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Investment stories in Latin America

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The 4th BBVA Latin American Local Markets Conference in London gave me the chance to speak in detail with some local Latin American representatives. In the following, I would like to share some of the insights I gained from these conversations and the narratives that may affect 2018.

Latin America (LATAM) had a great year in 2017, but 2018 is set to be slightly different. Selectivity will be key in assessing opportunities on the continent in 2018. In countries like Brazil, Columbia, and Chile, we expect the respective easing cycle to come to an end, while in countries like Argentina and Mexico the market focus will be on the development of inflation. With elections coming up in Brazil, Colombia, and Mexico this year, political risk will fuel volatility. Also, international trade ties within NAFTA and Mercosur are subject to negotiations.

Risks mainly stem from the tightening by FED, ECB and BoJ

The risk themes in 2018 are mainly based on the tightening of liquidity by the FED, the ECB and the Bank of Japan, on a stronger USD, and on higher real interest rates that could weigh down the growth potential on the continent. Lastly, one also has to bear in mind China's managed slowdown in economic growth and its effect on international trade and commodity prices.

Uruguay is the newcomer

Uruguay, a newcomer in international local markets issuing its first nominal bond in 2017, proved to have done its homework. Uruguay offers one of the most attractive macro profiles in Latin America. Its yield remains attractive, which is why it represents a good investment opportunity within the context of emerging local currency funds. The country managed to decouple from its neighbours Argentina and Brazil and has attracted foreign direct investments building new industries. It has invested in public infrastructure, which in turn has created jobs and generated potential for future prosperity. Politics appear stable compared to its peers, and based on institutional stability indices like rule of law, democracy and corruption, the country is ahead in almost all statistics in the region.

Brazil in a year of transition

Brazil has been the great recovery story of recent years since the crisis-ridden 2015. It has experienced a drastic decrease in inflation to all-time lows, and the central bank cut key-lending rates from 14.25% in 2016 to 6.75% on 7 February, with the end of the easing cycle in sight. Given the corruption scandals in recent years, the presidential and national congress elections on October will be of central interest for the market participants.

Mexico and Trump

The same focus on presidential and congress elections will be the case in Mexico in July. The economy in the country is under pressure due to President Trump’s protectionist measures and to the ongoing renegotiations of the NAFTA agreement that increase the uncertainty for the Mexican economic model. The economy is in transition, with the government and the private sector making efforts to diversify the country’s export destinations. In recent months, the economy has seen good support from local demand; also, a trend has emerged with the service sector gaining importance as a growth driver.

Peru with good fundamentals

Another story I want to focus on is Peru. The country has seen good fundamentals, with the primary sector losing importance with regard to its contribution to the gross domestic product (GDP). The economy has shown signs of becoming more independent of commodity exports and the commodity price cycle. From our point of view, the expansion by supporting downstream integration of the value chain is one of the core economic development stories in the emerging markets as in the long run it leads to prosperity. We will be closely monitoring fiscal consolidation and the development of institutions.

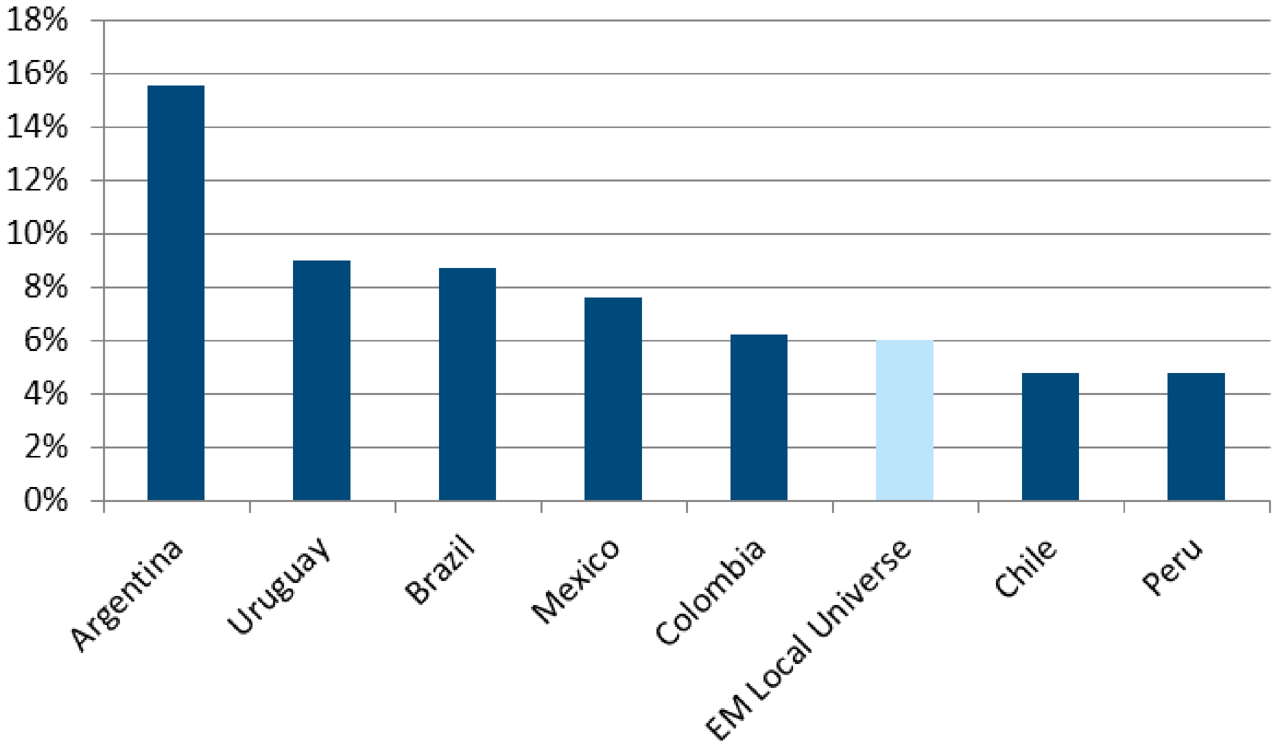
Venezuela not investible

For us as a local currency investor, Venezuela which is in a severe recession and undergoes a substantial national crisis is not investible. The currency is not free convertible and the country is rated by international agencies as default.

Latin America is the high-yield region in the emerging markets local currency universe

In summary, Latin America is the high-yield region in the emerging markets local currency universe. We can see a similar picture when looking at the hard-currency spreads. This high carry compensates for the risks taken when investing in LATAM.

Yield overview of local currency bonds of selected Latin American Countries:



Data as of 31 January 2018; Source: Bloomberg

Please note: the ratio “yield” equals the average yield of the securities issued by the respective countries before any costs; please note that this ratio is not equivalent to performance. The ratio “yield” is not a good estimate for the future performance (i.e. the development of the value of the bonds). The above-cited numbers do not account for any fees reducing returns such individual account or depositary fees or taxes.

If you would like to participate in the Latin America story, we actively invest in the region and manage the risk in the following products:

https://www.erste-am.at/en/private-investors/funds/erste-bond-local-emerging/AT0000A0AUE0

Legal note:

Prognoses are no reliable indicator for future performance.

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