Latin stock markets hit hardest by US credit downgrade

By Luis Arce
12 August 2011

Latin America's financial markets suffered the most severe losses of any in the world in the "Black Monday" global sell-off that followed the downgrading of US debt. Four of the five worst hit stock markets were in the region.

Hardest hit was Argentina, where the Merval Index collapsed by 10.73 percent. Brazil's Bovespa, representing the largest economy in the region, lost 8.08 percent. Peru, the country that experienced the largest economic growth in Latin America last year, saw its General Index lose 7.09 percent. Chile's IPSA was in fifth place among the worst hit, with a loss of 6.92 percent. Other countries whose stock markets lost significant value were Mexico, 5.88 percent, and Colombia, 4.11 percent.

These sharp declines served to shatter the much promoted notion that the Latin American economies had decoupled from their historic "big brother"—the US—by conducting larger portions of foreign trade with Europe and, especially, China.

Overall, 2011 has been a very bad year for the region. Since January, Brazilian stocks fell 26 percent; Chilean, 23 percent; and Argentine and Peruvian approximately 20 percent each. Though the immediate cause of the recent collapse of the Latin stock markets was the downgrade of the US sovereign debt from AAA to AA+ by rating agency Standard & Poor's and the explosive economic problems facing Europe, the continuous flight of billions of dollars from the region over the past seven month is an indication that the region itself is feeling the impact of the world economic crisis.

Among the reasons for this is, first, though allowed to float on the market, most Latin currencies follow the US dollar. Second, in spite of attempts by economic analysts and government officials to calm investors and restore confidence in the markets, there is a general recognition that the region is dangerously exposed to the US economic future because most of its foreign currency reserves are in US Treasuries.

Argentina

The Buenos Aires daily *El Clarin* reported: "The supposed Argentine 'decoupling' that would safeguard the country against contagion, about which officials continue to boast, translated into an average 10.7 percent collapse of stock prices for banks and companies, especially those linked to industrial production.

"Public bonds fell by as much as 10.5 percent. And the Central Bank sold US$230 million to maintain the value of the peso."

Recalling the consequences of Lehman Brother's collapse, *El Clarin* pointed out that in 2008 there was a contraction of economic activity in Argentina, exports fell and many industrial jobs were lost. It added, "Now, the international context is more recessionary and the position of Argentina weaker … A flight of capital is taking place which just in the first half of this year has amounted to $9.8 billion."

El Clarin added, "The national budget is very dependent on retaining exports, while the inflation rate is approaching an annual 25 percent with subsidized tariffs. The trade balance is shrinking despite restrictions on imports."

Furthermore, the newspaper warns of the "de-acceleration" of Asia's "strong growth rates, which have pushed the rise in the prices of raw materials that has so much benefitted the Argentine economy since 2003. Just in the last few days international prices of raw materials have been falling."

Another significant fact mentioned by the Argentine newspaper is the country's dependence on its giant neighbor: "The expectations are for a reversal of the 'tailwind' that benefitted a large part of the emerging markets, among them Argentina, above all at the hands of Brazil, the Asian world and the high prices of raw materials.

"Just last week evidence emerged of this change in the situation, with the president of Brazil, Dilma Rousseff, announcing a plan of fiscal and financial incentives. She did it to confront the fall in production, exports and industrial employment due to the revaluation of the real, the product of the entry of speculative capital."

Brazil

Finance Minister Guido Mantega told the *Jornal do Brasil*, that "the government is going to follow the spending in dollars by Brazilian companies.

"You cannot give freedom to the financial market. This is what the United States did and they almost went into bankruptcy. We will not allow Brazilian firms to go deeper into debt in dollars, because, when things change afterwards, the companies go bust and the government has to rescue them," he said.

According to Mantega, "As the Brazilian market is hot, countries more affected by the crisis increase their exports to Brazil, hurting the sale of national products.

"There is a lack of consumer markets to absorb the all the commodities and, with a lack of markets there, everybody goes in search of countries that are growing and have more solid markets, as is the case with Brazil. A competition has become tougher and is turning predatory. Everyone is desperate," he said.

The *Jornal do Brasil* reported: "Mantega said he favors measures to forgive taxes for companies, which is a means of making Brazilian products more competitive in the internal market than imports, but he stated that these must be graduated. Otherwise, the country goes bankrupt."

Thus Brazil's accelerated growth rate, which has catapulted it to what it claims is the fifth largest economy in the world, has not immunized it to the impact of the crisis centered in US capitalism; it only has meant that its impact makes itself felt in a different way.

"We have a strong internal market and we are not as dependent on exports as China and Germany, but we have to make an effort to see to it that this market is served by Brazilian production and by the predatory competition [of the developed countries which export production to the emerging ones], said Mantega.

As a consequence of the evolving crisis, one can expect that Brazil will become more aggressive in taking over as much as possible of the Latin American market. It is already a major player in Argentina and is substantially increasing its investments in Peru, where members of Brazil's ruling party, the Workers Party, helped Ollanta Humala become president.

Peru

According to the Peruvian daily *El Comercio*, "Lima's stock exchange (BVL), fell by 7.09 percent, its second largest fall this year, [despite its] suspending yesterday's session at 1:38 p.m. after a fall 7.03 percent. On resuming the session at 2:12 p.m. the fall intensified to 7.09 percent, in the face of which it was decided to close early at 3:15 p.m."

Minister of Economy and Finance Miguel Castilla made it clear that the government has little control over the economic future of the country. Trying to give a positive spin to the US sovereign debt downgrade, Castilla declared, "once the bad time has passed, the Peruvian stock market, because of the solidity of the economy, will become a pole of attraction for investors … it is not projected that there will be a collapse in the price of minerals this year."

But then he added, "In the short term, it is expected that the Chinese economy will grow between 8 and 8.5 percent, and as a result it will continue demanding Peruvian minerals. The danger is that the recession deepens."

Congressman Yonhy Lescano warned that in 2008 the Anti-Crisis Plan did nothing to avoid the capital flight of more than US$3 billion. Lescano asked for a doubling of the Fiscal Stabilization Fund.

Journalist Carlos Alonso Bedoya was not so optimistic about the future of Peru, writing:

"Eighty percent of our exports are raw materials whose prices we do not control. They represent 20 percent of fiscal revenues and they maintain external accounts in the black. Being frank, if it were not that exchange rates fell only at the beginning of the crisis, the Peruvian economy would still be in decline."

Bedoya added that 81.3 percent of the Peruvian Central Reserve Bank reserves "are effectively denominated in this currency [the dollar] and little less than 70 percent is invested in US Treasury notes. That is, the greatest part of our reserves is in a currency that is crumbling and in assets that are confronting serious confidence problems."

Chile

El Mercurio from Santiago reported that "the Chilean stock market suffered its greatest loss in 13 years, and analysts expect the volatility to continue … With the losses registered yesterday, the principal stock local index has suffered an accumulated loss of 23.19 percent."

"Market capitalization has fallen by US$17,147 million … It is the greatest loss since September 1998, when it fell 7.4 percent."

Among the sectors suffering the most was the salmon-producing sector, which has fallen by 11.95 percent since July 1. Retail "lost 7.58 percent, with an accumulated decline of 35.55 percent since the beginning of the year," said *El Mercurio.*

Construction and real estate, the Santiago daily reported, registered a 10.46 percent loss, with an accumulated fall of 31.15 percent this year.

El Mercurio added, "As operators commented, the sector has been punished in recent weeks because its valuations have been too high relative to historic levels. In 2010, the indices for the sector led the gains in the market, rising by 115.29 percent on expectations of a greater demand due to reconstruction."

The crisis of the Chilean construction sector suggests that what happened in the US may be repeated there and in other Latin American countries.

Mexico

According to *El Universal* of Mexico, "The national currency was not separate from the global volatility and reflected a depreciation of 2.88 percent."

El Universal predicts that the US and European crisis will affect "especially Mexico and Canada because of their dependence on the US economic cycle."

British economist Sherlin Pierce told the Mexican daily that "there exists an obvious risk for Mexico as the US is its major economic partner, where 80 percent of its exports are destined."

Julio A Millán, president of International Consultants, described the impact of the crisis in Mexico:

"Here it is not a stone, but a boulder that is coming and will affect the Mexican economy. There is no way to sustain a prolonged recession in the United States without having to affect totally the interaction we have with them."

In general, there is a consensus in the region that it faces the danger "that speculative capital will enter the region, fleeing from the problems the US has and trying to make short-term investments to reap benefits that will affect the reserves and balance of payments of these countries," according to Peruvian economist Jorge Fernandez Baca.