

LatAm

Economic Watch

Lima, 23 November 2010

Economic Analysis

South America
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Growing dynamism in trade flows and cross-investment in South America

- **In 2004-2008, trade flows (exports plus imports) between the more buoyant economies in the region (Brazil, Chile, Colombia and Peru) grew 150% (64% in the period from 2000-2004)**
Brazil is the highest exporter in the block, with a 43% share, while Chile has the highest percentage of imports at 31%.
- **Capital flows invested in these countries have also recorded a significant increase over the last few years. In 2009 only, we estimate that the FDI among these four economies was over US\$ 4 bn**
Investments are mainly being directed at sectors like construction, mining, energy and services.
- **The prospects for growth, improved connectivity among them, and higher relief on customs duty will boost inter-regional trade in the next few years**
It will generate business opportunities and financial requirements for commercial operations within the region.
- **This greater exchange, and especially flows of cross-investments, allow local economic areas to expand,**
opening up the opportunity to take advantage of economies of scale which, eventually, could lead the most successful companies in the region to compete in the higher leagues of world economy.

Trade flows

Latin America is a region that, in the past, has seen very little trade flows among the regions. Among the factors linked to this were poor physical connectivity between countries in the region, with customs tariff and protection tariff barriers which were not removed, and with high volatility in the economies which did not allow for guaranteed fluid exchange in time.

However, the situation has been changing since the second half of the 1990s. Taking the South American countries with a solid base as a reference (Brazil, Chile, Colombia and Peru), inter-regional trade shows a marked advance. Thus, for example, trade of goods and services in the group increased by 64% between 2000 and 2004, while between 2004 and 2008, the amount increased by 150% to US\$ 45 bn. It is true that activity fell in 2009, due to the effects of the global financial crisis, but it has been rapidly recovering in 2010 so far.

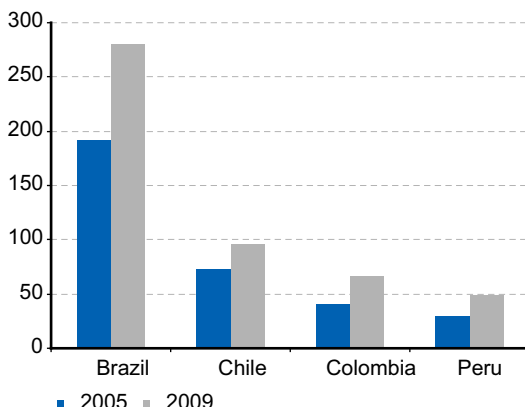
The situation has been primarily influenced by an emphasis on policies of opening trade. Brazil, Chile, Colombia and Peru have opened up their economies and lowered customs and protection tariffs, while also upholding free trade agreements, which mostly came into force in the second half of the decade, help the process even further. Secondly, it should be noted that there is greater acceptance of foreign investment in general, which together with the increasingly buoyant economies, has opened the field for locally successful firms to seek new horizons by expanding to neighbouring countries. In addition, investment in infrastructure enabling better connection to other countries is also increasing. Important among these is the creation of the IIRSA (Initiative for Integration of Regional Infrastructure in South America) dialogue forum, aimed at developing transport, energy and communications infrastructure among the twelve South American countries. Advances within the framework of this infrastructure have been extremely strong along the MERCOSUR-Chile, Andes axis (from Venezuela to Bolivia, through Colombia, Ecuador and Peru), and the central interoceanic axis (Peru/Bolivia/Brazil). This is improving connectivity among the various zones of the continent, uniting markets and boosting business opportunities. Finally, countries are displaying greater political and economic stability, with high growth, which are all factors that promote the building of more permanent links.

As for exports, Brazil has the largest sales in this block, with a 43% share of the total (US\$ 6 bn), with the main products being crude oil and passenger vehicles. However, the highest growth levels in exports to the block is seen in Colombia and Chile, with a growth of 88.6% and 51.4%, respectively, from 2005-2009. As for imports, Chile has the largest holding, at 31% of the total, with the main products being petrol by-products, machinery, tobacco and food, among others. Brazil has the highest growth in imports in the region, rising 73% in the 2005-2009 period.

An interesting aspect of trade flows among these countries is the importance of manufactured products. For example, the sales of industrial products from Colombia to Peru is 80% of its total exports to Peru. It should be added that there is a similar percentage of industrial products made in Colombia and exported to Venezuela (86%) and Ecuador (82%), its main trading partners in South America. Exports of vehicles, engine chassis and body parts from Brazil to Chile are also important. This type of trade, linked to the industrial sector, boosts the economy of scale, as well as opening up areas for expanding activity with a greater amount of added value based on technology.

We believe that the factors promoting inter-regional trade will continue, due to the buoyancy of these economies, with the ensuing rise in incomes and expansion of the middle classes, who drive the demand for imports. Improvements in transport and communications infrastructure (roads, waterways, ports, telecommunications) will also continue, as the IIRSA is well established and has guaranteed financing from multilateral organisations (BID and CAF). Finally, it should be pointed out that trade tariffs have been lowered as free trade agreements are gradually extending to more items. These trends suggest that there will be larger growth in inter-regional trade in the future, generating business opportunities and the requirement for cross-financing of operations within the region.

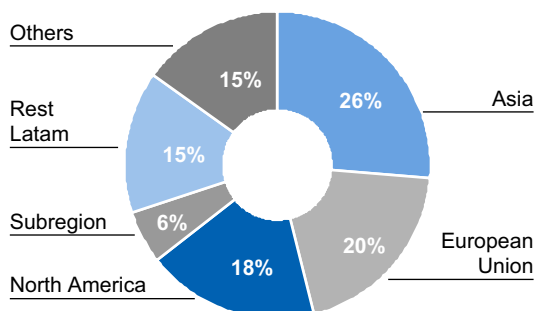
Chart 1

International trade (US\$ bn)*

* Includes largest exports of these countries to the rest of the world

Source: Peruvian Customs, Central Bank of Chile, Statistics Department of Colombia, Brazilian Ministry of Development, Industry and Foreign Trade

Chart 2

International trade 2009 (% total)*

* I/ Includes largest total imports of the four countries (Brazil, Chile, Colombia and Peru).

Source: Peruvian Customs, Central Bank of Chile, Statistics Department of Colombia, Brazilian Ministry of Development, Industry and Foreign Trade

Foreign Direct Investment (FDI)

However, and even more outstanding than the above, is the emergence of a hitherto unknown phenomenon in the region, at least, not recently: the rapid emergence of direct investment flowing between countries in almost all directions. In 2009, the flow of investment between Brazil, Chile, Colombia and Peru exceeded US\$ 4 bn, almost 14 times higher than levels recorded in 2005. One of the reasons for this growth seen in inter-regional investment flows is the boost given by companies growing and expanding into neighbouring countries, driven by economic development and preferential treatment policies for private investment. Opening up trade and the economic growth of these economies (average 5% y/y over the last five years) is increasing economic relations within the region, generating more business opportunities for cross-financing of operations among the countries.

83% of the FDI among countries in 2009 is explained by higher capitals going from Chile to Brazil and Peru. In the case of Chilean capital in Brazil, the energy sector, particularly generation and distribution of electricity, captured 40% of DFI stock, followed by the industrial sector (34%), especially investment in the production and sale of forestry, paper and wood assets, among others. On the other hand, Chilean investment in Peru, which rose to US\$ 9.4 bn between 1990 to June 2010, mainly concentrated on the service sector (51%), energy (31%) and industry (16.6%). The Chilean company Cencosud deserves mention. It opened in January 2008 in Peru with the purchase of Wong, a supermarket chain, with a 60% holding in the Peruvian market, and an annual income of US\$ 1000 bn. Also worth noting are the Chilean retail chains, Falabella and Ripley, which have obtained excellent results in their operations in the Peruvian market, with annual receipts of about US\$ 1500 bn.

There are also Brazilian firms that have also started to expand into the Peruvian market; one of the important ones is Votorantin Cementos, which recently invested US\$ 27 million to enter into the cement market in Peru. This is in addition to previous investment by the Votorantin Group in sectors such as refineries and mining. The total amount invested by the Group since 2004 now reaches US\$ 1500 million. Economic integration in the region is especially strong in the raw materials area. For example, Peru is already the second destination for investment from the Brazilian company, Petrobras. This oil company plans to invest US\$ 1100 million in Peru until 2014, of which US\$ 235 million will be in 2010, and US\$ 214 million in 2011.

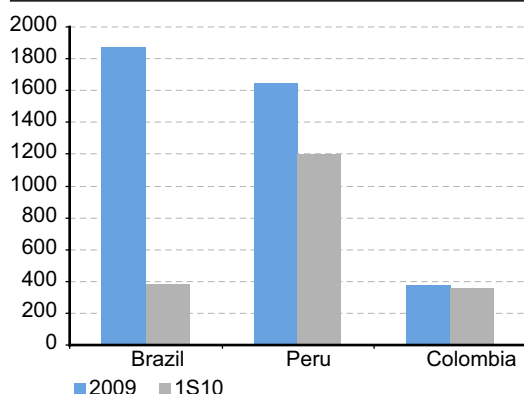
Chile and Colombia are the countries that have received least of the FDI flow from this group of four countries. Peru invested US\$ 343 million in Chile in 2009, representing 6.7% of total DFI in Chile, in its first large venture consisting of the purchase of a cement factory, but large Peruvian groups have shown interest in expanding to other areas, such as fisheries and mining. On the other hand, Chile invested US\$ 54 million in Colombia, aimed at the electricity sector, and Brazil invested US\$ 47 million, mainly in industry, real estate and commerce, among others. Notwithstanding the above, over the last few months, Chilean retailers have announced large plans to expand into Colombia, LAN has bought the local Aires airline, and even forestry companies have said that they will invest there.

There have also been announcements of heavy investments between Chile and Brazil, with the merger between LAN and TAM in the air transport sector, and the purchase of several IT companies by the Chilean company, SONDA.

These new trends are generating much more real integration among these economies after decades of rhetoric and scant results. It can be seen that a much wider economic area is being built, which will allow service and manufacturing companies to take advantage of economies of scale which, eventually, could lead them to gain the efficiency required to compete successfully on a global scale. This is a recent phenomenon and one which may significantly change the potential for growth in the region.

Chart 3

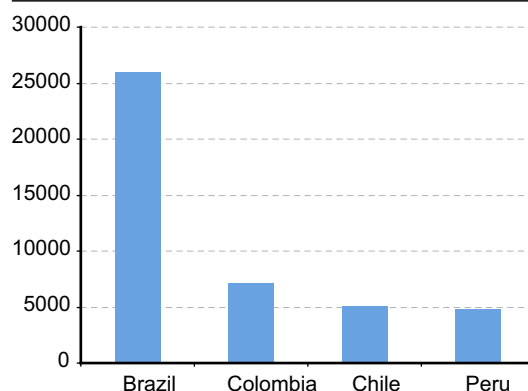
Investment flows of Chilean capital (million US\$)



Source: Direcon

Chart 4

DFI 2009 (million US\$)*



* Includes foreign investment from all geographical areas
Source: Central banks of several countries, Foreign Investment Committee

Attachment: Main companies with investments in the region

Table 1

Peru in Chile

Group	Company/Project	Sector
Grupo Brescia	Cementera Melón	Construction
Grupo Brescia	Sigdo Koppers	Petro-chemicals
Gastón Acurio	Astrid y Gastón	Restaurants
Gastón Acurio	La Mar	Restaurants
Gastón Acurio	Tanta	Restaurants
Empresa Montana	BASF	Chemicals
Empresa Montana	BNK Chile	Food
Grupo Wong	Censosud	Retail
Corporación Belcorp	Fábrica de Belcorp	Manufacturing
Intradevco	Klenzo	Manufacturing
Grupo Romero	Terminal Portuario de Arica	Commerce
Grupo Romero	Banco BCI	Finance
Grupo Interbank	Movieland	Services
Minera Vólcan		Mining
Química Sapolio Ltda.		Manufacturing
Cervesur	Transportes Transaltisa Chile Limitada	
105 Franchises		Services

Source: BBVA Research

Table 2

Chile in Peru

Group	Company/Project	Sector
Cencosud	Supermercados Wong	Retail
Compañía Minera Latino-Americana	Miski Mayo	Mining
Invercable	Participación en Indeco	
Alusa	Participación en Peruplast	
Sociedad de Inversiones Internacionales Parque Arauco		Construction
Grupo Falabella	Saga Falabella	Retail
	Banco Falabella	Finance
	Tottus	Retail
	Sodimac	Retail
Grupo Ripley	Ripley	Retail
	Banco Ripley	Finance

Source: BBVA Research

Table 3

Peru in Colombia

Group	Company/Project	Sector
Grupo Romero	Alicorp	Manufacturing
Ajegroup	Planta de Bebidas Gaseosas	Manufacturing
Ebel	Fábrica	Manufacturing
Gloria	Algarra	Manufacturing
Gastón Acurio	Astrid y Gastión	Restaurants
Grupo Brescia (Soldexa)	Soldaduras Megriweld S.A.	Metallurgy
	Soldaduras West Arco Ltda.	Metallurgy
San Miguel Industrias Pet		Manufacturing
Quimpac-Prodestal		Manufacturing
Creditex		Manufacturing
Topy Top		Manufacturing
Yobel SCM		Manufacturing
Pardos Chicken		Services

Source: BBVA Research

Table 4

Colombia in Peru

Group	Company/Project	Sector
Promigas	Cálidda Gas Natural del Perú	Hydrocarbons
Interconexión Eléctrica (ISA)	Línea eléctrica Chilca - La Planicie Zapallal - Zapallal	Electricity
Empresa Energía de Bogotá (EEB).	Gasoducto regional de Ica	Hydrocarbons
Empresa Energía de Bogotá (EEB).	Transportadora de Gas del Interior (TGI)	Hydrocarbons

Source: BBVA Research

Table 5

Peru in Brazil

Group	Company/Project	Sector
Grupo Romero		Mining
Grupo Brescia (Minsur)	Mamore Mineracao e Metalurgia Ltda.	Mining
	Mineracao Taboca S.A.	Mining
	Serra de Madeira Ltda.	Mining
	Acari Industria de Mineracao Ltda.	Mining
	Timbo Industria de Mineracao Ltda	Mining
Río Negro Mineracao e Comercio Ltda.		
Kuna by Alpaca		Manufacturing
San Miguel Industrias Pet		Manufacturing
Grupo Benavides	Minas Buenaventura	Mining

Source: BBVA Research

Table 6

Brazil in Peru

Group	Company/Project	Sector
Petrobrás	Modernización de la Refinería de Talara	Hydrocarbons
	Polo Petroquímico del Sur	Hydrocarbons
Vale do Rio Doce	Proyecto Bayóvar, exploración de fosfatos	Hydrocarbons
Votorantim	Modernización de la Refinería de Cajamarquilla, exploración de zinc	Mining and Hydrocarbons
Odebrecht	Chavimochic	Agriculture
	Proyecto Olmos / Irrigación y Energía	Agriculture
Gerdau	Modernización de Siderperú	
Consocio Odebrecht/Andrade Gutiérrez/Graña Montero	Carretera Interoceánica Sur	Infrastructure
Consocio Odebrecht/Andrade Gutiérrez/Graña Montero/Camargo Correa/Queiroz Galvao	Eje Multimodal Norte	Infrastructure

Source: BBVA Research

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