



**BREAKING TRADITIONAL STRUCTURES:
CAPITAL MARKETS AND MICROFINANCE IN LATIN AMERICA**

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The selected panel, "Trends in Latin American Capital Markets," moderated by Tom Trebat, executive director of the Institute for Latin American Studies (ILAS) at Columbia University, allowed panelists to share both their regional and global perspectives on emerging trends in the Latin American capital markets. Panelists included

- *Marcelo Mesquita, Deputy Head of Latin American Research, UBS*
- *Carlos Medina, Executive Director of Latin American Investment Banking, Morgan Stanley*
- *Moctar Fall, Managing Director and Head of Latin American Debt and Capital Markets, JP Morgan*
- *Nicolas Aguzín, Managing Director and Head of JP Morgan's Latin America Region*

Noting the generally positive economic trend in Latin America, moderator Tom Trebat, executive director of the Institute for Latin American Studies (ILAS) at Columbia University, opened the panel with the observation that "the roller coaster has been heading up since 2002," with many Latin American economies currently displaying a healthy vibrancy: exchange rates are stable, real interest rates are low, foreign reserves are up and both debt and equity markets are starting to flourish. Trebat also noted the growth of better-regulated and more competitive financial markets.

Marcelo Mesquita, deputy head of Latin American research at UBS, opened the panel by commenting on the recent shift in Brazilian business toward an expanding, "informal" private-sector economy, driven by the failure of governmental institutions to provide an environment conducive to economic growth. Mesquita noted that while previously most Brazilian MBA graduates would elect to work in state-owned companies, the current trend is for MBAs to enter the private sector.

The political arena is shifting too. It appears that Brazilian voters, from many years of experience, have developed an understanding of the detrimental effects of inflation, particularly in terms of the disproportionate effect inflation has had on the poorer members

of Brazilian society. As a result, says Mesquita, politicians have been forced to abandon traditional inflationary economic policies, such as unchecked growth of the money supply. Voter dissatisfaction has prompted institutional reform, such as the establishment of a central bank, and the adoption of more responsible fiscal and monetary policies.

Mesquita stressed the beneficial effect that another new institution, the Novo Mercado, has had on business. Under the Novo Mercado, an initiative of the Brazilian stock exchange, all shareholders of a newly listed company enjoy the same property rights. Previously, property rights were unequally distributed as preferred stock, common stock and golden shares. Additionally, the Novo Mercado has created a private system of arbitration between majority and minority shareholders, providing an alternative to the cumbersome legal system that had often taken 10 to 15 years to resolve a dispute. Unsurprisingly, the number of initial public offerings (IPOs) has increased dramatically in Brazil; 25 are scheduled in the next five months.

Carlos Medina, executive director of Latin American investment banking at Morgan Stanley, provided an investment banker's perspective on debt and equity markets in Latin America. As Medina explained, investors in Latin American capital markets have recently enjoyed yields significantly higher than those to be found elsewhere in the world, particularly when compared to developed economies. Furthermore, the entire Latin American region has benefited from dramatically increased capital flows as corporate issuers, both in debt and equity, have returned to the capital markets. IPO activity, particularly by local market leaders, has increased significantly.

Medina outlined two encouraging signs that reflect the increased confidence in the region's long-term growth and stability. First, investors have been willing to purchase perpetual corporate bonds; and second, investors have reacted favorably to the planned issuance of local currency denominated sovereign debt by Colombia, Brazil, and Mexico.

Medina additionally identified a number of general factors that he believes explain the rise in optimism in the region. First, large, mature foreign firms have identified Latin America as a source of fundamental growth. Second, the population is relatively young and numerous and enjoys an income per capita increasing relatively faster than that in developed countries. Third, Latin American commodities such as iron ore, soy, oil and coal are now in high demand, increasing the valuation of the producing companies. Finally, the underlying macroeconomics, particularly inflation, have remained stable.

Moctar Fall, managing director and head of Latin American debt and capital markets at JP Morgan, provided a historical analysis of the emergence of Latin American capital markets. According to Fall, today's vibrant capital markets have their roots in the debt restructuring that occurred in the mid-'90s. At this time, as Fall explained, many Latin American countries began to eliminate their U.S. dollar-denominated Brady bond debt, a legacy of the late-'80s debt restructuring coordinated by the United States. Although the Brady bonds provided Latin American countries with a mechanism to facilitate their borrowing from banks, they also became an indicator of Latin America's general lack of creditworthiness. Now, many countries in the region are well advanced in repaying their Brady bonds, thus removing the stigma of bad debt. Led by Mexico and Brazil, countries are increasingly turning to capital markets for their financing needs.

Next, Fall considered whether other high-growth countries, such as China, might present a threat to or an opportunity for Latin America. According to Fall, the benefits from Chinese growth outweigh the disadvantages. China may, as it develops, attract foreign direct investment away from Latin America; however, of much greater significance is China's mushrooming need for commodities and raw materials, which will allow many Latin American countries to gain enormously from exports.

Finally, Fall commented on trends in investment in Latin America. First, he considered the role played by investment managers in the United States, who, faced with reduced returns from U.S. investments, are increasingly seeing Latin American investments as a high-yielding asset class. However, policymakers must put in place the necessary checks and balances to prevent local capital markets from overheating or succumbing to speculation. As Fall elaborated, speculators with little regional knowledge may flood markets with capital, only to retract it in a hurry at the first sign of corporate underperformance—thus precipitating a crash.

In summary, Fall stated that once investors are happy with the region's macroeconomics, they will invest internally in local equities or local currency-denominated corporate debt, in addition to U.S. dollar-denominated bonds or sovereign debt. Fall predicted that as local markets mature, investors will treat Latin America as a core investment opportunity rather than as an opportunity to increase portfolio returns through high risk speculation.

The panel's final speaker, Nicolas Aguzín, managing director and head of JP Morgan's Latin America region, contrasted the current and historic interplay between regional companies and multinationals. Formerly, despite general ignorance of the business and economic environment in Latin America, multinationals purchased many local companies.

Subsequently, this trend reversed; in recent years, we have seen big conglomerates divest themselves of their Latin American holdings. Aguzín explained that this behavior was partly because of the more onerous financial reporting requirements, such as Sarbanes-Oxley, to which conglomerates have been subjected. However, Aguzín added that it was also because of the international perception that the local operating environment had become both volatile and corrupt.

According to Aguzín, regional companies have been quick to fill the gap left by the multinationals' departures. We now see evidence of the complete reversal of the historical trend: regional Latin American companies have become world-class market leaders and now, thanks to the maturation of local capital markets, can attract enough funding not only to expand regionally but also to buy international companies. Finally, Aguzín emphasized the need local companies have for leadership and management skills to fully exploit their growth potential.

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