to the board that TIM Brasil could be worth as much as US$40bn, almost three times its current market value. A *Reuters* report dated 14 January said that Marco Fossati, whose Findim investment vehicle is Telecom Italia's third largest shareholder (with a stake of 5%), had written to board members and included a study suggesting that TIM Brasil's current standalone value was around US$23bn, but when factoring in growth prospects, potential cost savings and the effect of other benefits that rivals in Brazil would gain from a sale, the true value would be over US$40bn. *Reuters* noted that "Telecom Italia only narrowly fended off an attempt by Fossati to oust the board in December, highlighting growing support from institutional investors to his argument that Telefónica has too much sway over the company."

POWER

Argentina: after the blackouts

The month from roughly 10 December 2013 to 10 January 2014 was a pretty miserable time for approximately 13m people living in the Greater Buenos Aires area. A record heat wave saw temperatures soar, often as high as 38 degrees Celsius (100 degrees Fahrenheit). The power grid could not cope, and power cuts rippled throughout the city. The government declared a state of emergency. Many neighbourhoods suffered repeated outages; the situation was particularly bad in high-rise flats, where water supplies were also cut off. Tempers flared, with many residents building street barricades and demonstrating their anger.

Why did this happen? The government, under mounting political pressure, pointed its finger at the two private sector companies that supply Greater Buenos Aires, Edenor (locally-owned) and Edesur (controlled by Endesa of Spain). Cabinet Chief Jorge Capitanich accused them of "negligence" and threatened nationalisation: "if they aren't able to provide proper service the government will. There are no excuses," he said. Planning Minister Julio De Vido, who insisted there could be no question of raising electricity rates to 'ration' demand, made similar statements.

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This was followed by an order from Enre, the electricity regulator, that the two companies should pay compensation to customers who suffered cuts on a scale of 490-870 pesos (US$74-US$132), or double in the case of repeated power interruptions. It is thought this will cost Edesur ARS221m (US$33.4m) and Edenorte ARS77.5m (US$11.7m). In addition, regulatory fines have been levied of ARS17.9m pesos (US$2.7m) for Edesur and ARS8m pesos (US$1.2m) for Edenorte. Finally, the government has also seized control of FOCEDE, a fund for maintenance and expansion of the electricity network previously managed by the companies.

In public, the companies have had a relatively muted response, but in private they have argued that they provided sufficient power: the fault lay with antiquated infrastructure and the insufficient interconnection system. When power demand surged, as hundreds of thousands of air conditioners were turned on, many wires were overloaded and exploded, cutting supply.

"Energy Minister Pedro Joaquín Coldwell has suggested that together the opening up of the oil and gas and power sector industries could attract an extra US$10bn a year in new foreign investment."

Critics of the government note that there is a fundamental problem with its business model for the power sector. Since the economic crisis of 2002 – in other words for over a decade – most electricity tariffs have been frozen, failing to keep up with inflation. Under the existing model the government subsidises power supplies, just as it does petrol and fuel prices. According to ASAP, a think-tank on public sector finances, government energy subsidies rose 72% in the first nine months of 2013 to around US$9.15bn.

To keep this ultimately unsustainable model in place, there has been a sharp reduction over the years in investment and maintenance. That, say the critics, is the real problem. Mauricio Macri, the mayor of Buenos Aires (and a centre-right opponent of the federal government) said "we have a government that instead of building solutions, always looks for those responsible… when there is no investment we reach these situations, which are here to stay and will take a long time to resolve."

Mexico: Looking for investment

Most comment on Mexico's primary energy reform legislation, approved by Congress last month, has focused on the proposed opening up of the oil and gas sector. But the same legislation includes important changes to the business of electricity generation and distribution.

Mexico's power sector was nationalised in 1960, and since then the Comisión Federal de Electricidad (CFE) has had monopoly powers. Since 1992 however, private companies have been allowed to generate their own power (for self use) or to sell it to the CFE, and now account for one-third of installed capacity, with CFE holding the other two-thirds. Iberdrola of Spain is the largest independent power producer, with 5,300MW capacity. Other companies active in the generation sector include Unión Fenosa, also from Spain, and Mitsubishi of Japan.

The primary energy reform legislation approved in December formally ends CFE's monopoly status (as it does with Pemex, the state oil and gas company). Under the new regulations, the government will retain control of the transmission and distribution system, which is to be run by a new grid operator separate from the CFE. This new entity will determine which generators sell their power to the grid and when and where to build new transmission lines to connect them up.

Miguel Toro, an energy analyst at the think tank Centro de Investigación para el Desarrollo (Cidac), said the key innovations in the new approach are the creation of a wholesale market for power, and the separation of generation from transmission, distribution, and marketing. He believes that the success of the new approach will depend on the degree to which the new grid operator is separated from the CFE.

Energy Minister Pedro Joaquín Coldwell has suggested that together the opening up of the oil and gas and power sector industries could attract an extra US$10bn a year in new foreign investment. CFE director Francisco Rojas says that around US$50bn of additional foreign direct investment (FDI) could come into Mexico in the next five years. By his calculation, some US$23bn of that would go into the construction of gas pipelines; US$13bn into the construction of 27 thermo-electric power plants around the country, and US$14bn into public-funded investment in generating capacity by the CFE.

Ultimately, the real challenge for the new approach is whether it helps reduce the country's cripplingly high tariffs. Mexico is trying to position itself as a competitive location for manufacturing, particularly for companies accessing the US market. And while its labour costs are definitely competitive relative to the US, its electricity costs are definitely uncompetitive. According to analyst Marco Oviedo from Barclays, in 2013 Mexican industry was paying 45% more for its electricity than factories in the United States.

REGION

The mild bear market of 2013

Much of Latin America has suffered from an equity bear market over the last year or so - but one that has been mild in most respects. Corporate deal making has continued apace. This year, 2014, should be a more rewarding year than last for most investors in the region.

The past year (2013) was not kind to portfolio investors in Latin America. Widespread concerns about the impact of the slowing of China's economy, lingering weakness in other important export markets in North America and Europe, lower commodity prices and fears over the implication of a 'tapering' of US Federal Reserve asset purchases (the so-called ‘quantitative easing’ policy) contributed to a slippage in most regional currencies during the year. **[See chart 1]**

CHART 1: Movements in selected currencies against US dollar

	2013	2014 YTD
Argentine Peso	-24.59%	-3.96%
Brazilian Real	-13.26%	0.03%
Chilean Peso	-8.86%	-3.53%
Colombian Peso	-8.28%	-2.99%
Mexican Peso	-1.03%	-1.23%
Peruvian Sol	-8.73%	-0.43%
Uruguayan Peso	-6.43%	-0.84%
Venezuelan Bolivar Fuerte	-31.68%	0.10%

Source: www.xe.com

“Much of the region has suffered from a bear market over the last 13 months or so. However, as bear markets go, Latin America's has been very tame.”

Problems specific to particular countries in the region also had an impact. In Brazil, investors focused on anaemic growth rates, the stubbornness of inflationary pressures and, by implication, the lack of progress in wholesale reform to reduce the ‘Custo Brasil’ (the country’s high-cost business operating environment). The authorities in Venezuela felt that they had no alternative but to undertake (another) major devaluation of the unfortunately named Bólivar Fuerte early in the year. Argentina's peso depreciates according to a sliding peg: this broadly compensates for the true (as opposed to official) rate of inflation.

Except in Argentina (and Venezuela), where local equities have been coveted for their real or perceived exposure to US dollar denominated assets, much of the region has suffered from a bear market (according to the conventional definition of a fall in prices of 20% or more) over the last 13 months or so. Mexico's stock market has been the main exception to this. The performance of the major indices in Brazil has been impacted by the slide in the Real. The MSCI Emerging Markets index slipped by 4.98% in US dollar terms in calendar 2013, and by a further 3.19% in the first three weeks of 2014: and the Latin American markets have performed poorly in relation to their counterparts in other regions. **[See chart 2]**

CHART 2:Performance of MSCI Indices (US dollar terms)		
*2013 and YTD**		
	2013	2014 YTD
Argentina	63.65%	-3.06%
Brazil ADR	-19.23%	-8.73%
Brazil	-18.68%	-6.74%
Chile	-23.05%	-4.51%
Colombia	-23.66%	-7.08%
Mexico	-1.99%	-3.95%
Peru	-31.05%	2.45%
Andean	-24.66%	-4.42%
EM Latin America	-15.72%	-5.58%
***21 January 2014**		
Source: MSCI		

However, we would stress that, as bear markets go, Latin America's has been very tame. In a truly difficult situation, investor risk aversion soars, liquidity dries up and the effective cost of capital essentially rises towards infinity. In such an environment, deal-making becomes impossible and it is usually extremely hard for companies (and, sometimes governments) to raise funds through equity and debt capital markets.

"However, we would stress that, as bear markets go, Latin America's has been very tame. In a truly difficult situation, investor risk aversion soars, liquidity dries up and the effective cost of capital essentially rises towards infinity."

Latin America has emphatically been spared such an awful outcome. Equity issuance, both in Brazil and across the region, rose quite strongly in 2013, according to figures compiled by Dealogic. This was true both in terms of the sums raised and the number of transactions. Thanks mainly to the US$5.7bn initial public offering (IPO) by the insurance giant BB Seguridade, the amount of money raised by IPOs quadrupled in Brazil, and increased by about one fifth in the rest of the region, relative to 2012. The number of follow-on issues in equity capital markets (i.e. placements, rights issues etc) and sums of money involved have also grown. The US$2.5bn issue in Mexico by Grupo Financiero Banorte was the largest follow-on deal in the region last year. **[See chart 3]**

Corporate deal-making at a glance - 2012 and 2013				
	Brazil		Latin America	
	2012	2013	2012	2013
Corporate debt issuance	US$67.5bn in 137 deals	US$51bn in 114 deals	US$162bn	US$164bn
Of which: international	US$51.5bn	US$39.1bn	US$119bn	US$125bn
NB Brazilian corporates accounted for 31% of total issuance in 2013 Mexican and Chilean corporates, for 34% and 9%.				
Equity issuance	US$7.8bn in 29 deals	US$14.7bn in 38 deals	US$24.4bn in 71 deals	US$36.0bn in 83 deals
Of which: IPOs	US$2.1bn in 3 deals	US$8.4bn in 10 deals	US$11.3bn in 20 deals	US$13.5bn in 20 deals
NB Brazilian corporates accounted for 41% of total issuance in 2013 Mexican and Chilean corporates, for 34% and 18%				
M&A deals targeting Brazil/Lat. Am.	US$67bn	US$62.7bn in 697 deals	US$138bn	US$111bn in 1,381 deals
Source: Dealogic, via Business News Americas				

> "The slippage in prices and currencies indicates that a lot of bad news has been discounted. Transactions in debt and equity capital markets, as well as in the M&A arena, suggest that portfolio investors and corporate/direct investors perceive asset prices as attractive. If 2014 is not significantly more rewarding to investors (and investment bankers) than 2013, we would be surprised."

Merger & Acquisition (M&A) activity contracted last year, particularly outside Brazil. Nevertheless, it remained substantial by most standards. The largest deals were varied, but indicate that the buyers perceived 2013 to be a good year in which to buy strategic assets in the region - and especially if the purchase is being undertaken as a member of a consortium. Examples include: the purchase by Trafigura/Mubadala of a 65% stake in the Porto Sudeste operation of Brazil's MMX; Bancolombia's US$2.3bn purchase of the Panamanian business of global banking giant HSBC and; the US$8.3bn bid by the Odebrecht/Changi consortium for Rio de Janeiro's Galeão Airport.

Overall corporate debt issuance across the region was, at US$164bn in 2013, only marginally higher than in the preceding year. Issuance by Brazilian corporates, and of securities to domestic investors generally, fell. However, this was more than compensated for by issuance by companies outside Brazil and of international bonds. The international bonds were overwhelmingly Yankee bonds, denominated in US dollars and distributed to US investors.

Taken together, all this augurs well for investors in Latin America's equity and bond markets in 2014. The slippage in prices and currencies indicates that a lot of bad news has been discounted. Transactions in debt and equity capital markets, as well as in the M&A arena, suggest that portfolio investors and corporate/direct investors perceive asset prices as attractive. The recoveries of developed economies are much better established than they were in early 2013. As we explain elsewhere in this edition of *Latin American Economy & Business*, it appears that economic activity in China has stopped decelerating. In the meantime, long-term regional trends such as substantial investment in infrastructure, the growth of consumerism and the development of financial services, remain intact. If 2014 is not significantly more rewarding to investors (and investment bankers) than 2013, we would be surprised.

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