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# PANORAMA

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## CHINA'S ROLE IN LATIN AMERICA IS MUCH MORE THAN A TRADE ISSUE

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By Patricia Krause, Coface Economist



**D**uring the China-Celac Forum<sup>1</sup>, held at the beginning of last year, China announced its intention to increase its investment stock in Latin America to 250 billion USD within the next ten years and to attain an annual trade flow of 500 billion USD during the same period. China also outlined the building of a "1+3+6" cooperation framework with Latin America. "1" would refer to one plan, "3" to the three engines of trade, investment and financial cooperation and "6" to six fields of industry connections to be strengthened as priorities between China and Latin America (notably energy and resources, construction of infrastructures, agriculture, manufacturing, scientific and technological innovations and information technologies).

This announcement is good news for Latin America, which experienced a recession in 2015. According to Coface's estimations, GDP dropped by 0.6 % in 2015 and is expected to show a marginal improvement in 2016 (-0.2 %). The deceleration of GDP growth seen in Latin America has been ongoing since 2011. The movement gained further intensity with the fall in commodity prices which began in mid-2014.

Although to some extent this slowdown results from internal factors, the impact of less dynamic Chinese activity has not been without consequences for Latin America, especially in terms of trade. Moreover, this phenomenon has contributed to the downwards pressure on global commodity prices which represent a major source of revenues for Latin American economies. With China's economic model shifting from an investment-led to a more

consumption driven economy, prices of metals and energy in particular are unlikely to benefit from a strong rebound. Prices of agricultural products will not increase significantly in the short term but should be higher in the long term, given the structural upwards trend of demand linked to the world's expanding population and the growth of the middle classes in emerging countries.

In this edition we will focus on the strengthening of ties between China and Latin America. What initially began as links for trade have now expanded to other areas. For example, the Asian giant is becoming an important financial player for economies with restricted access to international markets and is increasing its investments in the Latin American region. Nevertheless, loan conditions and project implementation remain key issues.

<sup>1</sup> CELAC: Community of Latin American and Caribbean States

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# CHINA'S ROLE IN LATIN AMERICA IS MUCH MORE THAN A TRADE ISSUE



**PATRICIA KRAUSE**  
LATAM Region Economist  
based in São Paulo  
[patricia.krause@coface.com](mailto:patricia.krause@coface.com)

“Although to some extent this slowdown results from internal factors, the impact of less dynamic Chinese activity has not been without consequences for Latin America, especially in terms of trade. Moreover, this phenomenon has contributed to the downwards pressure on global commodity prices which represent a major source of revenues for Latin American economies.”

## 1 THE TRADE BOOM BETWEEN CHINA AND LATIN AMERICA

**China has stronger trading relationships with Latin America and affects the region through its role in the commodities markets**

**Trade relations between China and Latin America have considerably increased over the past 15 years.** According to the American Council, exports from Latin America to China grew from 2 % of the region's total exports in 2000, to 9 % in 2014. Meanwhile goods arriving from the Asian country reached 16 % of the total imports of Latin American economies in 2014, up from only 2 % in 2000. This rise in bilateral trade has also led to a persistent and increasing trade deficit for Latin America. China is now the second largest source of Latam imports (following the United States) and the third largest destination for its exports (after the United States and the European Union), according to the 'Dragon among the Iguanas' paper<sup>2</sup>. In 2014, Brazil, Mexico,

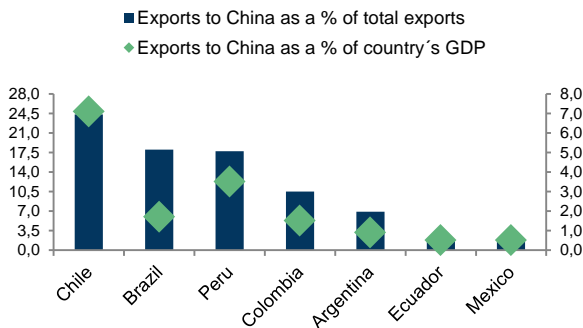
Argentina, Colombia, Chile, Peru and Ecuador, which together represented approximately 88 % of the region's GDP, exported 83.3 billion USD to China, against imports of 152.2 billion USD.

**Brazil is China's main Latin American partner in trade flow, representing approximately 78 billion USD in 2014. China is a major destination for Brazil's exports, accounting for 18 % of the country's total exports - but in terms of total GDP it only represents 1.7 % (chart 1).** The results from imports do not significantly diverge from those of exports. Imports from China represented 16 % of Brazil's total imports and approximately 1.6 % of GDP (chart 2). **In terms of trade, Chile's dependence on China is the highest in the Latin American region.** In 2014, Chile sent 24.4 % of its total exports to China, equal to 7.1 % of its GDP. In comparison, 21 % of Chile's imports, representing 5.5% of its GDP, came from China. Chile therefore tends to be the most heavily impacted country in the region when faced with a Chinese slow down. Peru also has tight trade relations with China. Peruvian exports to China represent 3.5 % of its GDP, while imports from China equate to 4.2 %

<sup>2</sup> Anthony Elson, Dragon among the Iguanas (IMF), December 2014

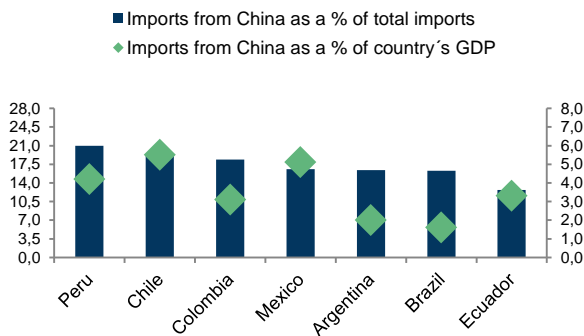
of GDP. As a reference, in 2003 exports to China accounted for only 7.7 % of Peru's total exports, compared to 17.8 % in 2014. Following a similar trend, imports from China, which currently represent 21 % of Peruvian imports, stood at just 3.5 % of total imports in 2003. **In contrast, Mexico tends to be the least impacted by lower Chinese demand. Exports to China account for just 0.5 % of Mexico's GDP. For imports, on the other hand, Mexico is one of the region's main destinations for Chinese products.** In 2014 it received 66.3 billion USD (or 5.1 % of GDP) of imports from China, achieving an impressive trade deficit of 60.3 billion USD (4.6 % of GDP).

Chart 1 - Breakdown of Latin American exports to China



Source: National Statistical Institutes, Central Banks and IMF; year = 2014

Chart 2 - Breakdown of Latin American imports from China

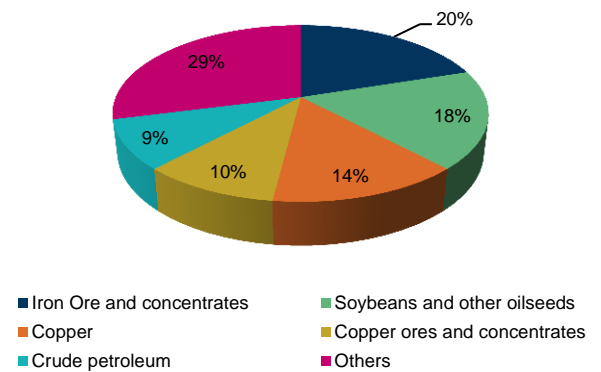


Source: National Statistical Institutes, Central Banks and IMF; year = 2014

**Commodities play a key role in the trade relations between LAC and China.** Latin America's abundant natural resources brought the region economic gains during the commodity bonanza period, between the early 2000's and 2014. It became a major supplier of basic products to China but was, in turn, invaded by cheap manufactured imports. Between 2009 and 2013, the five main exported products from LAC to China were commodities. These represented 71 % of the total exports from Latin American and Caribbe-

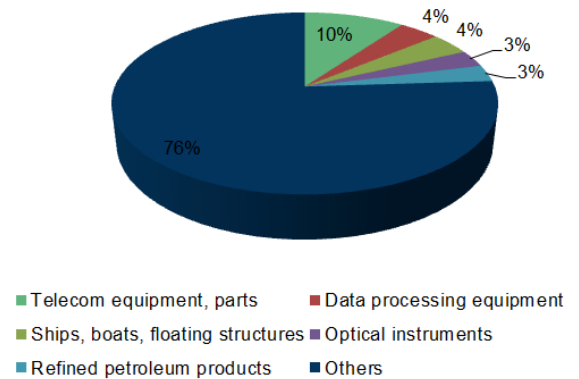
an countries (LAC), while the five main Chinese exports to LAC accounted for 24 % of the total (charts 3 and 4<sup>3</sup>). This illustrates how LAC exports are more concentrated and based on low added-value products, while China's exports are more diversified, with higher added-value.

Chart 3 - Latin America's main exported products to China (2009-2013)



Source: The Global Economic Governance Initiative

Chart 4 Latin America's main imported products from China (2009-2013)



Source: The Global Economic Governance Initiative

**The emerging middle classes consumed more and more 'made-in-China' products.** The period of high commodity prices contributed to the increase in Latin America's GDP growth rates. This movement increased GDP per capita and, together with the populist governments which gained

<sup>3</sup> Rebecca Ray and Kevin Gallagher, China-Latin America Economic Bulletin 2015 Edition (Boston, MA: The Global Economic Governance Initiative (GEGI), September 2015)

strength during that time in the region, led to the rise of a new middle class with a thirst to consume.

**Latam's poor infrastructure made it vulnerable to cheap Chinese imports.** During the commodity bonanza period, China strongly invested in the sectors. Latin American countries, however, did not take advantage of the profits obtained from high commodity prices to resolve the bottlenecks in their infrastructures. As an example, it is cheaper to ship from Shanghai to Colombia's main port of Buenaventura, than to ship from Buenaventura to the Colombian capital of Bogota.

### The future trade scenario appears less attractive

#### China's slowdown and low commodity prices will hamper the growth of Latin American exports

**China's GDP will continue to decelerate over the coming years.** Coface estimates activity growth of 6.2 % for 2016 - down from 6.9% in 2015 and well below the growth average of 10 % reported during the previous decade. According to Gauvin and Rebillard (2013)<sup>4</sup>, Latin America is one of the most affected regions in the world by the Chinese slowdown. The spillover effects of lower Chinese growth are expected to be felt by Latin American trade. A lower demand for imports tends to impact Chile and Peru more intensively. As previously explained, Chile's exports to China equate to 7.1 % of its GDP. Moreover, China's growth model is transforming from an investment-driven economy towards a more consumption-based one. This is generally bad news for Latin American countries, as commodity exporters. Nevertheless, the impact on the region's countries will vary. China's ongoing urbanisation process will make the prospects for agro exports more favourable than those of minerals and energy. This means, once again, that the slowdown is likely to hit Chile and Peru, as mineral producers, more intensively. Argentina, as an agricultural producer, should be less impacted.

**Beyond the volume effect, Latin America is also negatively affected by the fall in commodity prices.** Lower Chinese demand for commodities is pushing international prices down, deteriorating the terms of trade for producer countries. According to the World Bank<sup>5</sup>, a 1 percentage point decline in Chinese growth could decrease average commodity prices by around 6 percentage points after two years. One of its consequences would be to reduce the profitability of trading with other partners. Weaker terms of trade tend to depreciate free floating currencies, increasing the competitiveness of manufactured exports. The first phase of this movement is currently ongoing in Latin America and the region's main free floating currencies - the Brazil-

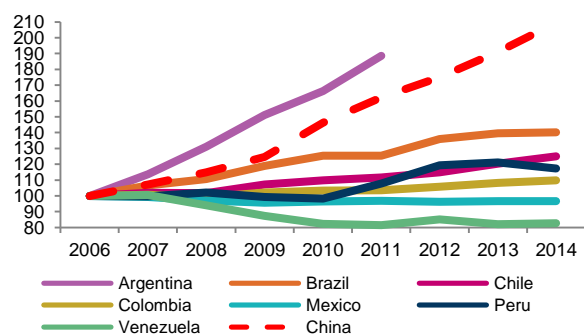
ian Real, the Colombian, Mexican and Chilean Pesos and the Peruvian Novo Soles – have all been depreciating. Exports, however, have not shown signs of a rebound. As previously mentioned, structural factors (such as poor infrastructure) are preventing these countries from gaining the benefits of their depreciated exchange rates. The reforms needed will be difficult to resolve, as they will require strong investments and political engagement. This means that in the short to medium term, trade will remain lackluster.

#### With China's price competitiveness deteriorating, the country could lose market share.

**China's loss of price competitiveness can be explained by two key factors<sup>6</sup>, namely (i) wages increasing above productivity and (ii) the appreciation of the Yuan over the years.**

**First and foremost, China's increasing labour costs over the last ten years have reduced the advantages of producing in the country.** The country had been known, for many years, for its relatively cheap labour force. This helped to increase the competitiveness of China's goods and explains the strong increase in exports to Latin America. This reality has, however, changed. When the evolutions in real minimum wages over the last 10 years are compared between Latin America and China (chart 5), it can be seen that (except for Argentina<sup>7</sup>) real minimum salaries in China have climbed more rapidly than in any of the Latam countries. This trend has been becoming more pronounced since 2010 and China's real minimum wage more than doubled between 2006 and 2014. Brazil achieved third place, with an increase of 40 % during the same period. Interestingly Mexico (the main regional destination for China's products), saw a decrease in real wages of 3 %.

**Chart 5 - Real Minimum Wage Evolution** (index number 2006 =100)



Sources: Celac and NBS

Data for Argentina not available after 2011

#### Secondly, the yuan's real effective exchange rate (REER) has appreciated much more than the currencies

<sup>4</sup> Gauvin, L. & Rebillard, C. 2013. "Towards Recoupling? Assessing the Impact of a Chinese Hard Landing on Commodity Exporters: Results from Conditional Forecast in a GVAR Model." MPRA Paper 65457, University Library of Munich, Munich.

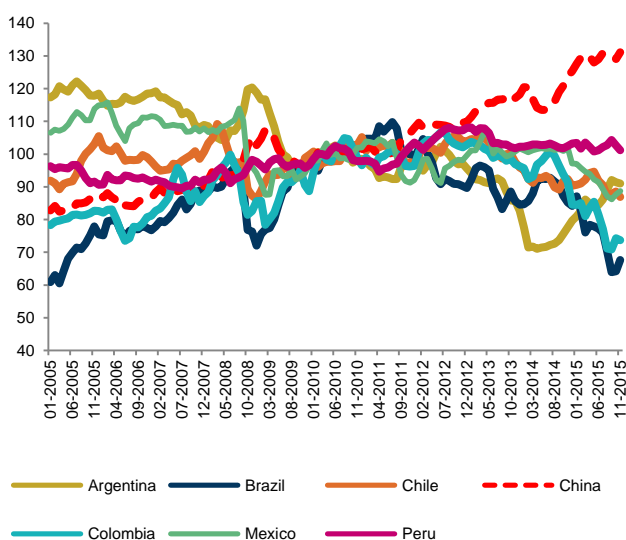
<sup>5</sup> "Commodity markets Outlook", World Bank, January 2016. The central scenario is an average quarterly growth rate of commodity prices of about 0.9 percent in sample.

<sup>6</sup> Coface Panorama Asia Challenged by China's Slowdown, September 2015

<sup>7</sup> The reliability of inflation indexes in Argentina were highly questioned during Cristina Kirchner's presidency (2007-2015), as unofficial indexes revealed much higher rates than the official data.

of Latam countries over the last ten years (chart 6). This has clearly had a negative impact on the competitiveness of Chinese exports. During the last decade, amongst the currencies compared, China observed the strongest appreciation, at over 58 % between January 2005 and November 2015. The Brazilian Real also strongly appreciated against the dollar, which reported a much lower volatility (+ 11 %). Conversely, the Mexican Peso reported the second largest weakening during the period (- 17 %). Mexico is currently the Latin American country with the highest trade deficit with China, at over 60 billion USD in 2014. Even prior to Macri's decision, in December, to devalue the Argentinian Peso, the depreciation of the Peso's REER was important (22 %). However, this is not the best basis for comparison, as the previous government, which ended in early December 2015, increased import barriers over recent years (in order to stem shrinking international reserves) and the nominal exchange rate was not free floating.

Chart 6 - Real Effective Exchange Rate of Main Latam economies (index number 2010 = 100)



Source: BIS

### The Trans-Pacific Partnership (TPP) and China's access to market economy status will not help to improve trade

Moreover, once the TPP comes into effect, China's market in Latam will be further threatened by competitive prices from other Asian countries, which could imply some trade reallocation at the expense of China. The aim of the TPP, announced in early October 2015 following five years of negotiations, is to improve economic ties between the member countries by reducing tariffs and fostering trade. The agreement involves three Latin American countries (Chile, Mexico and Peru) and another nine economies (US, Japan, Malaysia, Vietnam, Singapore, Brunei,

Australia, New Zealand and Canada) which represent nearly 40 % of the world's GDP. The implementation of the TPP will first need to be discussed in individual legislatures, before being ratified. However, once active, Chinese goods may lose market share in Chile, Peru and Mexico. As an example, textiles and footwear from China may shift to Vietnam and Malaysia.

In addition to these factors, if China attains the status of a market economy in December 2016, the Latin American trade deficit will further increase. When China joined the World Trade Organization in 2001, it was agreed that the country would not instantly gain market economy status. Developed economies argued that Chinese domestic prices were set by government policies, rather than by the forces of supply and demand. It was therefore decided that there should be a transitional period up to December 2016. This agreement was made due to the concerns of worldwide economies regarding the difficulties in competing with cheap Chinese imports.

In previous decades, many countries implemented anti-dumping duties<sup>8</sup>, in order to try to protect their local industries. The Anti-Dumping Investigations study concerning China in Latin America<sup>9</sup> show that the region, if taken as a whole, initiated more anti-dumping investigations and adopted more steps against China than any other jurisdiction in the world. The case of the steel industry is, perhaps, the most notorious. China accounts for around 50 % of the world's steel market, as both consumer and producer. As many of its mills are state-owned, they have produced above the efficiency point and thus pushed international commodity prices down. The slowdown in Chinese activity (and in particular the exhaustion of the investment-led economic model) has increased the world's steel oversupply, further threatening other steel producing countries - even with all the barriers they have imposed. As an example, Mexico, Chile, Brazil, Colombia and Peru have all used anti-dumping duties to try to protect their local industries from cheap Chinese steel. Even with these protectionist measures and the strong currency depreciations seen in the region's main countries in 2015 (particularly in Brazil and Colombia), statistics from Alacero (Latin America Steel Association) reveal that imports from China increased by 5 % from January to September 2015, compared with the same period of the previous year. Meanwhile regional steel production dropped by 1.9 %, using the same basis for comparison.

As the expiration of the agreement draws near, legal debates about its implications have already begun. This does not imply that China will automatically receive market economy status. The main question is, if countries will still be allowed to impose heavy anti-dumping duties. Industries around the world are concerned and are closely following the next steps. Latin America is far from immune to this threat. Over the last decade, the region has become a major destination for cheap Chinese manufactured imports, which has led to the dismantling of many local industries.

<sup>8</sup> Dumping: It occurs when manufacturers export a product to another country at a price either below the price charged in its home market, or below its cost of production.

<sup>9</sup> IBA Divisions Project Team, Anti-Dumping Investigations Against China in Latin America 2010, the International Bar Association (IBA)



Steel, footwear, textiles and apparel are some of the industries affected. As in other parts of the world, import barriers have become an increasingly-used tool against Chinese products. Granting China market economy status would therefore also negatively impact the Latin American region.

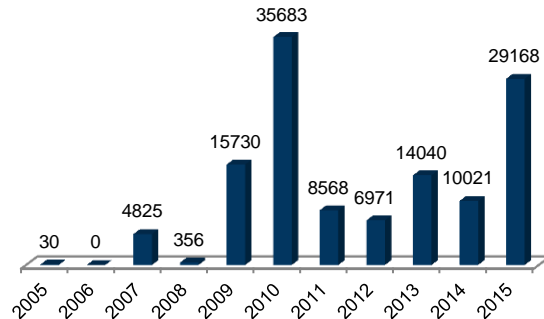
## 2 CHINA, AN INVESTOR LOOKING FOR OPPORTUNITIES IN LATIN AMERICA

### China plays an increasingly financial role but remains limited

Over the years, China has extended its international presence through other channels in addition to trade. It has particularly increased its financial presence in Latin America and in Africa - two regions where countries often experience difficulties in accessing external financing. Another common point is that these two regions have a strong need for development, particularly in their infrastructures. In addition, these loans generally lack transparency and the conditions and clauses of deals are not usually fully disclosed.

According to the Inter-American Dialogue, from the period of 2005 to 2015, China lent 125 billion USD (around 2.5 % of regional GDP) to countries and enterprises in Latin America. Public institutions, such as the Bank of China, China Ex-Im Bank and the China Development Bank were the main suppliers. The loans were not, however, at the same level throughout the years. In 2005 they amounted to only 300 million USD, but in 2010 hit their highest volume at 35.7 billion USD and ended 2015 at 29.2 billion (chart 7). These resources have been allocated to a variety of infrastructure projects and the borrowers were mainly countries with very limited access to global capital markets – such as Venezuela, the main destination for China's capital, as well as Argentina and Ecuador, in third and fourth position respectively. Brazil was the second largest receiver of Chinese capital, even though its access to foreign markets is not as difficult as for the previously mentioned countries. Moreover, 22 billion USD is not as significant when it is compared to the total size of Brazil's economy, equaling 1 % of the country's GDP estimated for 2015 (table 1). In contrast, the loans provided by China between 2005 to 2015 were substantial in terms of GDP for Venezuela (49 % of estimated GDP for 2015), Ecuador (15 %), Jamaica (15 %) and Trinidad and Tobago (9 %).

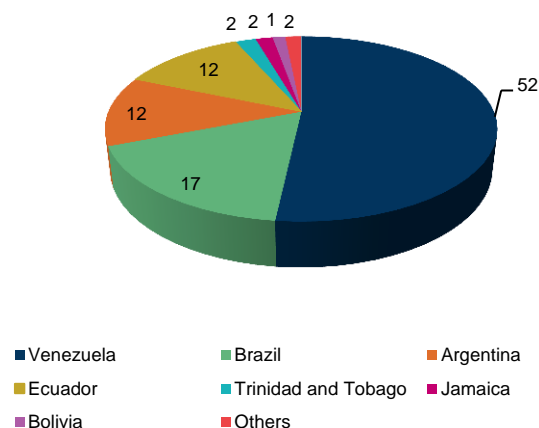
Chart 7 - Chinese loans to Latin America per year (million USD)



Source: The Dialogue

Energy received 56 % of the Chinese resources (chart 9), followed by the infrastructure segment with 32 %, others with 11 % and Mining with 1 %. As previously mentioned, infrastructure is a major hamper to growth in the region, thus the allocation of loans to this segment is welcome. This also applies to the energy sector, where supply needs to rise in order to meet increasing demand.

Chart - 8 Chinese loans to Latin American countries (% of total) between 2005 -2015



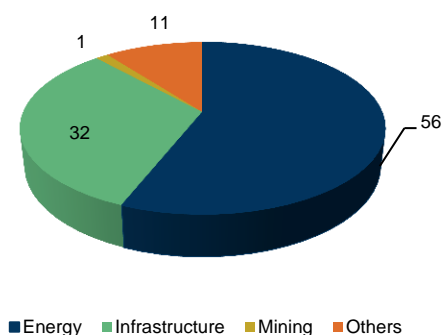
Source: The Dialogue.

Table 1

Chinese loans to Latin America Years 2005-2015	
Country	Total/GDP (%)
Venezuela	49
Brazil	1
Argentina	3
Ecuador	15
Trinidad and Tobago	9
Jamaica	15
Bolivia	5

Source: The Dialogue and IMF, GDP figures estimated for 2015.

Chart 9 - Loans Breakdown by Segment (% of total) between 2005-2015



Source: The Inter-American Dialogue

China is, however, still far from being Latin America's major source of foreign direct investments (FDI) and represents roughly 6 % of the region's total FDI<sup>10</sup>. The Netherlands is currently the largest single investor in the region, accounting for 20 % of all attributable<sup>11</sup> inflows in 2014, followed by the United States, representing 17 % in the same year.

The inflow of Chinese FDI resources to Latin America has sharply increased in recent years, effectively following the pattern of China's imports in the region. These investments are mostly involved in expanding the exploitation of basic products, such as soya, copper, iron ore, and hydrocarbon. According to the Economic Commission for Latin America and the Caribbean (ECLAC), the region received on average 10 billion USD per year in FDI from China between 2010 and 2013, up from 368 million USD between 1990 and 2009. Brazil received 56 % of the total investments during the 2010-2013 period, followed by Peru (16 %) and Argentina (15 %). China became Brazil's largest trade

<sup>10</sup> According to statistics from the UN Commission on Trade and Development, a relevant share of China's FDI in Latin America is channeled through offshore financial centers and cannot be clearly identified.

<sup>11</sup> Not all countries disclose disaggregated FDI inflows.

partner and the main destination for Chinese FDI in the region. China's presence in Brazil is more diversified than in that of the neighboring LATAM countries. Most of China's investments in manufacturing are in Brazil, as the country has the region's largest economy and is one of the most trade-protectionist (with import restrictions and local content rules). The aim of these investments is to target the local market, in contrary to the scenario in Mexico and to some extent in countries in Central America (where investments are driven to serve the US market). The most notable investments in manufacturing are taking place in the automobile industry. Nevertheless, some investment plans have been negatively reviewed, or postponed, due to changes in market conditions. As an example, the decision of Brazil's government in 2011 to increase the tax on cars (with less than 65 % of local content) by 30%, led to a Chinese automanufacturer suspending the construction of its first factory in the country. No improvements have been reported so far. Imported components from China are crucial for many manufacturing subsidiaries in Brazil.

Through its lending, China has especially helped to improve Latam's infrastructures. Over the last decade, China invested more in the region's domestic infrastructure than in any other economy. This has enabled engineering and construction companies to intensively develop their technological and logistical capacities. China's current reorientation towards a more consumption-based growth model is resulting in a slowdown in investment. Construction firms are becoming increasingly interested in investing abroad (a "going-out" strategy). Latam is well known for the bottlenecks in its infrastructure and its lack of capital and expertise to overcome them. The usual way to boost infrastructure investments in Latin America involves one of the region's government entities obtaining a loan from a Chinese state-owned bank to finance a specific project, subject to the condition that the project be conducted by Chinese companies. This reflects the strong influence of the Chinese government in enabling turnkey projects. This means packages of products that usually englobe trade, financing, investment and supporting services (mostly controlled by China's public sector). This model is generating debates worldwide about the benefits of using "Chinese aid".

The rising internationalisation of the RMB<sup>12</sup> is also affecting financial and trade relationships. The Chinese currency has been gaining in regional importance since the 2008 global economic crisis. Other countries may also set up similar arrangements in the future. China's Central Bank has also been the world's most active creator of swap lines. According to the study "China's Evolving Role in Latin America: can it be a win win?"<sup>13</sup>, Argentina, Brazil and Chile already have bilateral swap arrangements totaling more than 280 billion RMB (roughly 43 billion USD). The IMF's decision, on November 30 2015, to add the RMB to the basket of currencies which make up the IMF's Special Drawing Right (SDR)<sup>14</sup>, was considered an important milestone in China's global financial integration. It also pointed to the potential for economic exchanges directly in RMB, thus

<sup>12</sup> The renminbi is the official currency of the People's Republic of China.

<sup>13</sup> Enrique Dussel Peters, China Evolving Role in Latin America (Atlantic Council), September 2015

<sup>14</sup> Special drawing rights are supplementary foreign exchange reserve assets defined and maintained by the International Monetary Fund (IMF).

substituting the RMB for other existing currencies used in international exchange.

**Although countries are becoming more and more interested in having swap lines with China, so far, almost none of them have used them.** The stated intention of these swaps is to support trade and investment with other countries, but the only example of use in Latin America has shown divergent goals. China provided loans to Argentina through swap lines, with the aim of improving the country's weak foreign exchange reserves. In agreement with Argentina's new government, China allowed Argentina to convert 3 billion USD of its reserves in Yuan to USD (from a total of 10 billion), initially available only to pay for Chinese imports. It is worth noting that China holds swap lines of approximately 29 billion USD with Brazil and 4 billion USD with Chile.

### The relationship with China has raised some issues

#### China has strengthened its links with Latin America's populist governments

**China's role as a 'last stance' lender for Latin America has generated a rising debate.** Beijing has increasingly received visits from populist presidents who have freely spent over the last decade but are now in trouble with the collapse of commodity prices. These types of deals are often lacking in transparency and the conditions are not usually fully disclosed. Developed economies and international organisms usually stay away from risky countries - or make resources subject to deep economic and political reforms. Certain Asian countries are sometimes, however, less principled in terms of human rights and good governance. They usually require countries to buy their turnkey packages, or to pay back in millions of oil barrels.

**The most illustrative case involves Venezuela.** Its government has long been criticised by the international community for its strong authoritarianism and economic interventionism. The country has experienced decreasing activity, combined with hiking inflation, a growing shortage of basic products and shrinking international reserves. It has survived for many years due its important oil production - but prices have now been in free-fall since mid-2014. The country is thus on the brink of a default. Nevertheless, President Nicolas Maduro announced, in early September 2015, a new Chinese loan of 5 billion USD to be paid in oil.

**Relationships between the two countries gained strength during the mandate of Hugo Chávez and the tenure of Hu Jintao of the People's Republic of China.** In terms of trade it seemed a perfect match, as China was interested in oil and Venezuela holds the biggest proven oil reserves in the world. The timing also seems to have contributed to the improvement in Sino-Venezuelan relations. At the time, tensions between Venezuela and the United States were increasing. Upon taking office in 1999, Chávez accused the then American president, George W Bush, of supporting the failed Venezuelan coup attempt against him

in 2002. China's motivation was linked to its desire to reduce its dependence on Middle Eastern oil.

**China has already poured 56.3 billion USD into Venezuela since 2007 and it is estimated that 20 billion is still outstanding.** As China's growth rhythm has slowed, the country is now overwhelmed with oil and imports that have been stored in emergency reserves, rather than consumed. In addition, Venezuela's government urgently needs to pay short-term obligations (such as for salaries, imports and social security) and, since the loan payments are in oil, these loans do not need to pass through Parliament. Although China expects its resources to be used in investments for oil, the Venezuelan government is not required to provide accounts.

**Venezuela's coalition Democratic Unity (MUD) won a two-thirds supermajority in the legislative elections held on December 6 2015.** The results ensured the party 112 seats in the National Assembly, against the 55 seats obtained by the United Socialist Party (PSUV, President Nicolas Maduro's party). The outcome of the election was seen as a victory for democracy and represents the most important setback to *chavismo*<sup>15</sup>. Nevertheless, the MUD coalition is highly fragmented, as it is composed of 24 parties with little in common other than being opposed to the PSUV. According to The American Dialogue think tank, China is concerned about the outcome of the recent Venezuelan elections, fearing that the opposition's stronger role could lead to political infighting, rather than addressing the needs for economic reforms and thus jeopardising debt payments to China.

**Argentina is another example of a populist government that has strengthened ties with China over recent years.** In mid-2014, Argentina signed an 11 billion USD swap, for three years, with the Chinese government. This helped Argentina to avoid a default on its foreign debt commitments. The most recent announcement, in November 2015, involves two nuclear power plants in Argentina. China will be responsible for financing and constructing the projects, worth 15 billion USD. Again, the aim is to export China's homegrown nuclear technologies. This was one of the last measures to be carried out under the Kirchner presidential mandate. Some in Argentina are reticent about the rising dependence on Chinese investments and the decision to sign this new deal just before the presidential elections. The victory of the pro-business presidential candidate, Mauricio Macri, brings to a close 12 years of Kirchnerism.

**The new president took office on December 10 2015 and promised to review all agreements signed between Beijing and his predecessor.** He has already fulfilled one of his major campaign promises. Within just seven days of his mandate, he reestablished the free floating exchange rate regime. As he knew that the demand for US currency would be strong once the market was opened, Macri had to find a way to increase the country's dwindling international reserves in USD. In addition to the already mentioned swap with China, the Central Bank obtained in end January 2016 5 billion USD in loans with 7 foreign banks. They have also been trying to reinforce the country's foreign currency re-

<sup>15</sup> Chavismo: Name given to the left-wing political ideology created by former President Hugo Chávez.



serves, through deals with central banks in other countries. The Chinese aid should positively contribute to strengthening ties between the two nations.

### The implementation of projects show that Chinese financing can be complex

Although China has announced strong investments in Latin America, these investments are sometimes viewed with a high level of distrust concerning China's capacity to deliver. The "made in China" Hualong 1 reactor sold to Argentina has not yet been built, raising questions on whether China will be able to supply reactors to the global market.

China has also experienced disagreements with Latin American firms and governments about contract terms and environmental concerns. These have, at times, ended in stalled or rescinded projects. This has occurred in Mexico and Peru. In Mexico, the cancellation in November 2014, of the fast-speed train project won by the China-Railway Construction Corporation's (CRCC) has caused frustration. The agreement was cancelled following speculation that President Peña Nieto and his allies were benefitting from the project. In early 2015, a new hit to the bilateral relationship occurred when Mexico halted the Dragon-Mart mega-mall project, citing environmental concerns. China's overall lack of understanding of Mexico's political, socio-economic and legal frameworks has negatively impacted China's confidence in the Mexican public sector. As in Peru, China has a significant pipeline of investments involving mining extraction, where project vulnerability to environmental and social risks is high. These types of projects sometimes generate worldwide controversy. For instance, the Chinese MMG-Minmetals Corporation has acquired Las Bambas, expected to become one of the top three copper mines and currently on advanced track to begin operating in 2016. However, a recent protest by local citizens ended with four fatalities and serious injuries to 16 people. The protests were motivated by fear of environmental damage to the surrounding area. According to data from the Peruvian Institute of Economics, social conflicts and red tape have already led to the delay of 21.5 billion US dollars' worth of mining projects in recent years.

Another big project involving Chinese funding is also lagging behind. One of the most ambitious Chinese projects in Latin America, it involves a twin-ocean railway from the Pacific (Peru) to the Atlantic (Brazil). The project budget of 50 billion USD includes 3,500 kilometers of track. The idea is not new, but despite the strategic importance for global trade, it has failed to progress in the past due to local community concerns. The area is one of the most biodiverse lands in the region and has one of the highest concentrations of indigenous population.

As it would pass through the Andes Mountains and the Amazon jungle, the project has brought concerns on the environmental devastation that it could cause.

## 3 CONCLUSION

With the slowdown in Chinese growth and its negative effects on economies reliant on commodities, Latin American countries need to find other mechanisms to grow, such as improving its industries. These industries are, however, hampered by the region's infrastructural problems, at a time when local governments are unable to invest, due in particular to shrinking tax revenues from basic products.

China should, however, continue to play an important role in Latin America's near future, especially in terms of investments. The Inter-American Development Bank estimates that Latin America needs to double its installed power infrastructure and capacity by 2030, which would cost at least 430 billion USD. Investments in the region's natural resources could develop different power sources, such as untapped solar, wind, marine, geothermal and biomass energies. The natural resources and the demand are there, but the finance is lacking. For the moment, China is ready to retain its financial backing and its plans are very ambitious. However, experience up to now has failed to show relevant gains and has revealed points that need to be further addressed by both sides. China needs to improve its knowledge of the region's business environment and needs to be more transparent regarding its intentions (loan clauses should be clearer). Latin America, in counterpart, needs to work on guaranteeing investment reciprocity. That means if a Chinese company wants to invest in a specific sector of Latin America's economy, local companies of the same sector should have the same rights if they wish to invest in China. Secondly they need to improve their understanding of China's investment model, which has particularities when compared to other countries - as it is highly reliant on public resources. Possible environmental damage should also be carefully analysed, as Chinese interest in the region is highly focused on the exploitation of natural resources. Another key point is to improve export diversification, more specifically in high added value goods.

All in all, China remains a powerful source of investments, loans and trade that cannot be denied. However conditions need to be deeply analysed, as there are still many obstacles to be overcome in order to ensure a win-win partnership. Investments should not serve only to facilitate commodity flows, but are also essential for generating socio-economic growth in the region.

#### RESERVATION

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