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ECONOTE No. 30 **9/2/2015**

Latin America and China: A one-way deal?

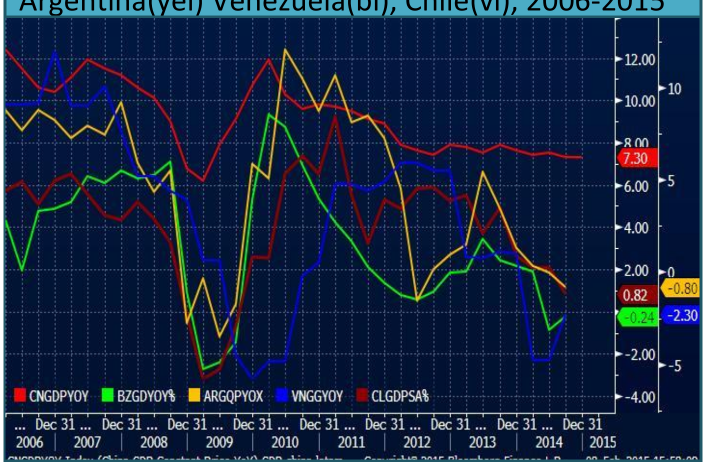
Summary	**Investment Conclusions**
Timing is of essence, and the timing of the downturn of the Brazilian, Argentinean, Chilean and Venezuelan cycles was unfortunate given the slowdown of the Chinese economy at the same time. These Latam economies are not uniformly "exports-driven", especially Brazil, but their key exports are all soft and hard commodities and China is their main client. It would be unfair to blame China for the sharp declines in commodity prices, as some of these falls are supply-driven especially in soft commodities and oil, but the deceleration of the Chinese demand did not help.	The "China factor" will play a secondary role in the current cyclical phase of these economies. If China bottoms out by mid 2015, this would be of some support for growth, for Brazil, in particular. China's contribution to the downturn of the commodity prices cannot be underestimated, especially in the case of iron ore, but weather-related factors impacting grain prices cannot be blamed on China's falling demand. Given these considerations, Brazil will be the economy most likely to benefit from an early China upturn as will, of course a number of commodities.

Money follow politics (or the other way around ?)

China's trade with Latin America is now rapidly becoming as important as that with the EU. At this point we should really drop the use of the term "Latin America" which is as useful as "Asia". The term covers numerous small countries whose links with China are modest and will remain so in absolute and relative terms for China, but not necessarily for them individually. Here we focus on the southern cone covering Brazil, Argentina and Chile, with Brazil clearly holding the first place. Mexico is a special case because of its links, via NAFTA with the US, as also is a special case oil exporter Venezuela.

China's engagement with Latam has been a combination of trade and FDI, by no means aimed at only securing sources of raw materials and of food. The accusation that China's investment and trade are strategic and aimed at displacing the US in global links is patently absurd, anymore than saying that investment by the US in oil producing countries, before the US shale boom, was unjustified simply because it was in pursuit of securing oil for the US market! It is always forgotten that the Chinese are buying these resources and are not, somehow, acquiring them illegally! China buying goods in global markets, either by open trading or by investing in their production, in no way "displaces" other countries from these markets. If the Chinese have the money and the willingness to pay the price, this is a pure market transaction. It is an unfotunate fact of life that the "poor" who do not have the resources, may not be able to avail themselves of these goods, but that is not fault of the Chinese! The chart in the Factbox shows the concentration of China's FDI, nearly 50% of total, in Brazil and Argentina, reflecting the importance of these two economies as major exporters of commodities.

Chart 1: GDP growth, PRC(red) Brazil(green), Argentina(yel) Venezuela(bl), Chile(vl), 2006-2015



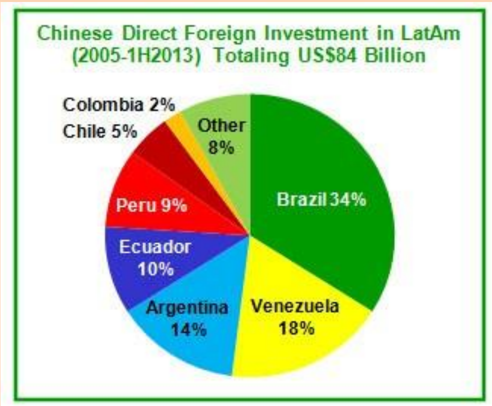
Source: Bloomberg

The facts and numbers

In 2013, **Brazil's** exports to China of soy, iron ore and oil accounted for 37.0%, 35.0% and 9.0% respectively of its total exports, while Chinese imports to Brazil accounted for 16% of Brazil's total, mostly electrical and mechanical appliances. As Chart 2 shows, the prices of all these commodites have been on a falling trend since the start of 2014, reflecting not only big crops and excess mining capacity but also China's GDP growth deceleration.(Chart 1 red)

Argentina sells nearly 45% of its soy crop to China and has been the most recent large recipient , at least in terms of agreeements, of Chinese FDI.For **Chile,** China is now its main exports market, accounting for 15.5% of total, of which copper,the biggest item, represents 80 % of Chile's output.

FACT BOX: China's LATAM FDI (Source: ECLAC)



Venezuela has a very special relationship with China which absorbs about 15% of its exports, two thirds of which is oil, thus making China the second biggest client of Venezuela. But this is not all. In 2008 China lent Venezuela USD 46.5 bl repayable in oil, which now means that 60% of all the oil exports to China are part of the repayment, thereby contributing little to external earnings. There is also the added factor of the steep drop in oil price, which is unrelated to the commitment to China. **Peru** has been the largest recipient of China's mining investment in the region. Last but not least, for **Mexico** China has now become the second biggest trading partner after the US.

Chart 2:Soy(gr),Cop(red), Wh(yel) ,Iron(br),2014-5

Source : Bloomberg

Strategy, money and the cycles

Not unexpectedly, China's FDI in Latin America has been concentrating on natural resources but not exclusively or directly. For example, in Brazil and Argentina a great deal of investment has been directed to commodities-related infrastructure such as ports, docks, railroads and related transport projects. In Brazil, Chinese interests are heavily involved in the trading and warehousing of oil seeds, sugar and cereals. Again in Brazil, Chinese oil exploration companies are involved in Brazil's major offshore drilling operations.

However, as Chart 1 shows, the deceleration in the GDP growth of all the key countries examined here, will not be helped by China's absorption of more imports as commodity prices are also falling.The likelihood is that Brazil may even slip into recession in 2015 ,with Argentina struggling with inflation and major political scandals and with Venezuela's economy unravelling as the support of oil prices has disappeared, China's trade can offer little or no comfort. However, selective help can be extended such as the USD 12.0 bl currency swap arranged by China in July 2014 with Argentina which has bolstered Argentina's reserves while the "holdout"l debt issues remains unresolved.

Andrew Freris (writing completed on 9/2/2015)