Latin American Capital Markets

Wednesday November 14 2012

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Resilience at the core of a continent's growth story

The 'lost decade' may have been consigned to history but more development work is needed to remain buoyant, says *John Paul Rathbone*

Sights set high: the New York listing of CTC, the Chilean telecoms company, marked an end to the 'lost decade' Dreamstime

Twenty-two years ago, Germany reunited. That July, as if to celebrate the occasion, the West German football team also took the world title from Argentina, to Diego Maradona's inconsolable tears. Europe, and the west as a whole, was ascendant; by contrast Latin America seemed a financial, geopolitical and even sporting backwater.

How wrong those perceptions were. Even before the Argentine team limped off Rome's Stadio Olimpico playing field without having scored a goal, the seeds of change were germinating several thousand miles away.

In January, CTC, the Chilean telecommunications company, listed on the New York stock exchange for an amount that seems almost derisory now – just $75m. Yet the offering marked a symbolic end to what had been called the continent's "lost decade". Since then, the MSCI index of Latin American stocks has risen by almost 1,400 per cent – double that of the MSCI World index. In 2010, Petrobras, the Brazilian oil company, then pulled off the world's largest equity listing, with a $67bn issue.

Latin American capital markets have certainly come a long way over the past 20 years. Banking systems have strengthened, domestic bond markets have deepened, stock markets have expanded, local pension funds have grown, and alternative markets – from derivatives and exchange traded funds to private equity – have multiplied. BM&FBovespa, the Brazilian securities exchange, is now the third largest exchange in the world.

As evidence of this new financial sophistication and resiliency, Latin American markets – with only a few exceptions – have weathered the global and eurozone financial crises relatively well.

In the first nine months of this year, Latin American bond issues totalled a record $120bn, according to Dealogic. Mergers and acquisitions rose by 3 per cent to reach $110bn, even as global M&A volumes fell by 15 per cent. As for equities, in September Spanish bank Santander raised $4.1bn in an initial public offering of its Mexican subsidiary, the third largest IPO globally this year.

> 'The region's financial services industry is underdeveloped by international comparison'

If Latin American capital markets are doing well it is thanks to a combination of factors, from better economic policy making and financial regulation and supervision, to improved payments and custody systems as well as buoyant economic growth.

Although the world economy is slowing, rapid domestic credit expansion – another relatively new Latin market – has helped keep local demand strong. The International Monetary Fund forecasts the region will grow over 3 per cent this year, and then 4 per cent a year through to 2017.

Nonetheless, as is sometimes said, this abundance of relative success makes complacency the biggest risk in the region.

That is as true of economic policymaking as it is of capital markets. "In many respects", concluded an in-depth World Bank report this year titled "The Road Ahead", "the region's financial services industry is underdeveloped by international comparison."

One metric which illustrates this is the relative size of Latin American financial assets. In 2009, they reached

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Groups prepare to play catch-up

Bonds Debt markets boom but still lag behind developing regions such as east Asia, says *Vivianne Rodrigues*

Latin American domestic bond markets have deepened considerably in the past decade. Gone are the days when many of the region's currencies were tied in some shape or form to the US dollar and when regional banks favoured lending exclusively to large corporations or rolling over massive quantities of sovereign debt.

The region's rapid growth in the past decade brought a new wave of companies, lenders and investors into local capital markets as financing needs rose sharply.

Yet, while the size of domestic bond markets in the largest Latin American countries more than doubled since 1995, according to BIS data, compared with other developing regions – in particular east Asia – it continues to lag.

Bond markets relative to GDP are small and the most developed segment remains that of government bonds, a legacy of Latin America's reliance on heavy government borrowing in order to fund large deficits. The number of firms issuing bonds or attracting foreign investor participation is still small and maturities are short.

Even in Brazil, the region's largest economy, total sales of corporate debt reached R$76bn ($38bn) in the first nine months of 2012, according to Anbima, the country's capital markets association. That compares with more than $400bn in corporate bond sales in east Asia in the first six months of the year, data from the Asian Development Bank show.

In addition, many corporate debt securities are not traded for extended periods. This absence of price quotes in secondary markets prevents many institutional investors from holding such securities, which further dampens an important source of liquidity. As a result, when many Latin American companies want to raise big money they still have to go the US debt markets.

Latin American companies have sold a record $68.4bn of bonds in the US this year, driven by issuance from some of the region's largest groups, including Brazil's Petrobras, Chile's Codelco and Mexico's Mexichem, according to figures from Dealogic.

"Domestic debt markets in Latin America have been traditionally pretty liquid on the sovereign front. For many years, government bonds provided a virtual risk-free asset, with attractive yields," says Sebastien Chatel, chief executive officer at Brasil Plural, a broker dealer based in New York.

"Trying to sell corporate bonds was tougher, given they were offering a marginal pick up in yields, which was not that appealing enough to a broad base of investors," he says.

Still, Mr Chatel adds the outlook for local debt markets is improving dramatically thanks in part to local governments' aggressive efforts to bring down benchmark borrowing rates.

Latin American companies have been attracted to the US market largely for its rock-bottom rates, which compare favourably with higher rates in their home markets.

Petrobras's bond issuance in the US was part of a Latin American total of $68.4bn

Bloomberg

But that is beginning to change. Brazil's central bank, for example, has slashed the benchmark Selic rate from 12.5 per cent last year to 7.25 per cent last month. In countries like Colombia, rates are still expected to be cut further.

"As we see interest rates in countries like Brazil collapse, further development of local fixed income markets is inevitable," Mr Chatel says.

But lower borrowing costs are not the only reason why many Latin American companies rely on foreign debt sales. Offering in international markets attract a much larger pool of investors to the companies' debt.

While liquidity in local debt markets has been rising steadily, the US is still a better option for the combination of long-tenor and large issuances, such as Petrobras's $7bn bond earlier this year. That issue marked the largest debt offer for a Latin American company in the US.

Sabur Moini, a high-yield portfolio manager at Payden & Rygel, which also invests in Latin American bonds, says: "It's a no-brainer for Latin American multinationals to come and sell bonds in the US. Local corporate bond markets are nowhere the size of the US market and rates are still quite high. So why not diversify and lock in long-term money at pretty low rates, in oversubscribed deals? Demand here is tremendous and it helps these borrowers establish themselves as true global players."

For global investors, the allure of the debt is clear. The average yield on Latin American corporate bonds sold in dollars stood at 4.3 per cent this month, according to the JPMorgan CEMBI Broad Index. By contrast, high-grade bonds sold by US companies yield 2.7 per cent on average according to a Barclays index.

That might be good news for investors and Wall Street-based investment banks, such as JPMorgan and Citi, which are the biggest underwriters of Latin American debt in US dollars. But for smaller companies, with riskier credit profiles and limited international presence, the foreign markets may not be that friendly.

"Domestic bond markets are crucial for these economies to keep up with their rapid growth rates. They provide financing alternatives for a broad base of local companies and not only the largest ones," says Roberto D'Avola, managing director and head of Latin America debt capital markets at JPMorgan. He adds most Latin American markets are moving "towards the right direction", with banks providing more liquidity to the securities and local institutional investors boosting their credit research departments. Regulators, exchanges and local governments have ramped up their efforts to develop the credit markets, seeking to roll out new products and attract a new pool of domestic investors.

> 'It's a no-brainer for Latin American groups to come and sell bonds in the US'

In one recent move, Brazil's government announced last month it will offer tax incentives for foreign investors buying mortgage-backed securities or invest in funds that purchase them. And earlier in June, Citigroup said it was in discussions with Brazilian regulators to create local global depository notes tied to domestic corporate bonds. "Five years from now, these markets will have changed completely," says Mr D'Avola. "There's a generation of local savers and investors stepping in and pushing for more local supply. Companies and regulators get that. Now, it's just a question of time."

Derivatives market enjoys solid outlook

Brazil

Good prospects await private and government debt-issuance, writes *Vivianne Rodrigues*

BM&FBovespa in São Paulo

Brazil's derivatives markets has long been popular among local and foreign investors who use it mostly to make money from the difference between the country's benchmark interest rates and those in developed markets.

While Brazilian equities and its currency have suffered this year, the number of derivatives contracts negotiated has continued to rise.

In the first nine months of the year, over 540m contracts, worth about $2tn were negotiated on the BM&FBovespa, a 4.2 per cent rise from the same period of 2011.

First designed in the late 1970s, the derivatives market catered to commodities products in response to Brazil's profile as a natural resources and agribusiness powerhouse. That original make-up has changed and now foreign exchange and interest rate futures are the bulk of all derivatives traded.

The biggest participants are institutional investors and banks, which account for almost 70 per cent of trading, according to BM&FBovespa data. In recent years, the share of foreign participants has risen steadily to reach 25 per cent this year, up from 16 per cent in 2011.

The popularity of Brazil's derivatives market can be explained in part by its focus on exchange traded products: about 90 per cent of all contracts are traded and cleared via the central counterparty BM&FBovespa itself.

Over-the-counter products are registered mainly through Cetip, Latin America's largest depositary of private fixed-income securities.

BM&FBovespa and Cetip monitor daily trading to prevent risk from building up and trades are settled the same day.

This breakdown is not widespread in most global markets, where over-the-counter products dominate. Brazilian regulations are tight and only institutions accredited by the central bank can perform transactions.

But while centralisation of trading minimises risks, some participants say the lack of competition pushes up costs and limits the pool of products.

Other global exchanges, such as BATS Global Markets, have tried to set up alternative trading venues in the country. But entrants would be required to do both trading and clearing, setting up the infrastructure for both activities.

For now, as the threat of competition grows, the exchange is accelerating moves to lower fees and broaden its derivatives portfolio. After launching a soyabean contract and eight currency derivatives in 2011, the exchange is rolling out a cross-listings of the Ibovespa index futures – in partnership with the US CME Group.

S&P 500 futures will also be traded in Brazil on the BM&FBovespa and the exchange is considering adding fixed-income exchange traded funds and real estate-backed contracts.

While recent measures by Brazil's government – including several taxes on international financial transactions and a series of benchmark rate cuts – have affected both currency and derivatives trading, analysts say the outlook remains solid.

The derivatives market, they say, may provide an attractive source of hedging for investors, as both private and government debt-issuance is likely to increase in coming years as the country prepares to host the 2014 World Cup and the 2016 Olympics.

Santiago aims to be hub for global investment

Markets

Chile has plans to become another Luxembourg, writes *Jude Webber*

While other countries in Latin America would like to be Chile – a byword for fiscal responsibility and sound economic management – Chile fancies itself as Luxembourg.

Latin America's investment-grade pioneer has long punched above its weight economically. For proof, look no further than its sale last month's of $1.5bn in dollar bonds, when it boasted of securing the lowest financing cost ever in Latin America and the cheapest for any emerging market – just 2.38 per cent, or 55 basis points over US Treasuries, for its 10-year debt.

"Chile liberalised its financial markets a decade before others got in on the act," said Michael Henderson of Capital Economics in London.

With that experience, plus a golden reputation for financial prudence and low political risk, Chile has increasingly been looking to position itself as the go-to place for investors attracted by a region that boasts growth and potentially high rewards.

LarrainVial, one of the Chilean capital Santiago's most established financial institutions, with $3bn in assets under management, earlier this year launched a Latin American Small and Mid Cap Latin American Equity Fund in Luxembourg.

It plans to follow that with a Latin American high-yield bond fund and a Latin American equity fund, as well as Brazil- and Chile-focused products.

The idea is to open the door to investment opportunities in Latin America through an experienced team with a footing in Chile, Colombia, Peru, Brazil and Mexico.

Instead of simply helping investors gain access to Latin America from abroad with the help of Chilean experts, however, the Andean country is increasingly angling to position itself as an attractive springboard for funds to flow in and do business across the region.

Brazil's Banco Itaú has announced plans to launch an exchange traded fund (ETF) tracking Chilean stocks – by the end of the year if possible – which it says will boost liquidity. The head of the stock exchange also says he wants to develop an ETF industry with sector and fixed-income funds in the future.

"Chile could be the launch hub for global investments, like Ireland and Luxembourg," said one Santiago-based fund manager. "But that needs regulation."

Sebastián Piñera, Chile's market-savvy president, who started his career at a financial services provider, is seeking to deliver just that.

The current tax rules are seen as stunting the outward-looking country's prospects as an international financial hub.

For example, non-resident investors in debt in Chile presently face being hit by a 35 per cent capital gains tax.

Legislation that is currently before congress, however, is seeking tax changes to make investing by foreigners in debt in Chile more enticing.

"I think it's pioneering. I think it will energise and deepen the market," said the fund manager.

The investment industry agrees – and is urging congress to pass the bill – as quickly as possible.

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Resilience remains at the core of a continent's growth story

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125 per cent of gross domestic product, a third more than only 10 years before but still well below levels in China, Asia, India and developed economies – although on a par with central Europe. The reasons for this are several.

Take equity markets. Despite the success of the Petrobras and Santander offerings, Latin American equity markets generally remain illiquid and highly concentrated.

That is partly because of the local preponderance of buy-and-hold local pension funds over more active institutional investors such as mutual funds, and partly because of corporate governance issues – although the more stringent requirements of Brazil's Novo Mercado is showing the way forward.

More fundamentally, subsequent to the spurt of equity listings in the 1990s when many large state companies were privatised, there was a rash of consolidation and buyouts by foreign firms.

In the process, many local blue-chip firms disappeared – although, thanks to the eurozone and US subprime crises "that trend may now be reversing," says Luis Oganes, head of Latin America research at JP Morgan.

Cash-strapped foreign firms have recently taken to using their Latin operations as a kind of ATM machine, selling or listing local subsidiaries to repair domestic balance sheets, as Santander's recent IPOs of its operations in Mexico, Brazil and Chile show.

Then there are fixed income markets. In many ways, these have been a huge and continuing success – despite the lingering stain of Argentina's $100bn default which continues to keep that country out of international markets.

Amid global investors' "quest for yield", last month even tiny Bolivia issued its first overseas bond since the 1920s, a $500m 10-year issue with a 4.9 yield, almost a percentage point less than Spain's 10-year borrowing costs.

Elsewhere, Latin sovereigns are increasingly raising money locally – especially in the region's deepest fixed income markets, Brazil, Mexico, Colombia and Chile.

One reason for that is the rising weight of local pension and insurance funds, with almost $1,000bn of assets under management.

Nonetheless, local corporate bond markets still remain relatively underdeveloped, prompting most companies to issue abroad, unlike in Asia with its thriving corporate "Dim Sum" market.

"It's part of a long process since the 1990s," says Peter Lannigan, head of Latin American credit at brokerage Exotix. "The first step was for sovereigns to issue internationally, the next phase was to issue sovereign debt locally, then companies started to issue internationally.

"The fourth phase will be when companies issue locally, too."

To date, though, this internationalism is reflected in debt capital markets' bookrunner rankings for the region. Among the top 10 this year there are only two Latins, both of them Brazilian.

Lastly, there are banks, which "lend less and charge more than they should", says the World Bank.

Although there has been a regional consumer credit boom – which has lately required banks to boost bad loan provisions – mortgage lending and credit to small- and medium-sized businesses lags elsewhere.

There are many reasons for this, some structural: property rights and credit recovery are often hard to enforce, which limits lending. Lack of competition may be another factor.

More developed swap markets, which would allow banks to move between floating and fixed rates, "would also help encourage long term bank lending," Mr Oganes adds. "That's another frontier."

Yet the biggest reason for the region's relatively underdeveloped capital markets, suggests the World Bank, may be a reflection of Latin America's turbulent financial past, when it experienced more financial crises, more frequently, than anywhere else.

Yet as that page has been turned in most countries so too, in time, will it likely turn for their capital markets.

One encouraging sign is the integration of the Chilean, Colombian and Peruvian stock markets, designed to provide greater market access and scale. Even in good times, there is always more work to be done.

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Clock is ticking
Belize's international debt default
Restructuring is painful, says Robin Wigglesworth

Obstacle course
Will lower rates clear the way for Brazilian bonds?
Better returns may become reality, says Joseph Leahy

Trading surge brings region together

Stock exchanges Stronger economies and pension investors are fuelling growth, writes *Adam Thomson*

A few weeks ago, a full mariachi orchestra accompanied by dancers in long white flowing skirts was piping out tunes as the sun climbed into a clear sky over Mexico City.

But the venue was not one of the city's many cantinas and the audience was not a group of inebriated punters. Instead, the songs were blaring from the Mexican stock exchange (the BMV) and the assembled crowd comprised bankers celebrating the listing of Santander México, the Spanish bank's local arm.

The deal marked not only a successful listing – the dual flotation in the US and Mexico raised about $4bn for roughly 25 per cent of the company, the biggest in the Mexican stock exchange's history – but also the start of a more dynamic era for the country's equity market.

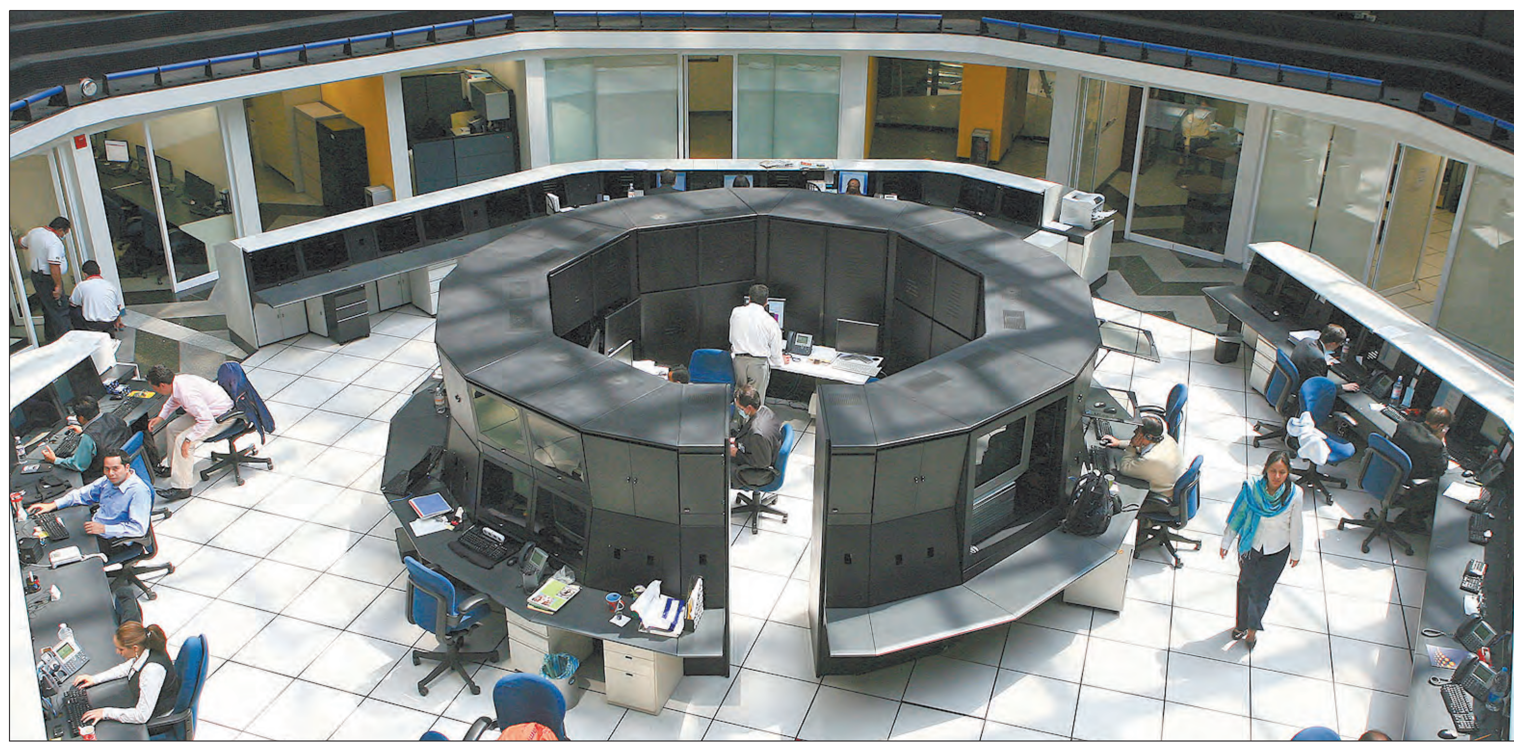
"Today, the stock exchange offers more possibilities for raising capital than ever before," José Antonio Meade, Mexico's finance minister, said at the celebration.

This new dynamism is part of a regional trend as equity markets across Latin America enjoy significant gains and start to eye initiatives aimed at greater stock market integration.

From Santiago, in Chile, where the IGPA index is up about 3 per cent so far this year in dollar terms, to Colombia, where Bogotá's IGBC index, is up 13 per cent, Latin American bourses are having a solid year. Indeed, with Argentina's Merval index up 2.47 per cent, Peru's Lima General index up 8 per cent and Costa Rica's exchange up 7 per cent, the only clear laggard is Brazil, where the Bovespa index is up only 0.7 per cent.

Driving that rise are strong macroeconomic fundamentals. Peru, Colombia and Mexico have joined Chile as shining examples of prudent economic management. Inflation is in single digits, fiscal deficits, if existent, are low and international reserves are at all-time highs. According to the International Monetary Fund, Latin America and the Caribbean are set to grow a solid 3.2 per cent this year – and 3.9 per cent in 2013.

Luis Téllez, BMV president, told the FT this month: "We have done our homework and it is starting to show."



On song: the floor of the Mexican stock exchange, the BMV Bloomberg

A second factor is that Latin America's private pension systems are becoming important engines of investment. In Chile, which has the best established private pension system, total assets equate to 60 per cent of gross domestic product, according to the Organisation for Economic Co-operation and Development. That is considerably higher than Denmark and is just behind Canada.

In Mexico, the private pensions system only began in 1997, a full decade after the Chilean system. But with total assets equivalent to 13 per cent of GDP, according to the OECD, the system has become an important stock market investor.

Overall, says Stacy Steimel, managing director for Latin America at Pine-Bridge Investments, an asset manager, the sum of the region's pension funds and mutual funds is close to $2tn compared with just $400bn in 2005. "The rise of the pension funds has given real buoyancy to the markets," says Ms Steimel.

That buoyancy has taken place thanks not only to the growing size of pension fund assets but also to progressive rule changes throughout the region that allow the funds to buy local stocks.

According to Consar, the Mexican pensions regulator, domestic pension funds invest more than 7 per cent of their portfolios in stocks and other variable income securities compared with less than 1 per cent in 2005. "We now have a local institutional investor base," says Mr Téllez of the BMV. "It's a huge success in terms of developing capital markets."

The bigger volumes being invested today – about 20 per cent of Latin America's pension and mutual fund assets are invested in equities compared with 14 per cent in 2003 – have made regional stock exchanges more attractive for companies looking to raise capital through initial and secondary public offerings.

Cemex, the Mexican cement producer, is floating part of Cemex Latam Holdings, its Central and South American unit, in an initial public offering (IPO) on Colombia's stock exchange. Colombian regulators say the company stands to raise up to $950m for roughly a quarter of the company.

In Peru, Intercorp, one of the country's largest lenders and retailers, recently listed InRetail, its supermarket and shopping centre business, on the local exchange, raising about $400m.

The increase in investment volumes has given rise to more connectivity between bourses, which see advantages in facilitating market access to listed companies (see the box, right, on the Mila tie-up).

Will Landers, managing director and senior portfolio manager for Latin American funds at asset managers BlackRock, says that while the emergence of institutional buyers with a long-term focus is good for reducing volatility, there is still insufficient liquidity and too few IPOs in the exchanges of Colombia, Peru and Chile to make them as interesting as Brazil or Mexico.

For many investors, the changes – along with the promise of investment opportunities – are already there. "Latin American equities used to be just Brazil and Mexico. Today, the emergence of a very real third market has created a triangle," Ms Steimel says.

Bourses Uniting to build critical mass

"In union there is strength," goes the old truism. For some of the Andean countries, unity goes well beyond an adage thanks to the Mercado Integrado Latinoamericano, or Mila – a tie-up between the Chilean, Colombian and Peruvian bourses.

"Mila has shown that in Latin America, financial integration is possible," explains Juan Pablo Córdoba, president of the Colombian stock exchange and one of the masterminds behind the harmonisation.

Mila was aimed at broadening and deepening the equity markets while bringing together exchanges with different strengths: Chile in retail and services, Colombia, financials and energy and Peru in mining.

"The main objective was to change the mindset that not everything has to be done in New York, that there are neighbours worth investing in," Mr Córdoba added. "That, and to build critical mass and increase liquidity."

Despite the effort, Mila still has some of the original challenges over the long term with lingering regulatory, currency, oversight and tax complications, and the market is still very thinly traded. Getting wary investors to take the decision to invest in countries and companies that they do not have first hand knowledge of is not that simple.

While Mila volumes are not spectacular and perhaps disappointing, notes Rupert Stebbings, managing director at Celfín Capital, a brokerage that operates in the three countries, "it has grown into something much bigger than a trading platform."

Retail players having the facility to execute in other markets, notwithstanding, among the most followed stocks over the past year were players already well-known such as Colombia's energy giant Ecopetrol and the country's biggest bank, Bancolombia, as well as Chilean airline LAN and retailer Cencosud.

For commentators, the success of Mila in terms of liquidity and depth should be judged over time because "Mila is now a region, an economic unit and much of the cross border financial activity," says Mr Stebbings.

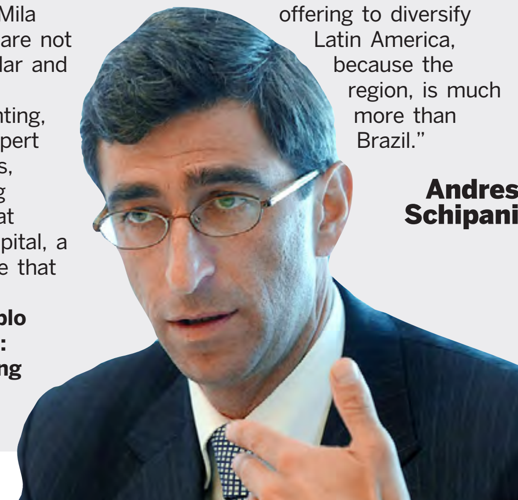
Mila has even extended its cross border reach outside the Andes as Mexico's Bolsa Mexicana de Valores has recently ratified its commitment to join it, subject to regulatory and legal authorisation.

This could give a boost in trading and initial public offerings. According to the latest data, groups listed on Mila have a combined market capitalisation of $703bn. With Mexico on board, the combined market capitalisation will exceed $1tn.

This will allow Mila to take on the capital markets might of Brazil's Bovespa with its giant market capitalisation of $1.2tn.

"We really love Brazil, they are admirable," says Mr Córdoba, "But we are offering to diversify Latin America, because the region, is much more than Brazil."

Andres Schipani



Juan Pablo Córdoba: embracing change

The 'only way is up' for an area with excellent growth prospects

Private equity

The investment industry appears to be maintaining its regard for the region, writes *Pan Yuk*

As in much of the investment world, private equity has taken a hard knock in Latin America in recent years as developed markets continue to languish.

After two years of record fundraising for the region, funds raised for private equity and venture capital investment in Latin America fell dramatically in the first half of 2012. Companies took a break from fundraising to focus on capital deployment.

Only $1.9bn was raised in the first six months of the year, a steep decline from the $4.9bn raised during the same period a year ago, figures from the Latin American Private Equity & Venture Capital Association showed.

Cate Ambrose, president of LAVCA, attributes the decline to a number of factors, most notably greater participation from mega funds last year. Brazil's Vinci Partners, Gavea Investimentos, BTG Pactual and Carlyle Group were among those that raised billion-dollar funds in 2011.

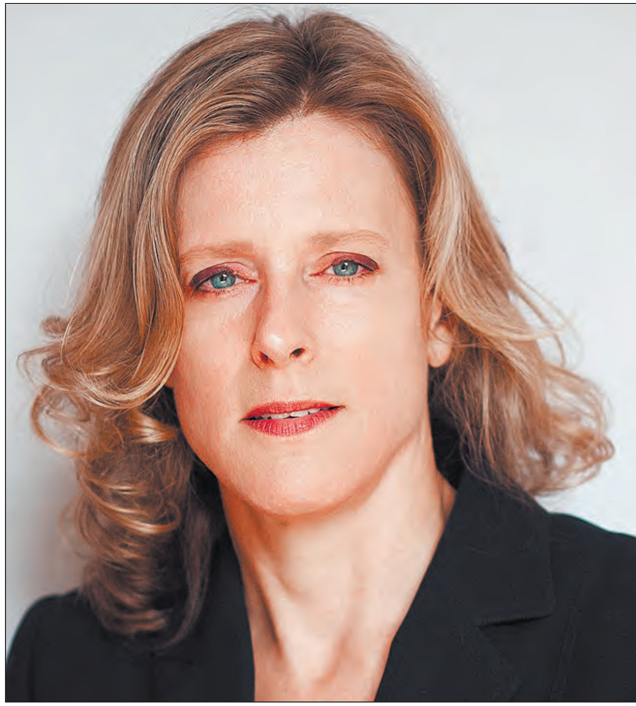
Ms Ambrose says: "2011 was an extraordinary year. There are still not that many Latin American funds that can raise more than $1bn. So obviously, if you raised $1bn last year, then you are not going raise $1bn again this year because someone has to go and invest the $1bn that has already been raised first."

The second half is not expected to get any better.

Patrice Etlin, managing partner at Advent International, says fundraising for the second half of this year would most likely be weaker than the first half.

"It usually takes three to four years for capital raised to be deployed," he says.

"The fundraising cycle should pick up again in 2013 and 2014."



Cate Ambrose: venture capital's role 'remains strong'

But, says Ms Ambrose, do not be fooled by the headline fundraising figures. Private equity's interest in Latin America, she indicates, is as strong as ever.

Despite the fall-off in fundraising this year, private equity investment in the region has held steady. Some 90 deals, worth $2.73bn, were struck in the first half, compared with 65 deals, worth $2.67bn, during the same period in 2011.

Separately, a LAVCA/Coller Capital survey of 105 private equity investors around the world, found that 87 per cent of those already investing in the region say they plan to maintain or increase their exposure to LatAm PE funds over the next 12 months.

Ms Ambrose points to the rise in the number of mid-sized funds, with $200m to $300m, as cause for optimism.

"In a way, these are more important numbers because these funds are more sustainable," she says.

Brazil still attracts the most private equity interest in the region – accounting for 45 per cent of funds raised and 83 per cent of deals struck by value. With 30m more people entering Brazil's middle classes over the past decade, much of investors' focus has been consumer-based.

Deals struck in the country during the first half of this year include: Thomas H. Lee Partners' acquisition of Fogo de Chão, the steakhouse chain for $400m; BTG Pactual's R$200m investment in Bodytech, the fitness chain; Carlyle Group's

> Some 90 deals, worth $2.73bn, were struck in the first half of 2012

acquisition of a 85 per cent stake in Ri Happy, the country largest chain of toy stores; and Actis taking a minority stake in the Brazilian university group Cruzeiro do Sul Educacional for ($102m).

But, with more than 80 per cent of the private capital available in Brazil chasing deals from among a small pool of just 3,000 large companies in the country (those with sales of more than $200m) competition for big deals is fierce.

Instead, the real opportunities will be in the midmarket and that is why the growth seen in the number of midsized funds is encouraging.

In Brazil, there are over 14,000 companies with sales of between $30m and $200m and these are the ones that need access to cheap capital. It is worth remembering that despite recent interest rate cuts, the benchmark Selic is still at 7.25 per cent. Faster growing economies in Spanish America are seeing increasing action. Mexico and Colombia have had a surge of private equity investment: Mexico, from $84m in the first half of last year to $228m in the first half of this; Colombia, from $1m to $99m.

One private equity company head says: "There's a lot of buzz around both Colombia and Mexico. People are interested in the countries' growth stories and see the lack of competition from other funds as a plus for valuations."

Indeed, much has been made about Mexico's resilience in face of the current global market downturn.

The country, with its strong manufacturing export base and the US as its northern neighbour, is expected to grow as much as 4 per cent this year, compared with the 1.6 per cent forecasted for Brazil.

Colombia has seen healthy economic growth during the last decade as the government has made significant efforts to reduce violence in the country and pursued market-friendly policies. The Colombian economy is forecast to expand between 4.7 and 5 per cent this year.

Recent deals include Nexxus Capital taking a 39 per cent stake in Maak Holding, which owns companies that commercialise marble, granite and other natural stones in Mexico.

Aureos Capital investing $10m in Investigación Farmacológica y Biofarmacéutica, a Mexican clinical research group.

All such developments are only encouraging for Ms Ambrose.

"LatAm is a region that is not going away," she comments. "It is going in one direction: up."

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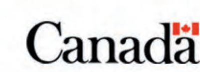


Neighbours show little appetite for Brazil's 'war'

Foreign exchange Intervention in the currency market could be a distraction from necessary reforms, writes *Jonathan Wheatley*

Strategy: Colombia asked Ecopetrol, the state-controlled oil company, to delay dividend payments worth about $6bn Bloomberg

Has Brazil won the currency war? Ministers certainly seem happy with the real's current level of about R$2 to the US dollar, back from about R$1.50 last year. They say they will defend the currency at its present level and admit that, after years of arguing for a freely floating exchange rate, they are now operating a "dirty float" of R$2.00 to R$2.10 to the dollar.

That is a significant change of stance for Brazil. But it is not alone in re-examining its exchange rate policy. Elsewhere in the region – notably in Colombia, Chile and Peru – governments have watched in alarm as their currencies have been carried up on a tide of global liquidity unleashed by quantitative easing in the US and loose monetary policy across the developed world.

Their responses, however, have varied, as have the results. By the time Brazil's currency reached its peak of R$1.50 to the dollar, the real had strengthened by about 40 per cent over the preceding two years, eating away at the competitiveness of Brazilian exports. Guido Mantega, finance minister, coined the term "currency war" in September 2010 after the first wave of quantitative easing led to what he called aggressive, protectionist devaluations of the US dollar and other currencies.

How to respond? Brazil did not want to shut out all foreign inflows. The government's priority is to generate jobs and growth. Foreign direct investment – running at about $60bn a year – is a crucial element in that, so could not be targeted. For the same reason, ministers did not want to deter foreigners from investing in Brazilian equities. But speculative "hot money", attracted to Brazilian bonds by the country's very high interest rates, was an obvious target.

Within weeks of declaring the currency war open, Mr Mantega had announced a 6 per cent tax on foreign investment in Brazilian domestic fixed income. While other countries in the region subsequently saw a huge increase in the share of their domestic bonds held by foreign investors, flows to Brazil slowed to a near standstill.

The fixed income tax was followed in March last year by higher taxes on overseas borrowing by Brazilian companies and from August last year by a steady reduction in Brazil's policy interest rate, from 12.5 per cent to 7.25 per cent today – although interest rate cuts were described as a response to slower economic growth at home and abroad rather than a direct assault on the exchange rate.

Indeed, Brazil only made explicit its attempts to manage its exchange rate as recently as last month. "For us, the ideal is a floating currency, without manipulation," Mr Mantega told a local newspaper. "But if the whole world is going to manipulate their exchange rates, we will too."

Other countries have balked at that kind of heterodoxy. In Chile, currency appreciation has contributed to steadily weakening exports to the extent that the country's trade balance has turned negative over the past few months. Yet authorities have so far resisted pressure for greater intervention in foreign exchange markets.

In Colombia, the government took the unusual step in February of asking Ecopetrol, the state-controlled but publicly traded oil company, to delay until next year dividend payments to the treasury worth about $6bn, in spite of the difficulty this would create in balancing the national budget.

Colombia has ruled out Brazilian-style currency warfare, even though by the middle of this year the peso had gained about 8.5 per cent against the dollar. But the government has stepped up its dollar purchases in foreign exchange markets, helping the peso to relax a little since midyear.

Peru, too, has turned to increased foreign exchange intervention as well as higher reserve requirements for local banks in an effort to slow currency appreciation and lessen the potentially destabilising effects of rising foreign inflows.

> Other countries with a more orthodox approach to economic policy have fared much better

Yet none of these countries has joined Brazil in its crusade. Indeed, Brazil's success in stemming the rise of the real may have less to do with the currency war than with its economy's sluggish performance. After surviving the global financial crisis of 2008-09 relatively unscathed, Brazil's economy surged ahead with growth of 7.5 per cent in 2010. But since then growth has slowed sharply, to 2.5 per cent last year and an expected 1.5 per cent this year. Brazil is no longer the darling of foreign investors it recently was and many investors have turned elsewhere in their search for yield.

Other countries with a more orthodox approach to economic policy have fared much better. Chile is growing at an annual rate of about 5.5 per cent. Colombia is growing at about 5 per cent and Peru at about 7 per cent.

In Brazil there has been an increase recently in investor appetite for local bonds. Yet there are signs that the Brazilian government is looking beyond foreign exchange markets for ways of boosting competitiveness.

While it continues to use targeted tax breaks to pick winners among industrial sectors, it has also turned recently to measures designed to promote competitiveness across the economy, such as lower payroll taxes to encourage hiring.

Like its faster growing neighbours, it may be realising such long-term, structural measures are more effective than fighting a currency war.

Change is in the air for stocks

Equities

Moves are afoot to sway investors' aversion, writes *Samantha Pearson*

From the moment they are born Brazilians are taught to invest in anything other than equities, says Edemir Pinto, chief executive of the country's stock exchange operator BM&FBovespa.

"Abroad, when a child is born they are given stocks but here in Brazil we give them a savings account," he says.

In the United States, for example, companies such as OneShare offer gift cards with stocks in companies such as Disney or McDonald's. In Brazil, though, few adults, let alone children, venture into the stock market.

It is easy to understand why. Up until a few months ago, Brazil had the highest real interest rate in the Group of 20 Nations according to Bloomberg – a legacy of the country's past struggle with hyperinflation.

The country's bond market was one of the most attractive in the world for foreign investors and even savings accounts in Brazil were guaranteed by the government at about 6 per cent.

Meanwhile, the Bovespa stock index has given Brazilians little reason to risk their money on equities, falling about 18 per cent over the past two years.

However, Mr Pinto hopes that is all about to change. Over the past 14 months, Brazil's government has made lower interest rates a priority in an attempt to spur short-term growth and reform the country's capital markets.

The central bank has slashed the country's benchmark Selic interest rate, bringing it down to an all-time low of 7.25 per cent last month. Brazil's president, Dilma Rousseff, has also helped clear the way for lower borrowing costs by changing the guaranteed returns on savings accounts, which had acted as a floor for the Selic for years.

"For any stock exchange, high interest rates are the biggest competitor you can have so this is a big moment of great transformation for the Brazilian market," says Mr Pinto. If the Selic remains close to the current low, the positive effects on the Brazilian equities market should be felt within two or three years, he says.

However, there is a great deal both BM&F Bovespa and the authorities can do to speed that process along.

After a series of key governance reforms introduced in 2000 known as the Novo Mercado (New Market) helped boost confidence in Brazilian stocks, the emphasis is now on bringing more companies and investors to the market.

Brazil's national development bank, BNDES, recently signed an agreement with BM&FBovespa to list several of the smaller companies it has invested in – an initiative which could lead to up to 10 more initial public offerings before the middle of next year, says Mr Pinto.

BM&F Bovespa has been trying to change Brazilians' long-held aversion to stocks by running beginners' courses online and across the country on how to invest in the equities market.

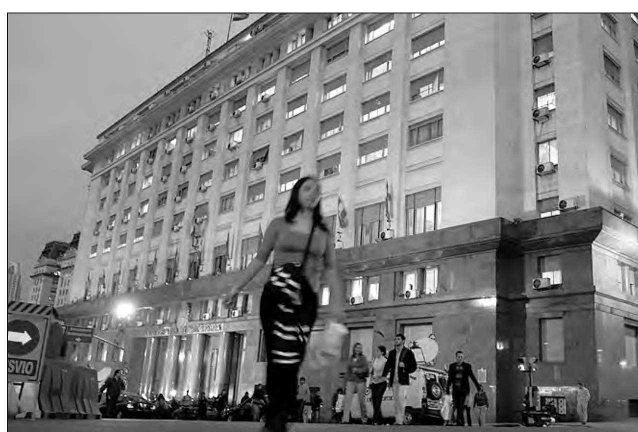
"It's a process of cultural transformation and it's going to take some time," says Mr Pinto.

Edemir Pinto: patience

Hangover from default is threat to development

Argentina

Need for inward investment stifled by uncertainty over nation's finances, writes *Jude Webber*



Constraints: the economy ministry in Buenos Aires AFP

Argentina, virtually cut off from international capital markets since its 2001 default on $100bn, had been hoping international investors would be kind when the time came to seek funds for YPF, the expropriated energy company.

Less than six months after the government seized 51 per cent of Argentina's biggest company from Repsol of Spain, Miguel Galuccio, YPF's chief executive, held 70 meetings with US and UK fund managers and investors in September to spell out his plans to develop Argentina's game-changing shale oil and gas resources.

YPF was optimistic that an international bond issue to help fund the resources would be possible, even if some investors had qualms about how easy or cheap that would be. But a serious setback in October, in the form of a US appeals court ruling in Argentina's long-running legal war with the holders of defaulted bonds who spurned debt restructurings in 2005 and 2010, could quash YPF's plans.

The court ruled that the defaulted bond "holdouts", and the owners of bonds issued in the swaps, must be treated equally – a Catch 22 that could mean Argentina will either have to pay the holdouts, which it has vowed never to do, or else fall into a technical default, when it has prided itself on honouring its post-default commitments.

While the exact mechanism for application of the equal treatment clause has to be spelt out, and Argentina is sure to appeal, the situation looks dim for YPF. Argentina's sovereign bonds, plus many of corporates, suffered ratings downgrades and country risk soared in the wake of the appeals court ruling.

Siobhan Morden, head of Latin America strategy at investment bankers Jefferies, noted: "A selective default would mean the clear closure for Argentina of external capital markets.

"Its prospects for international issuance could be clearly constrained. YPF clearly seems . . . subordinate to . . . constrained by the sovereign and by the legal battles and risk premium of the sovereign."

With Mr Galuccio, a respected oil man from the private sector at the helm, YPF has issued debt domestically since the expropriation, though much has been bought by the Argentine state pension fund, Anses. Though it plans to fund 80 per cent of its ambitious $37.2bn five-year plan from cash flow, YPF is unlikely to be able to meet its needs in the small home market.

Daniel Marx, a former government finance secretary, says: "Argentina is feeling the constraints more and more these days. It needs to be part of the international scenery."

Luis Secco, an economist, says the US holdout ruling and the shadow it casts over Argentina are a lesson for a country which takes pride in a heterodox economic model that it says is delivering results.

Mr Secco says: "Learning the lesson should translate into a change of the current course of economic policy, to stop us from ending up like we did 11 years ago."

'Superbank' IPO sets the bar

BMG Pactual

In spite of legal and market difficulties the offering raised about $2bn, writes *Samantha Pearson*

It was an initial public offering that, by many accounts, should have been a failure.

The day after BTG Pactual published the prospectus for its IPO, the controlling shareholder of the Brazilian investment bank, André Esteves, was fined for insider trading in Italy. While Mr Esteves said the charges were without merit, the bank still gave investors five days to pull out of the offering.

Even market conditions were unfavourable. Up until that point, there had been only one other company that had gone public in Brazil's moribund stock market in 2012, pricing its shares 18 per cent below target.

However, against the odds, BTG Pactual's IPO in April this year was a success, raising about $2bn and ranking as the seventh-largest IPO in Brazil on record, according to Dealogic. For many, it was proof of the future growth investors see in Latin America's biggest standalone investment bank and its potential to become a so-called "emerging markets superbank".

While other investment banks in Brazil have suffered from the recent turmoil in international markets and a sharp slowdown in dealmaking at home, BTG Pactual has remained resilient.

Net income at the bank almost tripled in the third quarter this year from the same period in 2011 to R$793m ($391m) thanks to tough expense controls and strong results across sales and trading, asset and wealth management, and corporate lending.

"We believe in Brazil, we think we have the right business principles and, above all, we enjoy coming to work every day," said Mr Esteves in a recent interview with the Brazilian newspaper Folha de São Paulo.

Mr Esteves joined BTG Pactual as a 21-year-old systems analyst in 1989, before wresting control of the institution with his partners a decade later. In 2006, he sold the bank to UBS for $2.6bn but, after the 2009 financial crisis, he bought it back for roughly the same amount and merged it with an asset management business he had started.

Since then, it has been one of the fastest-growing companies in Latin America. In 2010 Mr Esteves secured a $1.8bn injection of capital from nine funds, including Singapore's GIC, China's CIC and the Abu Dhabi Investment Council.

In 2011 the bank bought the Chilean brokerage firm Celfin Capital for $600m and invested $100m in China's Citic Securities.

This year, a month after going public, BTG Pactual announced the biggest private equity fund for Africa, promising to raise at least $1bn for investments in areas such as energy and infrastructure.

In June the bank strengthened its position in Latin America with the purchase of Bolsa y Renta, a Colombian brokerage, and signed a strategic partnership with VTB Capital in Russia.

"This stopped being about money a long time ago. It's much more about being able to tell this story and being an agent of change in Brazil," Mr Esteves says.

Global ambitions can be achieved through a single voice

Lars Ottersgård

When your country houses the third largest securities exchange in the world as Brazil does, you are not technically emerging any more, are you? Indeed, recent numbers on BM&FBovespa's derivatives market alone show an increase of 25m contracts in the first eight months of 2012 compared with the same period in 2011. Those are impressive numbers that show solid growth despite a global economy that continues to be riddled with low investor confidence and constant revisions to the regulatory landscape.

But Brazil is simply the largest country in a vastly diverse and complex region of the world.

Indeed, a recent third quarter report from BBVA shows lingering doubts about the sustainability of Brazil's growth model, particularly when contrasted with Mexico's competitive gains. There is a risk to all of Latin America if the Brazilian economy does not continue with its impressive recent growth rate.

This is a blessing and a curse. The diversity and depth shows a prime opportunity for growth from all directions with the stronger markets off-setting the weaker ones as demand waxes and wanes.

Some countries in the region boast stronger financial positions, with higher international reserves, better fiscal balances and a shock absorber through flexible exchange rates. Yet getting one unified regional voice from a group of countries with national pride and competitiveness is a challenge unto itself.

But if Latin America wants to compete for investors on the same playing field as Europe or North America, these sovereign assets, these national exchanges, should consider playing on the same team and sharing a single brand.

Take the Nordic marketplace. As the European exchange landscape swayed towards Continental Europe and Britain, the Nordic markets were too small to seriously compete. To bolster the region's competitiveness in the broader European landscape and enjoy a wider customer base, the Nordic markets needed to work together. So they built a common business and technical framework with one access, one platform and one set of regulations.

The Nordic integration process started in 1997 when the Danish and Swedish Exchanges started NOREX (Nordic Exchange Alliance), a cooperation designed to create a joint marketplace.

The result was 70 members, three exchanges and 30 market data vendors integrated into a single technical platform that included common information distribution and market surveillance systems. One shared set of Nordic market rules was set up, opening hours were harmonised and one set of member application and trader registration processes was developed.

Today, the successful integration in the Nordics has created a single point of entry for members to reach several countries, despite the different cultures, languages and currencies. The harmonisation of information technology (access) and trading rules has created a successful common region for financial transactions that has attracted local and international investment.

Currently, Latin America provides a solid example of regionalisation in action through Mila (Mercado Integrado Latinoamericano) which has integrated the exchanges and central securities depositories of Colombia, Peru and Chile. The goal was to develop the capital markets through the integration of the three marketplaces, thus giving investors a greater supply of securities, issuers – and larger funding sources.

> Currently, Latin America provides a solid example of regionalisation through Mila

Another potential benefit for the Mila exchanges is greater income based on larger transaction volumes. However, Mila has not had the tremendous debut it had hoped when it launched last year.

One of its biggest challenges has been cross-border taxation. As globalisation continues on the regional level, there needs to be dialogue among the various regulators and tax authorities. Creation of a tax-neutral level playing field for cross-border transactions would allow investment decisions to be based on investment fundamentals rather than taxation.

There are benefits for other Latin American exchanges to join the Mila alliance. But the region needs to consider the best practices that worked in the Nordics, and the three European exchanges that formed Euronext in 2000 and the three Colombian stock markets that joined to create the Bolsa de Valores de Colombia (BVC) in 2001.

As foreign investors continue to mine the globe for growth markets, it is hard to find a region as richly unique as Latin America; a region that is so distinctly tapped into its local pride, but also identifies itself as an international player.

The writer is senior vice-president and head of market technology, NASDAQ OMX